PRE-BUDGET SUBMISSION

TO

THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE

From

Direct Sellers Association of Canada

Association de ventes directes du Canada

November 1, 2004

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INDEX

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INTRODUCTION

The Direct Sellers Association of Canada (DSA), founded in 1954, is the national association of Canadian direct selling companies and the independent sales contractors (ISCs). The mission of the DSA is to further enhance trust, confidence and growth in the Canadian direct selling industry through self-regulation and ethical conduct.

The DSA is also a member of the World Federation of Direct Selling Associations (WFDSA). The WFDSA represents more than 50 DSA's around the world with retail sales in excess of US $90 billion through the activities of more than 50 million ISCs.

The DSA and its 41 direct selling member companies are committed to operating in accordance with the comprehensive industry standards set out in the DSA's Codes of Ethics and Business Practices (Appendix A). The Codes govern the direct sale practices and procedures used by DSA member companies in marketing the products and services to the public and refers to the relationship all DSA members and the ISCs should strive to obtain with the community. The purpose of the Codes is to emphasize the sense of responsibility and commitment all DSA members should express and exhibit towards Canadian consumers and the general public, thereby benefitting the individuals they serve and the community as a whole.

The direct selling companies and the ISCs market and distribute a wide variety of products and services directly to the consumer, usually but not exclusively in the consumer's home, rather than in traditional retail establishments. Generally, these products and services are sold by ISCs in the context of group presentations (party plan), or on a personal consultation basis.

The strength of direct selling lies in its tradition of independence, its simplicity, and its commitment to a free market system, providing accessible business and career opportunities to people whose entry is not restricted by gender, age, education or previous experience. It is a significant fact that direct selling is a manageable economic opportunity, which can further family income with minimal disruption and minimal investment. This opportunity is accessible to all women and men, everywhere in Canada, whether they live in urban or rural communities.

During the past year, close to 1 million ISCs were engaged in operating their own direct selling businesses, selling more than $1.6 billion of retail goods and services. The products and services sold by these individuals are as diverse as the individuals themselves, and include cosmetics and personal care items, clothing and accessories, home appliances, houseware specialties and decorations, household cleaning products, candles, natural health food products, toys, educational products and telecommunication services, just to mention a few. In terms of the ISCs, it should be noted that about 75% are women, 77% are married, 66% have full-time jobs - using this business opportunity to earn extra income, and approximately 33% work full or part-time and have no other occupation.

The DSA has always shared its expertise and knowledge with all levels of government. For example, the DSA has worked closely with Revenue Canada (now the Canada Revenue Agency or "CRA") in educating and encouraging ISCs to comply with Canada's income tax laws by assisting in the preparation of the *Tax Filing Information for Independent Sales Contractors* Income Tax Guide. The DSA continues to actively work with Health Canada concerning the regulation of Natural Health Products (approximately 60% of the DSA member companies and ISCs provide such products to their customers). The DSA is also continually working with Consumer Protection Agencies across the country, in promoting the harmonization of Provincial direct selling legislation, and Industry Canada's Competition Bureau, in promoting the principles set out in the *Competition Act* to its members and ISCs. Internationally, the DSA has worked with the Canadian representative at the APEC Ministerial Forum for Small and Medium Enterprises to support the Consumer Education and Protection Initiative (CEPI) aimed at enhancing consumer protection across APEC economies.

SUMMARY OF RECOMMENDATIONS

The DSA believes that the following recommendations will assist the House of Commons Standing Committee on Finance (the "Committee") in preparing this year's Pre-Budget report.

I. <u>Maintaining International Competitiveness</u>

The DSA recommends that the government continue with tax reductions that will contribute to Canada's economic growth and job creation.

II. <u>Draft Proposals Regarding the Deductibility of Interest and Other Expenses</u>

The DSA recommends that the government not proceed with the Draft Proposals given that they are not needed, lack certainty and, if legislated, would stifle entrepreneurial activity in Canada.

III. <u>GST/HST Relief for Dietary Supplements & Natural Health Products</u>

The DSA recommends that the "food and beverage" zero-rating provisions in the *Excise Tax Act* be clarified to expressly zero-rate dietary supplements and Natural Health Products to ensure the goal of investing in the health of Canadians.

