incentive. The incentive will take the form of a deduction from the company's tax otherwise payable—section 125(1). The deduction will be computed at the rate of 25 per cent for 1972, reducing by one percentage point a year commencing in 1973 to a rate of 21 per cent for 1976 and subsequent taxation years, of the least of, first, the company's taxable income from an active business for the then current year—section 125(1)(w)—and, second, the company's business limit for the year, business limit being defined as $50,000—section 125(1)(c) and section 125(2)(a).

Then there is the difference between the company's cumulative deduction account and its total business limit, a total business limit being defined as $400,000—section 125(1)(d) and section 125(2)(b). Then, again, the amount by which the company's total taxable income for the year exceeds an amount calculated under a formula with respect to foreign taxes paid by it—section 125(1)(b). The cumulative deduction account of a company is defined by section 125(6)(b) as the aggregate of its post-1971 taxable income plus four-thirds of certain taxable dividends received, less certain deductions. Taxable income includes all income from active business, investments, dividends, capital gains or otherwise, less applicable losses.

The cumulative deduction can be reduced by the company paying dividends to its shareholders—section 125(6)(b)—and in addition there are complex rules which allow the company to deduct its outstanding refundable tax in respect of ineligible investments and its dividend refund under section 129. Because the amount of the deduction is to be reduced concurrently with the reduction of the general corporate rate, the effect will be to maintain an effective rate of tax of 25 per cent payable by a corporation which qualifies for the small business deduction.

Since the total business limit is based on the company's aggregate total taxable income, dividend payments used to reduce the amount of the total business limit must be calculated on a comparable basis and, therefore, four-thirds of all dividends paid are to be deducted from the company's total taxable income—section 125(6)(b)(iii). This calculation takes into account the grossing-up of the dividend by the taxpayer when he computes his personal income tax.

Turning now to capital losses, a corporation's business limit and cumulative deduction account are the main criteria on which the small business incentive provisions are based. The cumulative deduction account requires the calculation of a corporation's aggregate taxable income for the relevant period of time. In calculating taxable income no account is taken of capital losses except to the extent they reduce capital gains. We submit that for the sole purpose of determining entitlement to the small business incentive a corporation's capital losses should be taken into consideration, since these losses will probably be reflected in an impaired working capital position. The company will be less able to grow and will run the added risk of exceeding its business limit and total business limit at the time when it can least afford to lose the incentive tax reduction.

What about the total business limit? The small business incentive provision places pressure on the shareholders of a company to draw out the reserves of the company as it nears the $400,000 level. The government's aim, as stated at page 39 of the Summary of 1971 Tax Reform Legislation, is the following:

> The main objective of continuing the incentive is to provide private corporations with funds for use in their business.

If that is the aim, why should small business be forced to pay out money by way of dividends that it requires for working capital, even though the recipients of these dividends could loan them back to the company and replace at least part of the working capital? It must also be remembered that the payment of dividends will, generally speaking, result in tax being paid by the recipient, so that the full amount of the dividend will not be available to be reinvested in the company.

We believe that in order to preserve the government's aim as stated above, the incentive provisions should not contain the limit of $400,000 on the aggregate of taxable incomes but they should be based on annual active business profits with the $50,000 annual limit on those profits. Otherwise, the small business will be forced to pay out its working capital as it approaches the $400,000 level. The concept of cumulative deduction account, on which the incentive provisions are based, is concerned with taxable income upon which tax has been or is about to be levied. Therefore, a particular company's cumulative deduction account must be reduced by 25 per cent—the amount of the exigible tax—in order to arrive at what is available to the company for working capital purposes. Thus, the total business limit represents only $300,000, rather than $400,000 of working capital reinvested in the company, assuming only business income.

• (8:30 p.m.)

Turning to the matter of dividends, curiously enough it may be more expensive for the shareholder of a small business to take the dividend than to leave it in the company. At page 9 of the summary it is stated:

> The 33 per cent reformed dividend tax credit completely offsets a corporate rate tax of 25 per cent.

The summary says that if a company which is eligible for the small business incentive pays out all its after-tax income as dividends to its shareholders, the effect would be that all of the company's earnings would be taxed at the marginal rates of its shareholders. However, this is based upon the shareholders receiving the entire amount of the tax dividend credit already added to their income for grossing-up purposes.

Under the bill, the shareholder is only entitled to deduct four-fifths of the amount grossed up from his taxable income under section 121. The extra deduction of the extra one-fifth is dependent on the provinces. Thus, when on page 36 of the summary the table in column 1 discloses a situation where a shareholder taxable at the 25 per cent level would pay no further tax over the amount paid by the company, this is dependent on the province of his residence having accorded him a similar tax credit. If there is no such credit, the extra tax payable by the recipient of the dividend would be $20. Even if there is a full 100 per cent tax credit, the proposal for crediting of dividends will result in more tax being paid in the short run than if working capital had been retained to enable the company to grow.