OBSERVATIONS TO THE SEVENTH REPORT OF
THE STANDING SENATE COMMITTEE ON NATIONAL FINANCE ON BILL C-15

SUMMARY OF COMMITTEE'S OBSERVATIONS

As part of its pre-study of Bill C-15, which took place from May 17, 2016, to June 16, 2016, your committee held a total of nine meetings. Over the course of these meetings, your committee heard from 52 witnesses from seven federal departments and agencies, as well as representatives from nine organizations outside the federal government.

Your committee has observations with respect to certain provisions of the bill, namely:

1. Sections 9, 26 and 34 of the bill propose maintaining the small business tax rate at 10.5% rather than the gradual reduction of 0.5% each year currently provided for in the law, which would drop the rate to 9% by 2019. Your committee recognizes the immense contribution of small businesses to the Canadian economy and believes that the government must support their development to enable them to grow and create jobs. **Your committee is concerned about the potential impacts of the proposed measure, which would take $825 million in additional tax each year from the pockets of small businesses**.

2. The bill aims to replace, as of July 2016, the Canada Child Tax Benefit and the Universal Child Care Benefit with the new Canada Child Benefit (CCB). According to the Minister of Finance, 9 out of 10 families would receive more money under the proposed benefit than in the current system. According to the Office of the Parliamentary Budget Officer, the proposed measure would cost $3.8 billion more than the existing two benefits, for a total of $22 billion a year. **While your committee supports the purpose of the Canada Child Benefit, it is nevertheless concerned about the high cost of this measure at a time when the government is forecasting an annual deficit of $29.4 billion for the 2016-2017 fiscal year.**

3. The tax credit for mineral exploration was introduced in October 2000 as a temporary measure to mitigate the impact of global slowdown on exploration on mining communities across Canada. Section 35 of the bill would extend the tax credit for mining exploration for one year. Your committee recognizes the important contribution of mining companies to the Canadian economy. The committee **believes it is time for the government to evaluate the results of the tax credit program for mining exploration.**

4. According to the existing legislation, the refundable tax credit for a labour-sponsored venture capital corporation (LSVCC) is 5% in 2016 and will be eliminated in 2017. Sections 36, 44, 57 and 61 of the bill aim to restore the LSVCC tax credit to 15%. Witnesses noted that many independent studies have shown that by offering a tax credit to LSVCCs, the government is doing significant harm to the economy and has done so since the introduction of this measure in the early eighties. **In light of this evidence, your committee questions the appropriateness of restoring LSVCC tax credit.**

5. Clause 47 would amend the *Income Tax Act* to enable the sharing of taxpayer information within the Canada Revenue Agency for the collection of non-tax debts. It would also allow the Canada Revenue Agency to share taxpayer information with the Chief Actuary to enable the conduct of actuarial reviews of the Canada Pension Plan and Old Age Security. While your committee realizes that some personal information needs to be shared to enable efficient and effective

administration, privacy needs to be protected. **Your committee believes that the Canada Revenue Agency and the Chief Actuary should develop a robust information sharing agreement that stipulates taxpayer information is only shared to the extent needed and includes strong privacy protection measures.**

6. A change to Statistics Canada's methodology for calculating provincial and local government data led to territorial financing payments to be approximately $88 million lower than the territories had been expecting. Division 7 of Part 4 would modify the formula for territorial financing to restore $67 million to the territories. As these jurisdictions rely heavily on federal transfers, **your committee urges the federal government to return to negotiations with the territories to reinstate the shortfall in territorial financing**.

7. Since 2007, the Minister of Finance is no longer required to seek parliamentary authority to increase market borrowing. Clauses 182 to 187 of the bill would reinstate the requirement that the Minister of Finance obtain the approval of Parliament to authorize the government to raise loans, with the exception of extraordinary circumstances. **Your committee supports parliamentary oversight of government's borrowing power, but will monitor the use of loans in "extraordinary circumstances" to ensure that they are in fact extraordinary.**

8. The previous government changed the age of eligibility for Old Age Security (OAS) from 65 to 67, which would have been gradually implemented from 2023 to 2029. Division 9 of Part 4 would re-establish 65 as the age of eligibility for OAS, cancelling the scheduled increase. As your committee is concerned about the rising cost of OAS and the economic signals sent by reducing the age of eligibility, **it urges the government to re-consider its decision to decrease the age of eligibility for OAS from 67 to 65**.

