

Elimination of Canada's Capital Gains Tax

Statement of Problem

Canada's Capital Gains Tax represents less than one percent of the country's total tax revenue and has been described by leading economists as being of marginal worth.^[i] However, to the businesses that pay the tax, the levy represents a huge burden that has a stultifying effect on their capacity to innovate and expand.

Our partners in NAFTA, and indeed our competitors around the world, have substantially lower capital gains taxes and indeed, in some countries for example, Germany, Turkey, Mexico, New Zealand, Belgium and others, have a zero capital gains tax.^[ii] By comparison, Canadian business shoulders an unfair tax that frustrates its ability to unlock the capital needed to update manufacturing plants, invest in new technology and keep pace in a competitive global environment.

According to the National Angel Corporation of Toronto in their report dated October 12, 2004, \$1 invested in an SME at early stages creates \$10 of economic activity and a further \$5 of later stage investment. Thus, a \$1 investment can lead to \$50 of economic activity. According to the autumn 2000 Perspectives Stats Canada study for the year 1997(the latest date such comparisons were reported), taxes were 36.8% of GDP. This would mean that \$50 of economic activity would generate \$18.40 of tax.

Details of the Problem

In 2005/2006, the Federal and Provincial governments collected approximately \$443.1 billion in tax revenue.

The bulk of the revenue came from personal income tax (37.2%), corporate income tax (11.1%) and sales tax (24.2%). Additional sources of revenue accounted for 26.7 % of the country's total tax revenue.

The Capital Gains Tax represented just .08 percent of that amount or approximately \$3.5 billion of the country's total tax revenue.

Numerous economists, including Alan Greenspan, the former chairman of the Federal Reserve in the US^[iii], as well as several leading Canadian economic thinkers have derided capital gains as detrimental to entrepreneurs, business and the communities that depend on businesses to create jobs.

In 2006, the Federal government committed to relieving Canadian businesses of some of that tax burden. It was a prescient plan that might have served to offset some of the difficulties currently being experienced by small and medium sized business in the current tight lending market. The reductions however, were never achieved.

Capital gains (or losses) occur when the value of an asset at the time of sale differs from its value at the time of purchase.^[iv]

In Canada, 50 percent of any capital gain (with exception of homes) is subject to tax at the taxpayers' marginal rate of tax. In particular, 50 percent of the gain realized on sale of a capital asset is considered income and the tax amount is calculated based the taxpayer's marginal income tax rate.

The provincial capital gains tax varies between provinces, however the western provinces have the lowest combined capital gains tax while Quebec, Nova Scotia and Newfoundland and Labrador have the highest rates.

Generally speaking, as a nation, Canada has a high capital gains tax when compared to other countries in the OECD. Canada in fact ranks as having the 9th highest capital gains tax rate.

The Capital Gains Tax was first introduced by the Liberal government in 1971 and there is wide spread agreement among economists that it represents an 'all pain-no gain' tax.

For example, it discourages business from reallocating capital. Business owners are more likely to hang on to outdated investments even if better opportunities arise.

Economists call this the locked-in effect.

Since business still must find ways to raise money, and can't access the gains they have made without being taxed, they are forced to find other ways to raise cash. This means businesses must incur borrowing costs in order to make new investments in their businesses, further stressing their capital.

The Capital Gains Tax also has a negative impact on entrepreneurship. For example, start up businesses searching for high quality talent may offer shares in the business or a partnership. However, when they wish to withdraw that investment – they are taxed.

There is a mound of academic research that indicates capital gains taxes run counter to entrepreneurship and to the creative, risking-taking and innovative environment that strengthens both economies and communities.

And finally, it is argued that by eliminating the capital gains tax, the resulting economic impact of re-allocation of capital will more than offset the .08 percent reduction in tax revenue.^[v]

THE CHAMBER RECOMMENDS

That the Federal and Provincial governments eliminate the capital gains tax.

Submitted by the Kamloops Chamber of Commerce Policy Committee
Supported by the Prince George Chamber of Commerce

References

^[i] Niels Velduis, Keith Godin, Jason Clemens. The Economic Costs of Capital Gains Taxes. Fraser Institute. Studies in Entrepreneurship Markets. Number 4/ February 2007.

^[ii] Newt Gingrich and Emily Renwick. Journal of the American Enterprise Institute. August 13 2009.

^[iii] Remarks by Chairman Alan Greenspan on Current Monetary Policy. Haskins Partners Dinner at the Stern School of Business. New York University. May, 1997.

^[iv] Canada Revenue Agency (2010). Calculating and Reporting your Capital Gains and Losses.

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^[v] Niels Velduis, Keith Godin, Jason Clemens. The Economic Costs of Capital Gains Taxes. Fraser Institute. Studies in Entrepreneurship Markets. Number 4/ February 2007.