CUPE ECONOMIC
BRIEF

Flaherty finally did the right thing on income trusts

Parties share blame for letting tax loophole develop into a disaster

Finance Minister Jim Flaherty must have a wicked sense of humour to choose Halloween to announce his Tax Fairness Plan for income trusts. The plan spooked the markets enough to erase more than $20 billion in value by the next morning, but also included a couple of tax sweeteners for seniors.

While he broke the Conservatives' election promise, he finally did the right thing. Income trusts are costing governments a billion dollars a year in lost revenues and they are endangering the health of the Canadian economy. But what lessons can politicians learn from this fiasco?

Both the Liberal and Conservative governments along with regulatory agencies must share the blame for letting this tax loophole develop into a disaster for many seniors, workers' pension funds and other investors. Former Liberal finance minister Ralph Goodale receives special mention for bowing to pressure from investment banks a year ago.

While some have made large profits off the income trust party, they have usually done so by cannibalizing these companies of investments and future returns. Weak investor protection rules allowed income trust promoters, and particularly investment banks, to mislead unsophisticated investors with the expectation of high yields. It was inevitable that the value of many trusts would come crashing down, together with the pension nests of many seniors.

The people who benefited risk free from this are the investment banks that have reaped a total of $4 billion or more just in fees from the creation of income trusts. Private capital funds and executives have also made massive profits by turning productive companies into income trusts. The sad irony is that they make even more by converting income trusts back into corporations. They will not only walk away from this train wreck without a scrape, they will be able to drive and fly away in their new Porsches and private jets.

And who has paid for these? Seniors, pension funds and other investors who joined the party late will have to pay for the $20 billion-plus cleanup.

The income trust fiasco has been used as an excuse to reduce corporate taxes, increase the dividend tax credit and to provide consolation tax breaks to seniors. The cost of these indirect measures will approach $10 billion in lower revenues for federal and provincial governments over the next six years.

What are some of the lessons that should be learned from this experience?

Lesson number one is that governments and self-regulatory agencies should act proactively and decisively to protect the public and investors. They have no excuse for not strengthening the weak disclosure requirements that allowed small investors to be misled by income trust promoters. Some of the most respectable independent actors in the investment community, including Standard & Poors and Phillips, Hager and North, long ago issued strong warnings about the lack of investor protection.

Instead of acting decisively, governments allowed conversions to proceed and sloughed off responsibility to the industry's self- regulatory bodies, which clearly haven't done a very good job when it comes to protecting small investors. Flaherty's announcement didn't include anything pushing for greater disclosure and protection for the public.

Lesson number two is that governments should close tax loopholes sooner, rather than later.

Unfortunately, Flaherty just this week suggested that he is actively looking at creating another massive tax loophole by eliminating taxes on capital gains. This misguided move could lead to yet another financial fiasco.

Corporations and affluent Canadians who would benefit the most from this move have never had it so good, with their massive profits and high incomes. They don't lack capital; they just lack the will to invest in truly productive investments in the Canadian economy rather than in short-term speculative profits.

To increase the productive capacity of our country, we need politicians who want to govern by investing in the long-term future of Canadians, through education, health care and other services. Instead we have politicians who seem to want to get out of the business of governing by creating more tax loopholes, cutting spending on public services and not regulating or protecting the public interest.

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