9. Budget 2016 is entitled "Growing the Middle Class." It indicates that the government's goal is to strengthen the middle class and generate more inclusive growth. However, the budget does not define the middle class, which makes it very difficult to determine whether the government is achieving its intended results with the measures announced in Budget 2016 and included in Bill C-15. Your committee believes **the government should define the middle class so Canadians can know whether its budgetary measures are having their intended effect**.

10. To assist this committee in its review of Bill C-15, the Standing Senate Committee on National Security and Defence, the Standing Senate Committee on Banking, Trade and Commerce and the Standing Senate Committee on Social Affairs, Science and Technology reviewed parts of the bill relevant to their mandates. They supported the proposed changes, with some observations.

DETAILED OBSERVATIONS ON BILL C-15

INTRODUCTION

In order to implement legislative provisions related to its budget, the government introduces budget implementation bills in Parliament. These bills are usually referred to the Standing Senate Committee on National Finance for review.

Bill C-15, An Act to implement certain provisions of the budget tabled in Parliament on March 22, 2016 and other measures (short title: Budget Implementation Act, 2016, No. 1), was introduced and read for the first time in the House of Commons on April 20, 2016. Bill C-15 is the first implementation bill of the March 2016 budget; established practice would have this bill followed by a second budget implementation bill.

On May 3, 2016, the Senate referred the subject matter of all of Bill C-15 to the Standing Senate Committee on National Finance for in-depth pre-study. To assist your committee with its study, three other standing Senate committees were authorized to examine the subject matter of certain divisions of Bill C-15 in advance of its coming before the Senate:

- the Standing Senate Committee on National Security and Defence: Division 2 of Part 4;
- the Standing Senate Committee on Banking, Trade and Commerce: Divisions 3, 4, 5, 6 and 10 of Part 4;
- the Standing Senate Committee on Social Affairs, Science and Technology: Division 12 of Part 4.

As part of its pre-study on Bill C-15, which took place from May 17, 2016 to June 8, 2016, your committee held a total of nine meetings. Over the course of these meetings, your committee heard from 54 witnesses from seven federal departments and agencies, as well as representatives from nine organizations outside the federal government.

Your committee has observations with respect to certain provisions of the bill, namely:

1. small business income tax rate;
2. Canada Child Benefit;
3. mining exploration tax credit;
4. labour-sponsored venture capital corporation tax credit;
5. sharing taxpayer information;
6. Territorial Formula Financing;
7. federal borrowing authority;

8. Old Age Security; and

9. defining the middle class.

Your committee also considered the reports of the other standing committees that examined parts of Bill C-15.

1 AMENDMENT OF THE TAX RATE FOR SMALL BUSINESSES

In 2016, Canadian-controlled private corporations can benefit from a reduced income tax rate of 10.5% on a maximum of $500,000 of active business income, compared with the general corporate income tax rate of 15%. According to the Department of Finance Canada, approximately 700,000 businesses benefit from the small business tax rate each year.

Sections 9, 26 and 34 of the bill propose maintaining the small business tax rate at 10.5% rather than the gradual reduction of 0.5% each year currently provided for in the law, which would drop the rate to 9% by 2019. Officials with the Department of Finance Canada said that maintaining the rate at 10.5% would allow the federal government to generate additional tax revenue of $825 million a year as of 2020-2021.

Representatives of Canadians for Tax Fairness support the measure. They said that offering a preferential tax rate of 9% to small businesses, compared with 15% for other businesses, would cost the federal government $5 billion in tax revenue each year.

