PRE-BUDGET SUBMISSION

TO

THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE

From

Direct Sellers Association of Canada

Association de ventes directes du Canada

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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 their 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 and its 40 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 governs the direct sale practices and procedures used by DSA member companies in marketing their products and services to the public and refers to the relationship all DSA members and their 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 bettering the individuals they serve and the community as a whole.

The direct selling companies and their 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 the Canada Customs and Revenue Agency (the “CCRA”), 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. A number of briefs were submitted to Health Canada concerning the regulating of natural health products. 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 asked 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. The DSA proudly notes that this initiative was endorsed by APEC in 1999 and already has produced highly positive results in a number of countries.

SUMMARY OF RECOMMENDATIONS

The DSA believes that the following recommendations will assist the House of Commons Standing Committee on Finance (the "Committee") in preparing a Pre-Budget report that addresses how the Canadian Government can: (i) ensure economic growth and job creation; (ii) ensure progress in investing in and caring for Canadians; and (iii) ensure that urban, rural and remote communities are desirable places to live and work and to maximize their contribution to Canada's prosperity.

I. Maintaining Competitiveness by Reducing Taxes

The DSA recommends that the federal government stay the course with regards to the announced personal and corporate tax reductions.

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

The DSA recommends that the *Excise Tax Act* be amended to expand the food and beverage zero-rating provisions to include dietary supplements and natural health products.

III. Job Creation and Transitioning to Independence

The DSA recommends that existing social programs be amended to allow transitional relief to all individuals moving from a position of dependence to a position of independence in operating their own small business.

IV. GST/HST and the Direct Sellers Mechanism

The DSA recommends that the Direct Sellers Mechanism be expanded so that it is 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 Competitiveness by Reducing Taxes

The DSA applauds the Canadian Government for its commitment to lowering taxes, specifically the Five Year Tax Reduction Plan that was introduced in 2000 and the further tax reductions introduced in the 2003 Budget that will serve to promote economic growth and job creation, including increasing the amount of income eligible for the low small business tax rate.

Reducing taxes, as acknowledged by the Honourable John Manley, Deputy Prime Minister and Minister of Finance, has played a significant role in contributing to Canada's "unprecedented economic and fiscal turnaround" during the past three years and is "essential for Canada's success in today's highly competitive global economy."

Recommendation

The DSA recommends that the government stay the course with respect to its announced tax reductions that will contribute to Canada's economic growth and job creation.

II. Providing 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, herbal teas, powdered drink mixes and natural fruit juices.

As Part III of Schedule VI of the *Excise Tax Act* provides complete GST relief to "food or beverages for human consumption" - with the exception of specifically enumerated items including snack foods, carbonated beverages and fruit-based drinks containing less than 25% natural fruit juice – many Canadians view dietary supplements and natural health products as zero-rated food and beverages. The CCRA, with its July 31, 2002 release of GST/HST Policy Statement P-240: *Application of GST/HST to Products Commonly Described as "Dietary Supplements"*, however, has changed its interpretation on what constitutes a zero-rated food or beverage and has indicated that most (if not all) dietary supplements are GST taxable.

The CCRA'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 places 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.

This rationale obviously discourages vendors from clearly disclosing the specific ingredients of a product and the benefits (or risks) derived from consuming the particular product and is contrary to Health Canada's objective – in creating the Natural Health Products Directorate and draft regulations - of "ensuring that Canadians will be able to make safe choices when buying and using natural health products." The CCRA's rationale also fails to recognize that many Canadians consume specific foods and beverages for their health benefits.

Recommendation 2

The DSA recommends that the "food and beverage" zero-rating provisions in the *Excise Tax Act* be amended to zero-rate dietary supplements and natural health products to ensure the goal of investing in and caring for 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.

III. <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).

One of the cornerstones for success in the direct selling industry has been the quality and availability of training for ISCs, who learn to properly present the products, guarantees and business opportunities of the companies that they represent, as well as enhancing their entrepreneurship skills.

By providing such training and educational assistance to people who have the ability to succeed in a sales career, the direct selling industry is contributing to job creation and the Canadian economy in a positive fashion while reducing the burden on the public sector. The direct selling industry provides an opportunity for all Canadians to increase their knowledge and skills set, providing benefits to the Canadian economy in the process.

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 severely 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. Some of the barriers include: limited employment options, absence of day care facilities during early and late hours of the day, time off for family problems, etc.

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. ***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 <u>employment</u> 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 self-employed person 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 a 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 principle 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.

When unemployed men or women become self-employed and begin operating their direct selling business as ISCs, they are required to complete a Human Resources Development Canada (HRDC) "self-employment" questionnaire. The purpose of this questionnaire is to determine whether individuals are still eligible to collect EI while operating their own businesses as ISCs. When individuals begin operating their own businesses as ISCs, they are only entitled to receive benefits if their involvement is of a "minor extent." Factors that are considered by HRDC include whether the ISC will be working more than 35 hours per week, whether they are capable of working at another job, whether staff will be hired, whether any investment in capital is required, etc.

In situations where HRDC 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 job, become ineligible for EI benefits, where they are devoting more than a minor commitment to their businesses.

Thus, 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 direct selling business, denying these persons any transitional EI relief during the start-up phase of their small businesses, and thus discouraging these persons from making the transition from dependence on social assistance to independence.

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 3

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 business. 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).

IV. GST/HST and the Direct Sellers Mechanism

The 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 contained in sections 178.1 through 178.5 of the *Excise Tax Act*, 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 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 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 affiliated ISCs have collected and remitted in excess of $700 million in GST/HST revenues since the inception of the GST/HST in 1991.

While the DSM is operating in a positive fashion, it currently only applies to those direct selling companies whose ISCs operate on a buy-and-resell basis. The 20-25% of the direct selling industry that operates through sales agents, who earn commissions for arranging the sales of the products involved, are currently excluded from using the DSM.

These companies and their sales agents have indicated that they feel discriminated against by not having the DSM equally available to them. This is because GST/HST must be charged by the direct selling companies on sales aids supplied to the ISCs and because needless administrative costs are incurred in determining whether GST/HST should be paid by the direct selling companies on the commission payments, which are ultimately recoverable in any event by way of 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 are becoming GST/HST registered, generally to enable them to claim input tax credits. This obviously unnecessarily increases the administrative costs of the direct selling companies, the ISCs and the CCRA.

Recommendation 4

The DSA recommends that legislative action be taken to extend the Direct Sellers Mechanism so that it will be available, not only to those direct sellers and their ISCs who operate on a buy-and-resell basis, but also to direct sellers and their ISCs who operate on a sales agent basis.

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 their 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 prepare a Pre-Budget report that addresses how the Canadian Government can (i) ensure economic growth and job creation; (ii) ensure progress in investing in and caring for Canadians; and (iii) ensure that urban, rural and remote communities are desirable places to live and work and to maximize their contribution to Canada's prosperity.

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 allowing it to participate in the 2003 Budget making process.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

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