Morneau credits simpler small business tax plan to 'crowdsourcing'

Finance Minister Bill Morneau in the House of Commons on Parliament Hill, in Ottawa, on Feb. 27, 2018.

JUSTIN TANG/THE CANADIAN PRESS
BILL CURRY
OTTAWA
PUBLISHED 2 DAYS AGOUPDATED FEBRUARY 28, 2018

After enduring months of condemnation from angry doctors, accountants and other small-business owners, Bill Morneau's latest small-business tax plan has successfully quieted some of his loudest critics.

This week's federal budget revealed a significant change to the Finance Minister's controversial plan to change the tax rules for passive investment income held inside an incorporated small business.

While far from effusive, the Canadian Federation of Independent Business concluded that the government's plans were now "less bad," and expressed appreciation for the change. From the right, the Canadian Taxpayers Federation called the changes "much improved," while the left-leaning Canadians for Tax Fairness praised the minister for following through on restricting a tax practice that primarily benefits high-income Canadians.

Speaking at an Economic Club of Canada breakfast in Ottawa on the morning after the budget, Mr. Morneau said he and his officials made a serious effort to understand and respond to the criticism generated by the original proposals.

"What I was saying to my team this morning is crowdsourcing seems to work," he said on Wednesday. "We listened to a lot of people."

The Liberal government's third budget was primarily focused on improving employment opportunities for women and boosting funding for scientific research. The document spread relatively small amounts of new funding across a wide range of areas. It projects an $18.1-billion deficit in 2018-19 with no timeline for returning to a balanced budget.

For the first-term politician, the small-business tax furor was Mr. Morneau's first exposure to being at the centre of a prolonged controversy. The issue dogged him on Parliament Hill and at town halls across the country.

It overlapped in the fall with questions about his personal finances, particularly his decision not to place his considerable personal assets in a blind trust to avoid potential conflicts of interests. The minister ultimately sold off his shares in his former company, Morneau Shepell, but he is still the subject of a continuing investigation by the federal ethics commissioner over whether he was in a conflict when he introduced pension reform legislation while still holding shares in Morneau Shepell, which is in the pension-management business.

The minister's original July proposals for incorporated small businesses included changes to the treatment of dividends and capital gains – which were later abandoned – and changes to the sharing of business income with family members, which went ahead this year. Yet the most controversial change was a proposal to restrict the use of a small-business corporation as a vehicle for making passive investments – such as investing in stocks – that are unrelated to the business.

The government's rationale is that high-income Canadians shouldn't be able to use a corporation as a way of paying less tax on investment income than if they held those investments as an individual. The original proposals were widely viewed as excessively complex. The new approach announced in the budget is winning praise for being a simpler approach, even though it is still fairly complicated.

While the federal corporate-tax rate is 15 per cent on business income, a lower rate applies on up to $500,000 annually for smaller businesses. The federal small-business tax rate was reduced from 10.5 per cent to 10 per cent this year and will be 9 per cent in 2019.

Under the new rules announced this week, that $500,000 threshold would be gradually reduced for incorporated small businesses with more than $50,000 in investment income. For context, that amount of income represents a 5-per-cent return on $1-million in assets or a 2-per-cent return on $2.5-million in assets.

"If they're saving millions and millions of dollars in passive investment ... then clearly you're not necessarily needing that small-business tax rate," Mr. Morneau said.

Allan Lanthier, a former chair of the Canadian Tax Foundation who has been a persistent critic of the minister's small-business tax plans, said very few private corporations will be affected by the latest plan and even those that are will still be entitled to the 15-per-cent corporate-tax rate.

"This represents a complete retreat by the government, but a welcome one," he said. "The government put the entire business community through months of uncertainty for a proposal that never should have been tabled, and has now been withdrawn."

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