Several witnesses said that the economic purpose of offering a lower tax rate for small businesses was to encourage them to invest and grow.[1] However, according to them, many studies,[2] including one by the International Monetary Fund, have shown that this incentive has had adverse consequences, such as encouraging businesses to remain small.

The representative from the Canadian Federation of Independent Business (CFIB) is, for her part, against the proposed measure. She explained that 83% of respondents to a survey of its members, who represent more than 109,000 small and medium-sized businesses across Canada and who collectively employ over 1.25 million Canadians, believe that the reduction of the small business tax rate is the measure that has most helped their businesses.

Your Committee recognizes the immense contribution of small businesses to the Canadian economy and believes that the government must support their development to enable them to grow and create jobs. **Your committee is concerned about the potential impacts of the proposed measure, which would take $825 million in additional tax each year from the pockets of small businesses**.

---

[1] Each witness proposed different policies to encourage the growth of small businesses.

[2] A report by the Office of the Parliamentary Budget Officer published on 10 May 2016 notes that "[r]ecent literature has found evidence in Canada that the preferential tax rate for small businesses has an effect on their behaviour" and in particular have "increase[d] the marginal effective tax rate on investment and disincentivize[d] growth."

2 REPLACEMENT OF THE CANADA CHILD TAX BENEFIT AND THE UNIVERSAL CHILD CARE BENEFIT WITH THE NEW CANADA CHILD BENEFIT

The bill aims to replace, as of July 2016, the Canada Child Tax Benefit and the Universal Child Care Benefit with the new Canada Child Benefit (CCB).

According to the Minister of Finance, 9 out of 10 families would receive more money under the proposed benefit than in the current system. According to him, eligible families would receive on average $2,300 more a year.

The non-taxable maximum annual allowance would be $6,400 per child under the age of six and $5,400 per child aged 6 through 17. The maximum annual allowance would be paid to families with an adjusted net family income of less than $30,000 a year. The amount of the benefit would depend on the number of children and their age, and gradually decrease according to the adjusted net family income. For example, a single parent with a child under five would not be entitled to any amount under the CCB when their adjusted net family income was $188,438.

The witnesses who appeared before the Committee support the objectives of the proposed measure, which is to provide financial support to help parents defray some of their child care costs. However, the cost of the measure was the subject of much discussion. According to the Office of the Parliamentary Budget Officer, the proposed measure would cost $3.8 billion more than the existing two benefits, for a total of $22 billion a year.

While your Committee supports the purpose of the Canada Child Benefit, it is nevertheless concerned about the high cost of this measure at a time when the government is forecasting an annual deficit of $29.4 billion for the 2016-2017 fiscal year.

3 TAX CREDIT EXTENSION FOR MINING EXPLORATION

The tax credit for mineral exploration was introduced in October 2000 as a temporary measure to mitigate the impact of global slowdown on exploration on mining communities across Canada. Originally, it was to end on December 31, 2003. Since then, it has been renewed annually, the last time on March 1, 2015.

Section 35 of the bill would extend the tax credit for mining exploration for one year. In addition, it would add costs associated with the launch of an environmental study and community consultation to the eligible expenses for the tax credit.

A witness told the committee that according to studies,[3] the tax credit for mineral exploration had negative economic effects. According to him, these generous tax subsidies cost about half a billion dollars annually to the federal government and lead to inefficient investment.

Your Committee recognizes the important contribution of mining companies to the Canadian economy. However, in light of the testimony heard, **it believes it is time for the government to evaluate the results of the tax credit program for mining exploration to determine if it is still relevant in the current fiscal context.**

---

3 Vijay Jog, "Rates Of Return On Flow-Through Shares: Investors And Governments Beware," University of Calgary, February 2016.

4 RESTORATION OF THE LABOUR-SPONSORED VENTURE CAPITAL CORPORATION TAX CREDIT

According to the existing legislation, the refundable tax credit for a labour-sponsored venture capital corporation (LSVCC) tax credit is 5% in 2016 and will be eliminated in 2017.

