The loudest voices should not drive the tax debate

By Michael Wolfson

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Finance Minister Bill Morneau's proposals for tightening tax breaks associated with private companies is generating several kinds of response on social media and in mainstream media. The most evident is an impressive deluge of evidence-free rhetoric claiming that the proposals are an attack on everything from the middle class to maternity leave for female doctors to farmers and even mom-and-pop corner stores.

Far less visible, but probably much more important, are the number of economists and tax and accounting professionals who are taking the discussion paper seriously. Even those who may be strongly opposed to the tax tightening are offering detailed and constructive advice.

Still, almost absent in this debate are any voices defending the idea of tax fairness.

A newly formed Coalition for Small Business Tax Fairness penned a letter to Mr. Morneau opposing the tax reforms, claiming that "two-thirds of small business owners earn less than $73,000 per year and half of those earn less than $33,000." Magicians call this "misdirection," but in this case let's call it spin: The numbers are correct – they just have nothing to do with the debate at hand.

It is unlikely that the modest earners identified by the small-business lobbyists will be affected at all by the proposed tax changes, although we still do not know the details of the government's proposals. We do know from the Finance Minister's remarks that only individuals with a private company – a Canadian-controlled private corporation, or CCPC – have even a chance of being affected.

As my colleagues and I showed in a study published in the peer-reviewed Canadian Tax Journal last year, less than 5 per cent of taxpayers in the bottom half of the income spectrum – with incomes below $27,500 – even owned one of these private companies (based on figures from 2011, the most recent year for which we had data); among those in the bottom 90 per cent – with incomes below $68,800 – less than 10 per cent had a CCPC.

Now, let's look at the top earners – people the coalition and other critics would rather we forgot. Almost half of those in the top 1 per cent, with incomes above $163,300, owned a CCPC, while more than 70 per cent of those in the top 0.01 per cent, with incomes over $2,305,700, owned one.

Requiring millionaires who use their CCPCs for aggressive tax planning to pay more tax is certainly not an attack on the middle class or mom-and-pop corner stores.

The Coalition for Small Business Tax Fairness, as well as many other, more strident voices, claims CCPC owners should also have the right to amass wealth in their private companies after paying only the 15-per-cent CCPC tax rate, then pass that wealth on to the "next generation" (their children) tax-free. But is it fair for CCPC owners to be able to multiply their lifetime $800,000-plus capital-gains rollovers three or four or five times for just one business – one of the practices Mr. Morneau's proposals seek to end? Shouldn't one lifetime rollover be more than enough? Even one of these rollovers is a much richer tax break than people without a CCPC get. And if you do own a CCPC, you have to be rather rich to have substantial capital gains in the first place.

It is valuable to compare the public discourse on tax-rate unfairness for the rich and the poor. In the case of private companies, a number of mostly high-income individuals face the prospect that their effective marginal income-tax rate may increase from 15 per cent (if they successfully sprinkle dividends to family members who will not need to pay any income tax at all on those dividends) to a maximum of about 50 per cent – in line with what all other upper-income earners who don't own CCPCs pay on their wages, salaries and self-employment incomes.

Some tax professionals are constructing examples in which they claim Mr. Morneau's proposals would saddle small businesses with tax rates of 80 per cent to 93 per cent. But these examples make the ridiculous assumption that CCPC owners would not rearrange their affairs – for example, by simply paying out their private-company incomes to themselves as salaries, which would bring them back to the top tax rate of 50 per cent.

On the other hand, there are hundreds of thousands of low-income seniors who face marginal income-tax rates of 75 per cent to 100 per cent and even higher – the so-called poverty trap that has persisted for decades. Where are their voices? Who is defending them? Why are 100-per-cent tax rates OK for low-income seniors, yet many among the top 1 per cent become apoplectic when the Finance Minister proposes to bring their tax rates back in line with that of every other high-income individual?

Of course, Mr. Morneau's proposals are still a work in progress. This is a complex area of tax law, so consultation is clearly important. But the loudest voices are not neutral. They are the ones with the strongest vested interests – and their interests do not necessarily accord with those of the people they claim to represent.

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