IV. <u>Job Creation and Transitioning to Independence</u>

The DSA recommends that existing social programs be amended to allow all individuals, including those starting their own businesses, the transitional relief needed to move from a position of dependence on social assistance to a position of independence in operating their own small businesses.

V. GST/HST and the Direct Sellers Mechanism

The DSA recommends that legislative action be taken to extend the Direct Sellers Mechanism so that it will be equally available to direct sellers and ISCs who operate on a sales agent basis (currently, only direct sellers and ISCs who operate on a buy-and-resell basis may use the DSM).

RECOMMENDATIONS

I. Maintaining International Competitiveness

The DSA applauds the Canadian Government for having completed the Five Year Tax Reduction Plan that was introduced in 2000. Further tax reductions, for example, as introduced in the 2003 Budget, will continue to promote economic growth and job creation, including increasing the amount of income eligible for the low small business tax rate.

It is the DSA's position, as stated by the former Minister of Finance, that reducing taxes has played a significant role in contributing to Canada's "unprecedented economic and fiscal turnaround" and is "essential for Canada's success in today's highly competitive global economy."

Recommendation

The DSA recommends that the government continue with tax reductions that will contribute to Canada's economic growth and job creation.

II. Draft Proposals Regarding the Deductibility of Interest and Other Expenses

The Draft Proposals Regarding the Deductibility of Interest and Other Expenses (the Draft Proposals), seek to legislate a "reasonable expectation of profit" (REOP) test. In the past, the REOP test has been applied in an unfair and arbitrary fashion to the business expenses of ISCs and has, in the DSA's view, created uncertainty and unfairness in the industry.

The Supreme Court of Canada (the "SCC") has rejected the REOP test due to its vagueness and uncertainty of application, which the SCC has noted resulted in unfair and arbitrary treatment of Canadian taxpayers. In rejecting REOP, the SCC developed a two-part test for denying the deduction of business expenses, where there is a personal or a hobby element involved.

The DSA believes that the approach enunciated by the SCC regarding the deductibility of business expenses is sufficient to ensure that only legitimate commercial undertakings may deduct their expenses/losses. It is the DSA's view that the Draft Proposals, as currently drafted, would re-introduce the uncertainty, unfairness and arbitrary treatment the SCC has sought to curtail, and would result in the disallowance of losses arising from wholly legitimate business activities.

This would clearly be inappropriate. Furthermore, it is the DSA's view that enactment of the REOP test would stifle entrepreneurial activity in the direct selling industry and in Canada generally.

Recommendation

The DSA recommends that the government not proceed with the Draft Proposals given that they are not needed, lack certainty and, if legislated, would stifle entrepreneurial activity in Canada.

III. GST/HST Relief for Dietary Supplements & Natural Health Products

With the globalization of the Canadian economy and the diversification of the Canadian population, more and more Canadians are using dietary supplements and Natural Health Products as a regular part of their daily diet and health routine. Whether it is to manage a specific dietary concern, or as part of an overall wellness centered approach to health and diet, dietary supplements and Natural Health Products play an integral role in many Canadians' purchasing and consumption decisions.

These products are consumed by Canadians in many forms, including liquid, powder, tablet, capsule, or solid form and include protein bars and shakes, and powdered drink mixes.

Part III of Schedule VI of the *Excise Tax Act* provides complete (zero-rated) GST relief to "food or beverages for human consumption" – with the exception of specifically enumerated items such as snack foods and carbonated beverages. Many Canadians view dietary supplements and Natural Health Products as necessary and important parts of their daily diets and view them as being "food and beverages".

The CRA, however, with its July 31, 2002 release of GST/HST Policy Statement P-240: *Application of GST/HST to Products Commonly Described as "Dietary Supplements"* has changed its administrative interpretation on what constitutes a zero-rated food or beverages and has indicated that most (if not all) dietary supplements are GST taxable. The CRA's rationale for taxing virtually all dietary supplements and Natural Health Products – whether consumed in a food or beverage form – is as follows:

> Any products "labelled or marketed as products to be consumed to facilitate the intake of certain ingredients (nutritive or otherwise) or which place an emphasis on claims relating to the benefits of the product, for example therapeutic or preventative effects, or enhancing performance or physique" are not considered food or beverage products by the average consumer.

