Presentation to House of Commons Finance Committee on Tax Planning Using Private Corporations

By Dennis Howlett, Executive Director of Canadians for Tax Fairness
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Thank you for the opportunity to speak to the issue of Tax Planning Using Private Corporations.

All Canadians have a stake in tax policy, not just the rich

One of the challenges with tax policy is that the wealthy have the most to lose or gain so are the most vocal. When governments offer tax cuts or close tax loopholes it is not likely to make much difference in what middle and lower income Canadians pay in taxes. Ordinary Canadians don't speak up and a result we have seen the progressivity of our taxes eroded by more and more tax cuts and loopholes that primarily benefit the rich.

A recent Canadian Centre for Policy Alternatives study found that the richest 10 per cent, on average, get a discount of more than $20,000 a year on their taxes from tax loopholes -- an increase of $6,000 since 1992.[1]

Middle and lower income Canadians are negatively impacted when governments don't have enough revenue to properly fund programs such as child care or public transit or other public services. We all have a stake in tax policy because it determines what capacity we have to tackle challenges like poverty or climate change. That is why Canadians for Tax Fairness was formed five years ago to re-frame the tax policy debate to make fairness the issue, and ensure the interests of middle and lower income Canadians gets heard.

Canadians for Tax Fairness has been calling on the government to conduct a public consultation on tax expenditures (what we call tax loopholes) and close those that are unfair or ineffective.

We welcome the proposed measures to curb the use of Private Corporations to reduce taxes as a step towards tax fairness but urge the government to follow this up with closing other unfair and ineffective tax loopholes such as the stock option deduction and the capital gains exemption, and the business entertainment tax deduction.

Our brief to the Pre-Budget Consultation highlighted $18 billion in additional revenue that could be raised from closing unfair and ineffective tax loopholes.

We have called out wealthy individuals using offshore accounts in tax havens to evade taxes as tax cheats and called for government action to tackle tax havens. But we have never accused

[1] David Macdonald. 2016. "Out of the Shadows: Shining a light on Canada's unequal distribution of federal tax expenditures." Canadian Centre for Policy Alternatives.

those who use Private Corporations to reduce their taxes of being tax cheats. What they do is legal. But legal tax avoidance is just as big a problem in terms of loss of government revenue. It is the government's responsibility to reform laws that no longer serve the public good or that are allowing a few wealthy individuals to pay less than their fair share of taxes.

At the root of this issue is inequality.

Our tax system has become less progressive over the past several decades and has been a major contributor to growing inequality. The International Monetary Fund (IMF) [2] and the Organization for Economic Cooperation and Development (OECD)[3] has determined that the current level of inequality in countries like Canada is negatively impacting the economy; it is slowing down our economic growth. Data also shows that inequality undermines wellbeing for everyone from education outcomes to health.[4]

Stagnant incomes of middle and lower income Canadians reduces consumer demand for goods and services that businesses depend on. The Canadian Federation of Independent Business survey of its members in 2015 found that the main factor limiting the ability of small businesses to increase sales or production was insufficient domestic demand.[5] Their biggest problem is not their tax rate but the lack of purchasing power of Canadians. They would benefit from government policies to boost aggregate demand such as raising minimum wages, day care to enable more parents to participate in the workforce and government investment in social and physical infrastructure.

Business and the economy would benefit from more greater distribution of wealth. The data on economic growth reveals that the economy, and thus, businesses will be better served by a more equal distribution of wealth than tax breaks for the wealthy. Taxes are not about taking money out of the economy - if those revenues are spent it on programs like child care, the job creation multipliers are far higher.

Our tax system is one of the best tools that can be used to help reduce inequality by curbing unfair and ineffective tax expenditures that exacerbate income inequality, ensuring wealthy Canadians pay their fair share of taxes and by raising revenue that will enable governments to invest in programs that would help reduce inequality.

