

**PRE-BUDGET SUBMISSION
TO
THE HOUSE OF COMMONS STANDING COMMITTEE ON
FINANCE**

**From the
Direct Sellers Association of Canada
Association de ventes directes du Canada**



November 4, 2005

INDEX

PAGE

SUMMARY OF RECOMMENDATIONS

INTRODUCTION 1

RECOMMENDATIONS

I. Maintaining a Competitive Corporate Tax System 4

II. Creation of Entrepreneurial Jobs, Training and Transitioning 4 to Independence

III. GST/HST Treatment of Dietary Supplements 7 & Natural Health Products

IV. Expanding the GST/HST Direct Sellers Mechanism 9

CONCLUSION 10

DSA 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. Maintaining a Competitive Corporate Tax System

The DSA recommends that the government continue with corporate tax reductions that will contribute to Canada’s economic growth, job creation and international competitiveness.

II. Creation of Entrepreneurial Jobs, Training and Transitioning to Independence

The DSA recommends that existing social programs be amended to allow transitional relief to all individuals – not just through employment but also through starting their own business – who are moving from a position of dependence to a position of independence.

III. GST/HST Treatment of Dietary Supplements & Natural Health Products

The DSA recommends that the “food and beverage” zero-rating provisions in the *Excise Tax Act* be clarified to ensure that dietary supplements and Natural Health Products are zero-rated, to further the goal of investing in the health of Canadians.

IV. GST/HST and the Direct Sellers Mechanism

The DSA recommends that legislative action be taken so that the Direct Sellers Mechanism 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).

PRE-BUDGET SUBMISSION
HOUSE OF COMMONS
STANDING COMMITTEE ON FINANCE

November 4, 2005

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).¹ 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 42 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

¹ The DSA is also a member of the World Federation of Direct Selling Associations (WFDSA). The WFDSA represents 57 DSA's around the world with retail sales in excess of US \$90 billion through the activities of more than 50 million ISCs.

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, 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, flexible hours and minimal investment. This opportunity is accessible to all women and men, everywhere in Canada, regardless of education and experience and whether they live in urban or rural communities. Direct selling increases access to retail markets in rural areas, generally underserved by traditional retail channels. Fully 26% of direct selling consumers live in rural areas across Canada.

During the past year, close to 1.3 million Canadian ISCs were engaged in operating their own direct selling businesses with more than \$1.96 billion of sales. In terms of the ISCs, it should be noted that about 88% are women, 81% are married, 56% have full-time jobs - using this business opportunity to earn extra income. Additionally 15% worked part-time and have no other occupation, while 11% were unemployed prior to entering the industry.

Direct selling contributes significantly to the Canadian economy both financially and in terms of quality of life. The industry's associated labour pool includes 3,900 permanent employees and 1.3 million ISCs. In 2003, the combined labour force earned an estimated \$966 million, in income, through their association or employment with the direct selling industry. Total labour compensation, including \$194 million in wages paid to permanent employees and \$772 million of commissions and bonuses paid to ISCs, represents a significant "direct" economic impact of the industry's activity in Canada.

In a recent **Socio Economic Impact Study of the Direct Selling Industry** conducted by Ernst & Young, using an income multiplier, it was estimated that an additional \$438 million in personal income was created, with the total personal income contribution of the direct selling industry to the Canadian economy being in excess of \$1.4 billion.

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 Income Tax Guide *Tax Filing Information for Independent Sales Contractors*. The DSA continually works with Consumer Protection Agencies across the country, in promoting the harmonization of Provincial direct selling legislation and with 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.

In the October 2004 Speech from the Throne and the 2005 Budget Plan, the Government of Canada renewed its commitment to a regulatory system and policies that instill and protect public trust and confidence, support innovation and foster a favourable business environment – the Smart Regulation Initiative.

A key objective of this Initiative is to improve transparency, efficiency, timeliness and predictability of regulatory and decision-making processes and reduce administrative burden for business and citizens. The 2005 Budget committed the government to building continuous improvement into the regulatory system, making it more transparent accountable and adaptable.

The DSA fully supports the objectives of the Smart Regulation Initiative. Yet, while the DSA continues to co-operate and 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 current *Natural Health Product Regulations*, in the DSA's view, do not meet the goal of Smart Regulation and *the interpretation and implementation of these regulations* have had a negative effect on entrepreneurial activity.

RECOMMENDATIONS

I. Maintaining a Competitive Corporate Tax System

As recognized by the federal government in the 2005 federal budget, corporate tax rate reductions are necessary in order for Canadian tax rates to remain internationally competitive. Such tax reductions will promote economic growth and job creation.

Recommendation

The DSA recommends that the federal government reintroduce the corporate tax reductions that were initially included in the 2005 federal budget.

II. Creation of Entrepreneurial Jobs, Training and Transitioning to Independence

The direct selling industry is a vital part of the small business sector in Canada, investing in entrepreneurial and human capital. The direct selling industry has a tremendous capacity to create jobs, promote entrepreneurial activity amongst Canadians and, in the process, to reduce dependence on social assistance programs.

