

Extending Tax Relief for Small Business

Currently (2011), the federal government taxes businesses earning under \$500,000 per year at a rate of 11 per cent. Amounts exceeding \$500,000 are taxed at a rate of 16.5 per cent. Recognizing recent and current challenges, and in an effort to foster a sustainable and competitive small business sector, the cap of \$500,000 for the lower tax rate should be increased to \$1,000,000.

January 2011 Federal Corporate Tax Rates (%)	
Incomes up to \$500,000	Incomes greater than \$500,000
11.0	16.5

With approximately 98 per cent of Canadian businesses having fewer than 100 employees, the impact of small business on job creation and the economy at large is difficult to overstate. In 2009, small businesses alone employed approximately five million Canadians, representing a major source of employment in Canada whose growth needs to be supported by effective public policies and tax measures. The recent economic downturn has been particularly hard on small business, which typically lack the financial depth and economies of scale found in large business plus, are often challenged with access to sufficient financing. The impacts on small business of a less than preferable economic climate will be felt for another five years ahead.

In an environment where job growth remains tepid, despite the best efforts of small business, all reasonable action should be undertaken to support and encourage the success of small businesses.

Despite past moves to increase the corporate tax threshold, the current cap of \$500,000 (increased from \$300,000 in 2009) on the lowest tax bracket is not an effective way of encouraging businesses to thrive or grow. The 11 per cent federal tax rate does not include the tax rate for each individual province/territory. When both the provincial/territorial and federal tax rates are combined, the burden felt by small business becomes significant.

Moreover, small businesses are disproportionately affected by administrative and regulatory compliance issues that are much more onerous and consuming given its minimal resources, than for larger business. Reducing the tax burden felt against the first million dollars in earnings would both serve as recognition of that burden that is exceptionally prominent with small businesses, while providing tangible measures to help alleviate it.

Recognizing the importance of small business in relation to economic and job growth, some jurisdictions are taking proactive measures to lessen the burden on small business. Recently, Manitoba announced that it would implement an effective small business tax rate of zero percent, with British Columbia to follow suit in 2012.

For many small businesses, a healthy return on investment is often not realized until well after the \$500,000 income mark is reached. The current tax structure adversely affects small businesses just as they are beginning to achieve some measure of sustainability and return. So the question must be asked, why is it that the small business owner is hit with a hefty tax increase the moment they approach self-sufficiency and becoming poised for growth. The current policy only makes it harder for an owner to succeed and raises the bar for how much a business must make in order to realize a good profit margin. As stated in the Canadian Chamber's policy position paper entitled "The Rationale for Cutting Business Taxes", "taxes on growth discourage investment and kill jobs".

Given the high sales volume needed for small businesses to become profitable, it is recommended that the annual tax rate on businesses at 11 per cent have a higher income threshold of approximately \$1,000,000. This encourages and incents small business owners to continue to grow and invest in more

equipment, marketing, exploring and expanding in global markets and the hiring of extra staff in order to cope with increasing sales.

At a \$500,000 threshold, small businesses hit a wall of taxation that keeps small businesses small. There is also an argument that the current \$500,000 threshold which attracts the lower 11 per cent tax rate encourages the split up of companies into \$500,000 inefficient units. Thus, if the threshold were increased to \$1,000,000 SME's who do fall into this category could combine operations to increase efficiency. Likewise, it would discourage SME's from splitting their businesses into two units in the first place. At the same time, the tax reduction would free up cash for the SME's which is often important for cash flow and/or financing purposes.

A review of global tax rates finds very specific taxation rates, with increases applying to increments of ten or one hundred thousand dollars in earnings. A graduated structure is more reflective of the reality faced by many small businesses, as opposed to grouping by \$500,000 increments. Utilizing the current suggestion it is further recommend that businesses which are between the \$1,000,001 to \$2,500,000 million range be taxed at a rate of 13 per cent and companies which have reached incomes of \$2,500,001-plus should be taxed at 15 per cent.

Recommended January 2012 Federal Corporate Tax Rates (%)		
Incomes up to \$1,000,000	Incomes \$1,000,001 to \$2,500,000	Incomes greater than \$2,500,000
11.0	13.0	15

The effectiveness of corporate tax relief and the cost to government of forgone tax revenues is widely debated. The Canadian Chamber of Commerce has historically taken the position that corporate tax relief and cuts has a multiplier effect that stimulates the economy, contributing to government revenues. In its recent policy statement paper entitled "Business Tax Relief Is Crucial to Canada's Economic Success," the Canadian Chamber states "low business taxes promote better economic performance and lead to more tax revenue of all types in the long-run, not less." In addition to increasing competitiveness with a lower tax, if in the future the government does decide on a single tax rate as suggested by some economists, the more graduated rate could act as a useful bridge rather than SME's facing a substantial tax rate adjustment.

Recommendation

That the federal government increase the annual amount of active business income eligible for the reduced tax rate – generally referred to as the small business limit – to \$1,000,000 from \$500,000. Companies that earn between \$1,000,001 to \$2,500,000 should be taxed at 13 per cent, and businesses which earn \$2,500,001-plus at 15 per cent, thus making it easier for businesses to expand and not make a sudden jump from one tax bracket to a much larger one.