Sections 36, 44, 57 and 61 of the bill aim to restore the labour-sponsored venture capital corporation tax credit to 15% for share purchases of provincially registered LSVCCs for the 2016 and subsequent taxation years. Currently, purchases are eligible for a 5% refundable tax credit, to a maximum of $250.

The 5% rate that currently applies to federally registered LSVCCs would be maintained for 2016, but would be eliminated in 2017. As of 2017, only share purchases of provincially registered LSVCCs would qualify for the 15% tax credit, for a maximum credit of $750. This measure would cost the federal government $815 million for the 2015-2016 to 2020-2021 period.

According to the Minister of Finance, the Canadian banking system is competitive and efficient but concentrated among a small number of large and very large banks. The aim of the proposed measure is to encourage more competition in Canada's venture capital market.

However, some witnesses do not share this opinion and recommend that the refundable tax credit for LSVCCs be eliminated. They argue that many independent studies have shown that by offering a tax credit to LSVCCs, the government is doing significant harm to the economy and has done so since the introduction of this measure in the early eighties.[4] They believe that LSVCCS are not the most appropriate organizations to promote innovation, technological advancement or the growth of small businesses.

In light of this evidence, your committee questions the appropriateness of restoring LSVCC tax credit.

5 SHARING TAXPAYER INFORMATION

In order to protect the privacy of Canadians, the *Privacy Act* requires organizations to use personal information only for the purpose for which it was collected.

Clause 47 of Part I would amend the *Income Tax Act* to enable the sharing of taxpayer information within the Canada Revenue Agency for the collection of non-tax debts. It would also allow the Canada Revenue Agency to share taxpayer information with the Chief Actuary to enable the conduct of actuarial reviews of the Canada Pension Plan and Old Age Security.

According to officials from Finance Canada, the changes would lead to administrative efficiencies within the Canada Revenue Agency, as the Agency could avoid having two people working in parallel not knowing what the other is doing, and debtors would not be contacted by separate debt collectors. They also said that information shared with the Chief Actuary would be "masked" to protect the privacy of taxpayers.

An official from the Privacy Commissioner said that as long as the information shared within the Canada Revenue Agency is limited to that which is necessary to fulfill the stated purpose, the changes would be

[4] C. D. Howe Institute, Financing Entrepreneurs, Better Canadian, Policy for Venture Capital, 2007.

consistent with the *Privacy Act*. However, the official was more concerned about the provision to permit the sharing of information with the Chief Actuary, as the bill would permit the sharing of personal tax information, when anonymized information would be sufficient for the purpose. While she would prefer that the bill be clarified to only share information that is required to conduct actuarial reviews, a formal information-sharing arrangement including privacy protection measures, such as limiting the collection and use of information, securing information, establishing retention times and providing for effective destruction of information, between the Office of the Chief Actuary and the Canada Revenue Agency would mitigate privacy concerns.

The Chief Actuary, Jean-Claude Ménard, explained to your committee that micro-data is essential for his office to be able to fulfill its statutory obligations, and his office never asks for personal information, such as Social Insurance Numbers, names or addresses. The office has a robust system to protect information, destroys files when no longer needed, and conducts audits on information privacy management.

While your committee realizes that some personal information needs to be shared to enable efficient and effective administration, privacy needs to be protected. Your committee believes that the **Canada Revenue Agency and the Chief Actuary should develop a robust information sharing agreement that stipulates taxpayer information is only shared to the extent needed and includes strong privacy protection measures.**

6 TERRITORIAL FORMULA FINANCING

Through Territorial Formula Financing, the federal government transfers funds to the three territorial governments to enable them to provide their residents a range of public services, such as hospitals, schools, infrastructure and social services, comparable to those offered by provincial governments.

Each territory’s grant is based on the difference between a proxy of its expenditure needs (the gross expenditure base) and its capacity to generate revenues. However, in December 2015 as part of its efforts to align its statistics with international standards, Statistics Canada changed its methodology for calculating provincial and local government data, which had the unintended consequence of lowering the gross expenditure base relative to Statistics Canada’s previous data release in September 2015. This change led territorial financing payments to be approximately $90 million lower than the territories had been expecting—a reduction of $33 million for the Northwest Territories, $34 million for Nunavut and $23 million for Yukon.