The direct selling industry provides accessible business opportunities, with little or no

investment (usually less than \$500), that is open to all Canadians without any restrictions with respect to gender, age, education, knowledge or previous experience. This business opportunity is accessible to all women and men, everywhere in Canada, whether they live in urban or rural communities. The accessibility of these earning opportunities is highlighted by the fact that close to 24% of all ISCs have no more than a high school education; 49% have some post secondary education; and 27% have either a graduate or undergraduate degree.

As part of this process, the direct selling companies provide important business training and experience. Direct selling companies provide assistance to new ISCs by offering product specific training and assistance and suggestions in developing their entrepreneurial skills and abilities in order to start-up and run their own direct selling businesses. In the Ernst & Young Study, 65% of respondents cited the development of new business/personal skills as a benefit of becoming a direct seller. For example, 78% cited “build self esteem”; 75% cited “build better sales skills”; and 70% cited “build management skills.”

With 88% of ISCs being women, operating their businesses usually on flexible hours within their own homes and/or on a party plan basis, 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, 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, by assisting in and promoting entrepreneurial activity by offering flexibility of hours, training, education and support as to running a business, a wide variety of earning situations, and the opportunity of maintaining, or returning to, a meaningful and fulfilling standard of living. This viable business

opportunity, provided by the direct selling industry, has been clearly recognized by the U. S. Internal Revenue Services, which has stated the following in its *Direct Seller Audit Technique Guide*:

Direct selling provides important benefits to individuals who desire an opportunity to earn an income and build a business of their own; to consumers who enjoy an alternative to shopping centers, department stores or the like; and to the consumer products market. It offers an alternative to traditional employment for those who desire a flexible income earning opportunity to supplement their household income, or whose responsibilities or circumstances do not allow for regular part-time or full-time employment.

The direct selling industry offers a viable business opportunity that has an unlimited capacity to transform individuals who are dependent on social programs, such as employment insurance, into successful small business operators.

Accordingly, the DSA recommends a partnership between itself and the government to educate and promote the direct selling business opportunity to individuals currently receiving social and employment insurance. In that regard, information published by the DSA regarding the direct selling industry could be made available in EI offices and could also be made available at job fairs.

While the DSA is committed to partnering with the government to promote the direct selling industry among individuals receiving social assistance, as a means of becoming successful business operators, the current EI rules must be amended to allow for the transition from social assistance to successful small business operator. In that regard, the present rules for employment insurance and social assistance, 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 chooses to become 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 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 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 work week 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.

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 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.

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).

III. GST/HST Treatment of Dietary Supplements & Natural Health Products

More and more Canadians are using dietary supplements and Natural Health Products as a regular part of their daily diet and health routine. These products play an integral role in managing specific dietary concerns, and as part of an overall wellness centered approach to health and diet for many Canadians.

Part III of Schedule VI of the *Excise Tax Act* provides complete GST relief (i.e., zero-rated) 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 Canada Revenue Agency, however, has changed its administrative interpretation² on what constitutes a zero-rated food or beverage and has indicated that most (if not all) dietary supplements and Natural Health Products are taxable, on the following basis:

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 disputes this rationale and believes that most consumers consider such

² See: GST/HST Policy Statement P-240: *Application of GST/HST to Products Commonly Described as "Dietary Supplements"* July 31, 2002.

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 convenience, nutritional and health benefits that they provide. Furthermore, it fails to recognize that reduction of the costs associated with properly feeding and nourishing Canadian families is as indicated in a 1997 Health Canada study, an important issue facing the Canadian health care system.

Recommendation

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

IV. Expanding the GST/HST 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 more than 900,000 ISCs across the country.

The DSM is based on pre-collection of GST/HST by the direct selling companies on the suggested retail price. It removes much of the burden for ISCs (and the CRA) in terms of their otherwise being required to be GST/HST registered, and results in a cash-flow advantage to the government with no “underground economy” with respect to GST/HST in the direct selling industry.

While the DSM is operating in a positive fashion, it currently discriminates against the ISCs of the 20-25% of the direct selling industry that operates through independent sales agents. These companies and their ISCs are currently excluded from using the DSM because – unlike the direct selling companies whose ISCs buy and resell – 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).

This has resulted in ISCs who are “small suppliers”, nevertheless becoming GST/HST registered to enable them to claim input tax credits on their business expenses. This unnecessarily increases the administrative costs of the direct selling companies, the ISCs and the CRA without any increased government revenues.

By extending the DSM to this sector of the direct selling industry, GST/HST rules would apply on the same basis throughout the industry. As the sales agents would no longer be required to be registered for GST/HST purposes, the administrative and compliance burden for these companies, the sales agents and the CRA would be significantly reduced.

Recommendation

The DSA recommends that legislative action be taken so that the Direct Sellers Mechanism will be equally available to direct sellers and ISCs who operate on a sales agent basis – and not only to direct sellers and ISCs who operate on a buy-and-resell basis.

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

Direct Sellers Association of Canada

Association de ventes directes du Canada

180 Attwell Drive, #250

Toronto (Ontario)

M9W 6A9

www.dsa.ca

Telephone: (416) 679 - 8555

Email: information@dsa.ca