



September 25, 2017

Hon. William Morneau  
Minister of Finance  
Office 80 Wellington Street  
Ottawa, ON K1A 0A2

**Re: Proposed changes to the tax treatment of Canadian-Controlled Private Corporations**

Dear Minister Morneau:

On behalf of the nearly 2,500 direct members of Canadian Manufacturers & Exporters (CME), I am writing to you to express our views regarding your government's proposed changes to the tax treatment of Canadian-Controlled Private Corporations (CCPCs). Our intent is to provide constructive feedback on the impact of those changes and to offer specific recommendations that will help advance the government's goal of tax fairness, while also encouraging investment, job creation and economic growth across Canada.

Since you formed government in 2015, CME has been actively engaged with you on many files to support the growth of advanced manufacturing in Canada. Manufacturing is the largest business sector in Canada with over 1.7 million direct employees and nearly 11 per cent of the country's GDP. While employment has remained stable for over a decade and output is at near-record levels, the sector, and until recently the economy as a whole, has stagnated over the past several years. Most concerning for CME has been the decline in business investment and the impact it has had on productivity growth. Today, US manufacturers are investing over 8 times more in their operations than Canadian companies. If this continues long-term, Canada's global competitiveness in manufacturing will shrink and we will risk the millions of jobs tied to the sector in every region and community across Canada.

Your actions since becoming Finance Minister, with the support of others in Cabinet, especially Minister Bains, show that you understand this reality and are prioritizing action. The new Strategic Innovation Fund, Super Clusters, and innovation support program reviews, are items that CME has been aggressively pursuing for years. We believe your actions in these areas will have long-lasting positive impact on Canada's economy and society.

Another area we have been discussing with the government to support growth, investment and innovation in manufacturing has been strategic tax reform. We were pleased with some of the initial measures announced in Budget 2017 towards that end. In particular, we look forward to participating in the long-overdue review of the Scientific Research and Experimental Development program. Similarly, we also view the proposed changes to the CCPC as an opportunity to strengthen and improve the tax system to support advanced manufacturing in Canada.

Background

As you know, small businesses are the engine of the Canadian economy. In the manufacturing sector alone, there are nearly 68,000 establishments with fewer than ten employees and another 20,000 with fewer than 100 employees. Many of these manufacturers are CCPC's and collectively

they employ over 1,000,000 Canadians. Many of these companies are our members, engaged in risk-taking as they build their businesses and compete locally and internationally.

CME believes that an internationally-competitive tax system is critical to attract new manufacturing investment to Canada and to foster entrepreneurship and growth. From this, we have three specific guiding principles that we believe must govern any and all changes to the tax system for manufacturers to thrive in Canada. The tax system should: incentivize investment and growth; reward and support risk-taking, innovation and entrepreneurship; and be simple, clear and fair.

### Input on the Proposed Changes

We accept the motivation behind the proposed changes to the taxation of CCPCs; self-employed individuals – primarily in services sector industries – are using the tax advantages of private corporations to lower their tax burden. However, based on our analysis and consultation with members, we are concerned that the proposed changes will impact a much broader range of business activities and do not live up to our guiding principles as they apply to owner-operated manufacturing companies. They focus on a narrow and incomplete view of tax fairness and by so doing, strike well beyond their intended target, potentially resulting in significant negative unintended consequences for small manufacturers.

Some of our specific concerns include the following:

- The proposed tax changes reduce the incentive and economic return on entrepreneurship, risk-taking, business investment and job creation;
- In an effort to treat like income alike, they fail to account for key differences between small-business income and employee salaries;
- They raise the cost of doing business and add to the complexity of an already burdensome tax system; and
- They inconsistently apply the “tax fairness” principle and create new instances of unfairness in the process.

We also share the concerns expressed by many other businesses and associations about the consultation process itself. Specifically the scope of the consultations is severely restricted – limited to questions about transition issues or specific preferences within a very narrow range of options. Critically important questions about tax fairness, administrative simplicity or alternative proposals appear to be off the table. Moreover, the timeframe for consultation and implementation is unnecessarily brief given the importance, complexity and potential impact of these changes.

In short, we believe that the Government of Canada should not rush to apply significant but flawed piecemeal amendments to the tax code with only limited consultation and a rapid implementation timeline. With that in mind, we urgently recommend that the Department of Finance should indefinitely postpone its proposed changes to the tax treatment of CCPCs. Instead, it should undertake a broader and more comprehensive approach to reform. The goal should be to create a tax system that is simple and fair; that encourages business investment and growth; and that rewards entrepreneurship and innovation.

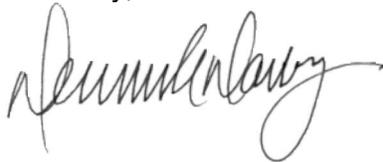
If, however, the government is intent on proceeding with immediate tax reform, we recommend the following amendments to the current proposals. These recommendations should be considered as interim steps in advance of comprehensive reforms and not a substitute for those reforms:

- In recognition of the important role they often play in private businesses – especially in the early stages of a start-up – spouses of CCPC owners should continue to be eligible for income splitting benefits.
- Amend the proposed changes to better distinguish between legitimate business operations and those individuals who use CCPCs for tax sheltering purposes. In our formal submission to the Department of Finance, CME offers several options that would allow the government to achieve its goal of tax fairness while also creating an incentive for small businesses to expand and prosper. For example, introducing a parallel tax credit on labour income and capital expenditures would reward companies that are trying to grow, while still allowing the government to eliminate instances of personal tax avoidance.
- Steps urgently need to be taken to reduce the complexity and administrative compliance burden these changes will impose on small businesses. Our submission offers two proposals in this area. Foremost among them is the need for clear and explicit definitions and guidelines on the record-keeping and compliance requirements created by these tax changes.

We fully agree that tax reform in Canada is badly needed. We strongly believe that Canada needs to work towards a simpler, fairer tax system that is globally competitive; that encourages innovation and economic growth; and that rewards reasonable risk-taking, entrepreneurship and job creation. Moreover, we are eager to take a leadership role in working with you and the entire federal government to achieve this end.

Thank you for consideration of our proposals to help grow and strengthen advanced manufacturing in Canada. We have offered your office the opportunity to meet with our members to have a constructive dialogue on CCPC tax reform and we would be pleased to meet with you at any time to discuss the details of our submission.

Sincerely,

A handwritten signature in black ink, appearing to read "Dennis A. Darby". The signature is fluid and cursive, with a long horizontal stroke at the end.

Dennis A. Darby, P.Eng., ICD.D  
President and CEO