As a result of discussions between the federal government and the territories, Division 7 of Party 4 would amend the *Federal-Provincial Fiscal Arrangements Act* to establish each territory’s 2015–2016 gross expenditure base as the new basis for the future determination of payments, remove the ability for the minister to recalculate the gross expenditure base of previous years, and authorize the minister to re-determine the payments for 2016–2017. As a result of these changes, the federal government would be providing the territories $67 million more than was initially calculated.

While an official from Finance Canada told your committee that the department had received positive feedback on its changes, in a presentation by the Premier of Yukon, Darrell Pasloski, and written briefs from the Northwest Territories and Nunavut, your committee learned that the change would still leave Nunavut with a shortfall of $7.7 million and Yukon with a shortfall $6.5 million.

As these are small jurisdictions that rely on federal transfers, the shortfall has led to significant budgetary pressures. The key principles of territorial financing are predictability and stability. When technical changes have led to reductions in the past, the federal government always ensured the territories were made whole.

The Premier of Yukon told your committee that consultation and dialogue is the appropriate thing to do; it is how governments get results for citizens. Your committee agrees and **urges the federal government to return to negotiations with the territories in order to reinstate the shortfall in territorial financing**.

7 RESTRICTION ON BORROWING MONEY WITHOUT LEGISLATIVE AUTHORITY

Since 2007, the Minister of Finance is no longer required to seek parliamentary authority to increase market borrowing.

Articles 182 to 187 of the bill would reinstate the requirement that the Minister of Finance obtain the approval of Parliament to authorize the government to raise loans. However, the bill contains a provision that would allow the Governor in Council to bypass this requirement particularly in cases of natural disaster, or if the Minister of Finance considers it necessary to promote stability or maintain the efficiency of the financial system in Canada.

The Minister of Finance would have to submit to Parliament a report on the activities in connection with any outstanding debt within 30 days.

Some members questioned the lack of definition of "extraordinary circumstances" in the legislation and the interpretation of the Minister of Finance of " extraordinary circumstances ". Without offering a precise definition, the Minister of Finance explained that the proposed measure is intended to preserve the ability to borrow without going through Parliament in an emergency. Bank of Canada officials have previously reported on the efficiency of the measures adopted in 2007 before the committee, explaining its relevance to Canada during the global financial crisis of 2008.

Your committee understands that the Government must give the necessary legislative tools in order to give the opportunity to borrow quickly in case of emergency, such as a financial crisis for example. **Your committee supports parliamentary oversight of government's borrowing power, but will monitor the use of loans in " extraordinary circumstances " to ensure that they are in fact extraordinary.**

8 OLD AGE SECURITY

The Old Age Security (OAS) pension is a monthly payment available to Canadians 65 years of age or older. The payment is approximately $570 per month in 2016, but it gets clawed back for individuals with income over $77,000 per year and is completely clawed back at income of $120,000 per year.

The previous government changed the age of eligibility for OAS from 65 to 67, which would have been gradually implemented from 2023 to 2029. Division 9 of Part 4 would re-establish 65 as the age of eligibility for OAS, cancelling the scheduled increase.

An official from Employment and Social Development Canada explained that changing the age of eligibility would have increased the number of people aged 65 and 66 living in poverty from 80,000 to 100,000, and the incidence of poverty of people in this group would have increased from 5% to 16%.

She noted that 20% of people aged 65 and 66 rely on OAS and the Guaranteed Income Supplement for more than half of their income.

The official indicated that without the change in age eligibility, the cost of OAS would be $92 billion in 2029–2030, and with the restoration of 65 as the age of eligibility, the cost of OAS would be $104 billion in the same year. As some of the difference would be recouped in taxes, the net cost of the change would be $9.9 billion in 2029–2030.

The Minister of Finance told your committee that the change is designed to help people who are of more modest means, as the increase was too heavy a burden for people who are in a precarious financial situation. He said there is no fiscal problem with OAS over the long term.