The DSA seriously questions this rationale and, quite to the contrary, believes that most consumers consider such products as essential parts of their daily intake of "food and beverages". The CRA's restrictive rationale also fails to recognize that many Canadians consume these products and beverages for the health benefits that they provide.

Recommendation

The DSA recommends that the "food and beverage" zero-rating provisions in the *Excise Tax Act* be clarified to expressly zero-rate dietary supplements and Natural Health Products to ensure the goal of investing in the health of Canadians.

By zero-rating dietary supplements and Natural Health Products, the Canadian Government will (i) encourage more Canadians to assume ultimate responsibility for their health and well being (as opposed to relying upon Canada's already strained health care systems); (ii) encourage more Canadians to be cognizant of their diet and nutrition needs, thereby significantly lowering the risks Canadians face in developing chronic diseases; (iii) reduce the costs associated with properly feeding and nourishing Canadian families (which, as indicated in a 1997 Health Canada study, is an important issue facing Canada's health care systems); and (iv) provide Canadians with a natural and more cost effective means of promoting and maintaining their health.

IV. <u>Job Creation and Transitioning to Independence</u>

The DSA believes it is important for the government to understand that the direct selling industry is a vital part of the small business sector in Canada. We have a tremendous capacity to create jobs and economic growth and, in the process, reduce dependence on social assistance programs by providing accessible earning opportunities, with little or no investment, to a broad spectrum of Canadians. The accessibility of these earning opportunities is highlighted by the fact that close to 33% of all ISCs have only a high school education (or less).

With 75% of the ISCs being women, operating their businesses usually on flexible hours within their own homes, there is a reduced burden on the already strained child care system than there would be if these women were working in more conventional jobs with fixed hours. A previous study, "Women in the Labour Force", published by Statistics Canada, focused on the challenges encountered by single mothers in their attempts to re-enter or remain in the labour force and some of the negative perceptions associated with their particular status. The report raised the question as to the new and growing barriers that are keeping single mothers on welfare when they would rather be productive working members of society.

The direct selling industry can meet the needs of hundreds and thousands of Canadians, who find themselves in these familiar situations, offering flexibility of hours, a wide variety of earning situations, and the opportunity of maintaining, or returning to, a meaningful and fulfilling standard of living.

We believe that the small and medium-sized business sector will continue to be the engine for Canadian economic growth. It is this area that continues to create jobs when the economy is at a standstill as well as during periods of growth. ***The direct selling industry has an unlimited capacity to transform individuals who are dependent on social programs, such as employment insurance, into successful small business operators.***

The present rules for employment insurance and social assistance, however, create a barrier to entering the direct selling industry for those who are receiving such benefits. While there is now a provision that allows for a certain level of additional income to be earned from employment before social benefits are reduced, there is only uncertain and limited transitional relief for earnings from self-employment.

First of all, under the current legislation, a person who is self-employed (as opposed to becoming an employee) is generally considered to have worked a full working week and, therefore, not considered unemployed and thus not entitled to benefits. Accordingly, when persons receiving unemployment/employment insurance begin operating their own business as ISCs, they are no longer entitled to benefits, unless the activity is of such a "minor extent" that they would not normally rely on it as a principal means of livelihood. Secondly, to the extent that the involvement is of a "minor" nature, and the persons are otherwise entitled to receive benefits, once the persons receive a certain level of income, their benefits are reduced.

In situations where Human Resources Development Canada determines that the ISC is still eligible to continue claiming his or her EI benefits, certain restrictions are imposed. The more stringent requirements include a workweek of less than 35 hours and earnings of less than 25% of the total EI benefits received. Once the 25% threshold is surpassed, the claimants will have their EI benefits deducted dollar per dollar with every additional dollar earned as an ISC.

The current rules respecting eligibility do not apply with a sufficient degree of certainty for ISCs. Although there is a slight transition period (i.e., until earnings reach 25% of their EI benefits), ISCs who have a solid, reliable business plan for self-employment, and who plan on making direct selling their full time activity, become ineligible for EI benefits, where they are devoting more than a minor commitment to their businesses.

In the DSA's view, the current rules discriminate against the direct selling industry, and inhibit the transition from dependency to independence, by discriminating against those who are serious from the outset in establishing their own direct selling business.