While we have a fairly progressive income tax system with higher rates for those with higher incomes, this is undermined by the large number of tax loopholes than mainly benefit the wealthy and enable many of them to pay much lower effective rates of taxation.

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[2] See Dabla-Norris, et al. *Causes and consequences of income inequality* and Ostry et al., *Inequality and Efficiency*.
[3] Cingano, *Trends in Income Inequality and its Impact on Economic Growth*.
[4] https://www.thestar.com/opinion/commentary/2014/11/23/income_inequality_is_killing_thousands_of_canadians_every_year.html
[5] http://www.progressive-economics.ca/2015/09/14/small-business-taxes-big-loopholes/

Tax Avoidance using Private Corporations
The research clearly shows that the wealthy are far more likely than a middle or lower income Canadian to own a private corporation and that the wealthy are far more likely to take advantage of these tax loopholes. Less than 10% of those with incomes under $51,600 had a significant interest in a private company. For the top 1 percenters about 50 percent own a significant interest in a private company and for the top 0.01% the number rises dramatically to almost 80%.

Most small business will not be affected. Statistics Canada data shows that two-thirds of Canadian small business owners are earning less than $73,000, and employers earning less than $40,000 outnumber those earning more than $250,000 by four to one. Thus, most small businesses would not be noticeably negatively impacted by the proposed changes.

These private corporation tax loopholes are not the way to help small businesses make the leap at start up – Most new and struggling small businesses would not have enough income to make effective use of these loopholes. The lower small business tax rate is already in place to help all small businesses to make the start up easier and compensate for differences related to size at a significant taxpayer subsidy of $3.6 billion a year.[6]

There is a broad range of other *targeted taxpayer funded programs* to help new businesses get out of the gates. The government's business network grants and financing website lists 550 grants, contributions, financial assistance, loans and cash advances, loan guarantees, tax refunds and credits, and wage subsidies that businesses can access.

We need broad universal programs to address concerns about insecurity
It is true that the self-employed don't have pension plans, paid parental leave, mandatory vacation, sick leave or disability benefits. However, increasing numbers of private sector workers are also denied access to these benefits as we see a shift in the public and private sectors to precarious work arrangement. This is reaching crisis levels, and will only get worse as the march of automation continues to eliminate and change jobs. Dividend sprinkling for a few is not the answer for lack of child care and pensions for the many. We need a well funded public pension program, we need universal access to childcare, we need well funded parental leaves for all workers and more. For this, we need tax fairness.

Business owners will still be able to save for retirement – Existing passive investments will be grandfathered. Business owners also have access to the same RRSP/RPP/TFSA contribution limits as everyone else. These are already disproportionately accessed by the wealthy and are heavily subsidized by taxpayers to the tune of $16 billion a year.[7] It is not fair for business owners to be given extra subsidized retirement savings room (through passive investments) that their own staff and the average Canadian cannot access. If public pensions

[6] https://www.fin.gc.ca/taxexp-depfisc/2017/taxexp17-eng.asp
[7] https://www.fin.gc.ca/taxexp-depfisc/2017/taxexp17-eng.asp

are not adequate, the solution is to improve pensions for all, not boutique tax treatment for a privileged few.

This does not penalize job creators – Active investment in business operations and employment is not affected. The change would just mean the businesses could not be used by the wealthy to pay lower taxes on outside investments.This does not penalize and, in fact, should help to incent employment. It refocuses the small business tax advantage on active investment, instead of channelling funds into passive investments such as real estate and stocks.

The reforms are not an attack on family farms – These reforms do not affect the $1 million lifetime capital gains exemption that is in place to facilitate the transfer of family farms.

This issue needs to be considered in the context of inequality and fairness in our society. There are kids dying from bad water in indigenous reserves while we debate whether or not the wealthy should get to keep unfair tax breaks. Do high income professionals deserve taxpayer subsidies of more than $20,000 when high rates of child poverty persist, especially in indigenous and racialized communities? No.