

Income Tax Act

There would appear to be a further anomaly in the suggestion that companies will be allowed to reduce their total business limit by the amount of dividends paid to their shareholders. The payment of dividends presupposes that the company has cash on hand or cash otherwise readily available to it for this purpose. This would be cash not otherwise required for business purposes. But the purpose of the incentive is to allow the company to grow, presumably by plowing back its earnings. Therefore, the company which has surplus cash which it can use for the payment of dividends will be in a position to retain the small business incentive for a longer period of time than a company earning the same before-tax business income but requiring all its cash for business purposes.

We recognize that the payment of dividends by a company eligible for the small business deduction will often result in the payment of tax by the recipient of the dividend so that the total tax on the dividend will be at the personal rate of the recipient shareholder, but the combined effect of the two tax bites will usually be less than the top rate of corporate tax, even when this has been reduced to 46 per cent. This will result in the decision to pay dividends and keep the total business limit below \$400,000 rather than to reinvest the earnings in the company and pay the top corporate tax rate thereon. This is not consistent with the intention of the small business incentive provisions, although it would appear to be consistent with the scheme of the small business shareholder treatment to tax corporate earnings at the rate of the individual shareholder.

I should like to speak now of associated corporations. In order to prevent the proliferation of companies for the purpose of the small business incentive, the bill perpetuates the concept of associated corporations under section 125 (3) and (4). The rules are similar to those under the present act but it does mean that associated corporations will allocate the \$50,000 business limit among the members of their group and the \$400,000 total business limit will be determined for the group as a whole.

There is an apparent paradox here. It is of interest to note that with the effective corporate tax rate being increased to 25 per cent from the present federal rate of 21 per cent, companies now earning no more than \$35,000 per year will pay more tax than at present, while companies now earning between \$35,000 and \$50,000 per year will pay less tax. It hardly appears equitable for the very small business company to have to pay more tax while at the same time a relatively large corporation will receive a tax deduction.

So I think the government has gone a long way toward nullifying the effect of the small business incentive provision for the company earning below \$35,000. Whereas under the old system that company had the advantage of 29 per cent as opposed to large corporations, under the new legislation it would be much less, the difference between 25 per cent and 46 per cent as opposed to 21 per cent, so that the reduction is by one-third. This comes at a time when we say that we should be giving small businesses aid.

What are the incentive restrictions? When a company which was receiving the small business incentive reduction becomes a foreign-controlled corporation, it will be

[Mr. Ritchie.]

required to pay any tax savings previously received under the incentive. These are to be repayable over a five-year period. This will certainly impede foreign takeovers of small businesses. I believe that the repayment requirement constitutes an undue hardship and penalty. If the reason for the deduction was to help the company to grow, then in our submission all that should occur is that when a company becomes foreign controlled it should no longer be eligible for the deduction.

The new, foreign shareholders would not receive the benefit of the incentive except that perhaps the company's surplus on hand might be larger than if it had paid the regular rate of corporate tax. However, if all of the surplus had been paid out by way of dividends to the old shareholders, the new shareholders would not be receiving any benefit from corporate surplus on hand.

If two companies that are eligible for the small business incentive become associated or amalgamate with each other, and if as a result of the amalgamation their combined cumulative taxable income exceeds \$400,000, they will not have to repay the amount of the incentive they have respectively enjoyed but the benefits of the incentive will no longer be available to the new company, nor is repayment of the incentive required if the company becomes a public company but, of course, the low rate will no longer be available to it.

What are the investment restrictions? Ineligible investments are defined as every conceivable type of investment except cash, certain bonds and short-term notes. These investment restrictions are much too narrow and should be expanded to include all reasonably short-term and liquid investments. If the small business incentive has as its purpose to allow companies to grow, it should be given to those who cannot easily raise money on the market. Surely these companies should be allowed to have a reasonable reserve on hand to expand their business.

After all, companies cannot each year expand their business by a specified amount. It must come in fits and starts, and it would be reasonable if moneys were allowed to be accumulated at the incentive rate so that when an opportunity presents itself the company can make an expansion which would be reasonable for it. Companies should be able to have a reasonable reserve on hand not being immediately used for business purposes, and this reserve should be allowed to be invested properly without tax penalty or disadvantage.

To those who have studied the bill, such as accountants and so on, one of the major technical problems with the general small business incentive proposal would appear to be the substantially increased requirement for record keeping.

The Deputy Chairman: Order, please. I regret to interrupt the hon. member, but the time allowed to him has expired unless he receives unanimous consent of the committee to continue. Is there such consent?

Some hon. Members: Agreed.

Mr. Ritchie: Thank you, Mr. Chairman. I shall shortly complete my remarks. As I was saying, one of the criticisms is that there would be a substantially increased requirement for record keeping. This is a criticism which in my opinion may fairly be applied to all the proposals as