

**Flaherty's Fairness:
The Minister Surpasses for Seniors,
Is Mistrusted on Trusts**

**BDO Dunwoody CEO/Business Leader Poll
by COMPAS for publication in
the *Financial Post* November 6, 2006**



**COMPAS Inc.
Public Opinion and Customer Research
November 6, 2006**

1.0 Introduction

The COMPAS/*Financial Post* panel of CEOs and business leaders appears to have been roiled by Finance Minister Jim Flaherty's announcement in mid-week of tax changes affecting income trusts, corporations, and the elderly.

Flaherty's two provisions for the elderly earn outstanding performance scores—higher than virtually all scores achieved throughout the Chretien and Martin period in COMPAS' large database of performance scores given to governments by CEOs and the general public. Indeed, these scores (73% and 80%) are among the highest in the entire COMPAS database.

By contrast, Flaherty's income trust tax increases and corporate tax reductions earn among the lowest scores achieved by the Harper government.

The panel's moderate dismay over the income trust change appears to be driven by three factors. First, panelists are far from embracing the conventional wisdom of economists and editorialists on the issue. Only 38% of CEOs and business leaders on the COMPAS panel believe strongly that the income trust phenomenon threatened to weaken the Canadian economy by discouraging firms from reinvesting in technology, capacity, and innovation. Meanwhile 19% strongly repudiate this view.

Secondly, while some panelists are delighted by the secrecy with which the policy was developed, others are livid at the absence of warning. Some in the latter group perceive the Flaherty announcement as breaking a campaign promise. Even some panelists who embraced both Flaherty's income trust policy and the reasoning behind it volunteered that poor communication on the government's initiatives on the issue could harm the Harper government's prospects.

Thirdly, some panelists expressed concern that the income trust and corporate tax provisions were piece-meal and inadequate—inadequate because the corporate tax reduction was too small or because the government had missed an opportunity to clean up and simplify the vast array of taxation provisions.



These are the principal findings from the weekly business web-survey conducted by COMPAS for the *Financial Post* under sponsorship of BDO Dunwoody LLP.

2.0 Exceptional Scores for Provisions for the Elderly; Mediocre Scores on Income Trust and Corporate Tax Provisions

The panel scores Flaherty's provisions for the elderly very positively, as shown in table 2A. But the income trust and corporate tax provisions earn mediocre grades. Indeed, the one-half percent cut to the corporate income tax rate to be implemented in five years earns a near failing grade.

Table 2A: (Q1) On a 100 point performance scale, what grade would you give the following initiatives under Finance Minister Jim Flaherty's new Tax Fairness Plan for Canadians... [ROTATION]

	Mean
Income splitting for pensioners beginning in 2007	80
A \$1,000 increase in a federal tax credit for low and middle income seniors, effective January 1, 2006	73
The distribution tax on income trust income--a tax on distributions from new income trusts to begin in 2007; distributions from existing income trusts will be subject to the new tax in 2011	59
A cut to the corporate income tax rate by one-half percentage point as of January 1, 2011	52

Respondents were asked to what extent they agreed with two widely mediated concerns about the impacts of income trusts on economic growth and government revenues. While a majority tends to agree with both, support for these two concerns tends to be tepid, as shown in table 2B. Tepid concern



*Tax Fairness Plan for Canadians, BDO Dunwoody CEO/Business
Leader Poll, by COMPAS for Publication in the Financial Post on
November 6, 2006*

about the impact of income trusts on the economy may indeed be a key factor in why the government earned such mediocre performance scores on the issue.

Table 2B: (Q2) To what extent do you agree with the following concerns about income trusts, using a 7 point scale where 7 means agree strongly and 1, disagree strongly.

	Mean	7	6	5	4	3	2	1	DNK
Income trusts were a threat to government because they deprived governments of necessary income	4.7	18	24	20	10	9	9	9	1
Income trusts were a increasing threat to economic growth because income trusts, unlike normal companies, were obliged to distribute their earnings and could not readily reinvest	4.6	15	23	23	16	4	9	10	1

Table 2C: Mean Performance Scores for Each Level of Agreement that Income Trusts Are a Threat to Economic Growth

7=Agree strongly, 1=disagree strongly re economic threat	Mean performance
1	19
2	19
3	38
4	56
5	61
6	77
7	85



Indeed, tepid concern about the impact of income trusts on the economy does emerge as a key factor when one compares the performance scores given to the government according to whether panelists agree or do not agree with this concern. Table 2C displays the performance scores given to the government for each level of agreement on the substance of the issue.