The change in age eligibility for OAS was not, however, supported by other witnesses, who said that it fails to recognize the broader reality of longer life expectancy and the current trend toward later retirement. Witnesses said that the beneficial economic and fiscal impacts of working longer are clear, and a higher retirement age could improve our ability to bear the fiscal and social cost of an aging population. Instead, senior's poverty could be addressed in a more targeted way.

While your committee recognizes the importance of addressing senior's poverty, it is concerned about the rising cost of OAS and the economic signals sent by reducing the age of eligibility. Your committee **urges the government to re-consider its decision to decrease the age of eligibility for OAS from 67 to 65**.

9 DEFINING THE MIDDLE CLASS

Budget 2016 is entitled "Growing the Middle Class." It indicates that the government's goal is to strengthen the middle class and generate more inclusive growth. The budget also says that the government will be using a new results and delivery approach by focusing on outcomes and "making evidence-based decisions that are anchored in meaningful data and indicators."[5]

However, the budget does not define the middle class, which makes it very difficult to determine whether the government is achieving its intended results with the measures announced in Budget 2016 and included in Bill C-15.

When asked for a definition of the middle class, the Minister of Finance referred to the reduction of the tax rate for the $45,000 to $90,000 tax bracket as an important measure to help the middle class, which will benefit nine million Canadians. He also mentioned the Canada Child Benefit and the top-up to the Guaranteed Income Supplement.

Officials from Finance Canada said that they do not have a technical definition of the middle class. The Parliamentary Budget Officer, Jean-Denis Fréchette, said the middle class is a moving target, so his office uses categories of income in its calculations.

Some witnesses suggested that quintiles could be used to define the middle class, whereby the population is divided into five groups of equal size, and the top 20% of individuals would be the upper class, the middle 60% would be middle class, and the bottom 20% would be the poor or lower class.

[5] Finance Canada, *Growing the Middle Class*, Ottawa, 2016, p. 210.

Regardless of the definition used, your committee believes **the government should define the middle class so Canadians can know whether its budgetary measures are having their intended effect**.

10 OTHER COMMITTEE REPORTS

In order to assist this committee in its review of Bill C-15, other standing senate committees reviewed parts of the bill relevant to their mandates.

The Standing Senate Committee on National Security and Defence examined Division 2 of Part 4, which would make changes to the benefits available to injured Canadian Forces members and veterans. The committee supports the proposed changes, but noted some concerns raised by witnesses:

- **the proposed changes to the Permanent Impairment Allowance and condition of "totally and permanently incapacitated" can be assessed only once the regulatory changes are known; and**
- **the increase in the Earnings Loss Benefit from 75% to 90% is a step forward, but the increase would be minimal for veterans in the lower ranks.**

The Standing Senate Committee on Banking, Trade and Commerce examined Divisions 3,4,5,6 and 10 of Part 4. The committee supports the changes, which include:

- **extending the current statutory sunset date for the renewal financial institutions' governing legislation by two years, which would provide more time to conduct a review of the legislation;**
- **providing protection for provincially regulated cooperative credit societies that are in the process of becoming federal credit unions;**
- **creating a bail-in regime whereby the Canada Deposit Insurance Corporation would be able to convert debt into common shares of a domestic systemically important bank in the unlikely event of its failure; and**
- **amending the trade remedy procedures in the *North American Free Trade Agreement*.**

The Standing Senate Committee on Social Affairs, Science and Technology examined Division 12 of Part 4, which would amend the *Employment Insurance Act* to reduce the waiting period prior to the payment of employment insurance benefits (EI); remove provisions relating to new entrants and re-entrants to the labour force; and extend the number of weeks of benefits for workers in regions affected by an economic downturn related to commodity prices. The committee supports the changes but noted:

- **there is insufficient clarity and transparency with respect to the criteria used to determine the EI economic regions listed; and**
- **small businesses may be negatively affected by the decrease in the waiting period for the payment of EI benefits.**