In addition, the current rules do not take into account the fact that, like any business venture, there are certain risks/costs associated with establishing a business venture. An individual entering the direct selling industry has some start-up costs, such as a small investment in a new business starter kit, and usually requires a reasonable period of time (which, in the beginning, is often time intensive requiring in excess of 35 hours per week) before a customer base is established and income is generated.

Recommendation

The DSA recommends that existing social programs be amended to allow <u>all</u> individuals, including those starting their own businesses, the transitional relief needed

to move from a position of dependence on social assistance to a position of independence in operating their own small businesses.

Additionally, once a taxpayer's earnings have surpassed the allowed level of transitional relief (currently 25% of EI earnings), the DSA recommends that social programs be amended by providing additional pro-rata relief, through only deducting 50% of additional earnings from EI eligibility (i.e., for every dollar earned EI eligibility is reduced by only 50 cents).

V. GST/HST and the Direct Sellers Mechanism

The GST Direct Sellers Mechanism (DSM) is a classic example of government and business working in partnership to develop a policy that has been beneficial to consumers, the government, the direct selling industry and almost 1 million ISCs across the country. It is this type of cooperation between government and business that is necessary to strike the proper balance among the competing concerns of raising revenue and ensuring broad-based voluntary tax compliance, while freeing business from unnecessary administrative burdens.

Subject to the important concern noted below, the DSA is pleased to state that the needs of the member companies and the ISCs have generally been met by the DSM in that it relieves much of the burden for ISCs in terms of filing and collecting GST/HST. This mechanism is based on pre-collection of GST/HST by the direct selling companies on the suggested retail price, with the result that (a) there is a cash-flow advantage to the government, and (b) there is no "underground economy" with respect to GST/HST in the direct selling industry.

The DSM has also significantly reduced government administrative costs by negating the need for ISCs to be GST/HST registered, while maintaining the same level of GST/HST revenues and allowing more tax "bang" for every administrative "buck." The DSA member companies and ISCs have collected and remitted in excess of $800 million in GST/HST revenues since the inception of the GST in 1991.

While the DSM is operating in a positive fashion, it currently does not apply to the 20-25% of the direct selling industry that operates through ISCs who are sales agents and earn commissions for arranging the sales of the products involved.

These companies and their ISCs are currently excluded from using the DSM and feel discriminated against. This is because – unlike with the other direct selling companies – GST/HST must be charged on sales aids supplied to the ISCs and because needless administrative costs are incurred in determining whether GST/HST should or should not be paid by the direct selling companies on the commission payments (such tax ultimately being recovered by the direct selling company in any event as an input tax credit).

Notwithstanding the fact that most ISCs are "small suppliers" and, as such, are not required to be GST/HST registered, many ISCs who acts as sales agents are becoming GST/HST registered, generally to enable them to claim input tax credits. This unnecessarily increases the administrative costs of the direct selling companies, the ISCs and the CRA.

Recommendation

The DSA recommends that legislative action be taken to extend the Direct Sellers Mechanism so that it will be equally available to direct sellers and ISCs who operate on a sales agent basis (currently, only direct sellers and ISCs who operate on a buy-and-resell basis may use the DSM).

The benefits of extending the DSM to this sector of the direct selling industry would be significant: (i) the GST/HST rules would apply on the same basis throughout the industry with minimal, if any, impact on government revenues; (ii) the companies and the sales agents would face a significantly reduced administrative and compliance burden; and (iii) the CCRA's administrative costs would be reduced as the sales agents would no longer be required to be registered for GST/HST purposes simply so they can recover the GST/HST they paid on sales aids through an input tax credit. Additionally, consistent treatment regarding the availability and application of the DSM will reduce uncertainty and confusion that has resulted within the industry.

CONCLUSION

The Direct Sellers Association of Canada appreciates the opportunity to appear before the Committee and believes that its recommendations are consistent with the Committee's objective to present a Pre-Budget report that addresses the needs of Canadians.

As always, the Direct Sellers Association of Canada is prepared to provide its support to the government to help achieve these goals. The DSA, and all its members, thank the Standing Committee on Finance for inviting it to participate in the Pre-Budget consultation process.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Ross P. Creber, President

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