One concern about the income trust changes emerged out of desire for a more systemic revision. As one CEO put it, "The Conservatives have blown an opportunity to overhaul corporate tax by reverting to the bad old system, rather than do what Ireland did to make them competitive: cut taxes. A giant victory for the ivory tower bureaucrats who do not have to worry about their gold-plated pensions as we pay for them."

Another related perspective from a CEO:

Income splitting, averaging and joint returns should be permitted for all Canadians, not just seniors. Similarly, special credits for seniors is just plain politics. It should not be for low-income seniors because income in many cases is not a proper measure of ability to live/pay. Net worth would be a more appropriate measure. But really, fewer complications would be the best. Income Trusts were created by lawyers and accountants and they have been the main beneficiaries. The only reason they "work" is because our income tax system is not properly integrated in the sense that the dividend tax credit does not in fact compensate for the corporate taxes paid and so in fact a dollar earned by an individual directly results in more after-tax income than a dollar earned via a corporation. That is the problem: fix that and income trusts go away. In addition, if it were desirable to tax distributions, a simple income tax change where "distribution dividends" could be paid in a corporation and the distribution, dollar for dollar would be deductible from a corporations taxable income and straight income to the person receiving it. This would eliminate the need for very expensive trusts.



A few respondents were ecstatic about both substance and process. As the leader of a national business association put it, "Flaherty made the right decision. A government that has the sense to review the facts and change its platform shows maturity and discipline. The Telus and BCE proposals for income trusts changed the ball game and the federal government had to respond to this. Congratulations to Flaherty. In my book he gets an A+ for being the Finance Minister we need." According to the CEO of a firm in the communications and media sector, "Flaherty had the balls to stop a fundamental [and dangerous] restructuring of corporate Canada." According to a sanguine CEO in the construction industry, "A simple fair and easily transparent tax system is most important to the health and competitive state of the economy." "Income trusts are simply a tax-avoidance scheme," volunteered a partner in a services firm. "They do not encourage corporate growth or success."

Still another very positive response: "I am impressed with the secrecy surrounding the income trust taxation move. That is so unlike Ottawa, or any government action. And, while it cost taxpayers a lot of money in lost capital value of income trust investments, I think this was the right move. I might have considered a longer-term "grandfathering" (i.e., 5 - 10 years) but it was the right move nevertheless."

"Mr. Flaherty was given no choice," volunteered the owner-manager of a firm, "and took the courageous step that the previous government wanted to take but lacked the intestinal fortitude. Offsetting benefits to seniors are appropriate and fair. Sorry Mr. Entwhistle and Mr. Sabia, you just tried to go too far!

Several panelists volunteered a concern that the Harper government was no more farsighted or trustworthy than the Liberals or any government in particular:

Income trusts have become a source of higher returns for those requiring a steady income stream. The government knew well what the effect of trusts would have on the tax base, and should have written the rules to compensate



accordingly. They only reacted when there was a threat of huge corporations to convert. The planning for trusts by the government clearly showed a lack of foresight and the decision to claw back taxes is one made for political reasons. It's again a clear signal to voters that politicians cannot be trusted. They make promises and break them. This happened with the Liberals in Ontario and now the Conservatives in Ottawa. It's time that ethical people stood up and acted as our representatives, and it's time the voters give a very clear message to politicians that do not keep their commitments that they will not be voted in.

The Conservatives have been underhanded, deceitful, and they lied to the Canadian voters. It remains to be seen how they fair at the next election.

I gave a lower rating on the changes to income trust taxation, not because I disagree with the policy, but because it is the second time the investment community and the investing public have been blind-sided in regard to tax policy in this area. There should have been clearer signals from the government regarding their probable intention to back track on an obviously misguided and harmful policy.

Several respondents volunteered that the attenuating aspects of the Flaherty announcement were too paltry to assuage tax payers.

The [small] cut to corporate tax is too little, too late. It is unlikely that the Conservatives will even be in power in 2011. As far as the trusts are concerned, the small retail investor is the one hurt.

Flaherty's proposal would be much better received if he had made a significant cut to corporate income tax, say 5 percentage points, instead of proposed tiny reduction of only 0.5%; and even that delayed to 2011.



3.0 Methodology

The COMPAS web-survey of CEOs and leaders of small, medium, and large corporations was conducted November 1 - 3, 2006. Respondents constitute an essentially hand-picked panel with a higher numerical representation of small and medium-sized firms.

Because of the small population of CEOs and business leaders from which the sample was drawn, the study can be considered more accurate than comparably sized general public studies. In studies of the general public, surveys of 129 are deemed accurate to within approximate 8.7 percentage points 19 times out of 20. The principal and co-investigator on this study are Conrad Winn, Ph.D. and Tamara Gottlieb.

