

September 22, 2017

Rt. Honourable Bill Morneau
Minister of Finance
DEPARTMENT OF FINANCE CANADA
14th Floor
90 Elgin Street
Ottawa, ON
K1A 0G5

Delivered via mail

Dear Sir:

RE: TAX PLANNING USING PRIVATE CORPORATIONS

As requested in your July 18, 2017 communication, we are writing you to share our views and to provide our input on several aspects of your proposed changes to the taxation of private corporations and their shareholders (the “Proposals,” “Measures” or “Proposed Measures”). This letter is broken up into several sections as follows:

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IMPLICATIONS OF RAISING TAXES ON SMALL BUSINESSES AND THEIR OWNERS

OUTRAGE

No doubt you have already received a significant number of comments from the people regarding these Proposals. We would imagine that you are surprised by the degree of outrage which these proposals have already created. **The reason for this outrage is that existing small and medium sized business owners and professionals believe we already bear an inappropriate and unfair burden of compliance costs, business risks and taxes.** To put it bluntly, we, Small and Medium Enterprises (“SMEs”) already feel abused, unappreciated and unwanted. One of the ways that we have rationalized acceptance of our situation, including these costs, risks and taxes is that we get some token tax concessions from the government. We had thought that the government was working with us and recognized the burden we bear; and so, these Proposals come as a slap in the face. Many of us, our spouses, our children, our parents and our employees voted for the Liberal Party and have now realized that doing so was a monumental mistake.

LOOPHOLES

The term which you have used to describe our tax planning efforts: “loopholes” is offensive. It implies that we are “tax cheats” or “tax manipulators” which we are certainly not. In fact, income splitting tax strategies being branded as “loopholes” today were effectively approved by the Supreme Court of Canada in 1990 in the Mcclurg Tax Case and then again in the Neuman Tax Case in 1998. The Mcclurg income splitting transactions reviewed by the Court occurred starting in 1978 which was 39 years ago! **In fact, what we are doing by income splitting is following the direction laid down by the Supreme Court of Canada.** Pierre Trudeau once again became the Prime Minister in 1980 and he took no steps to stop income splitting and, as a lawyer, it is extremely likely he would have been aware of the Mcclurg Supreme Court case. Successive Liberal and Conservative governments were also aware of these techniques and took no steps to stop them, other than to limit them with the “kiddie tax.” This hardly seems like an unintended “loophole” and painting it in that way is offensive. The only reason we see for using this kind of language is to start some sort of “class war.” Perhaps, rather than attempting to “spin” it as closing loopholes, the government should honestly state it as it is, it is a change in tax policy intended squeeze more taxes out of small business owners.

WHY BUSINESSES AND PROFESSIONALS ARE FED UP

The reality is that SMEs are an easy target for the government. The vast majority of these businesses participate in our tax system which is one of voluntary compliance. They attempt to accurately report their expenses and revenues and pay their taxes on time. They have a tremendous compliance burden in managing employee payroll remittances to the government,

payroll reporting, HR, double entry bookkeeping, T4, T5, T-1 and all manner of other Customs, GST/HST and provincial sales tax collection and reporting. The income splitting measures included in the proposals are estimated to bring in approximately \$250 million of tax revenue. In the meantime, noncompliant businesses (the Underground Economy) are estimated to earn revenues of over \$46 Billion. It seems to us that instead of persecuting voluntary reporting, job creating, tax-paying good citizens by rebranding us as tax cheats the government should instead spend some of their energy collecting just the GST on that \$46 billion which would provide it with \$2.3 billion in additional tax revenues. This is almost 10 times the tax revenues the government is trying to squeeze SMEs for. If they went further and could collect tax and penalties on all of the unreported income it would probably amount to an additional \$10 or \$15 billion of tax revenue. This one effort alone could almost balance the budget.

In 2013, 83,240 small and medium sized businesses closed their businesses ([Innovation Canada Website Link](#)). From that same government of Canada website, we see that 84% of SMEs used personal funds or personal borrowing to finance their business and 17% borrowed funds from family and friends. This implies that when 69,922 of those businesses “went under,” they lost personal savings and/or money that they had borrowed personally from the bank. Think about that. Extrapolating that data again, we would estimate that 14,151 businesses lost the money they had borrowed from their families and their friends. The canned response that the Liberal MPs have been sending to those of us who have been writing letters on this subject have trumpeted the special exclusive BDC programs such as the CanExport program and the Canada Small Business Financing Program. In fact these programs are, **in all fairness**, only available to a very select few business and are not available to the vast majority of Canadian businesses. So much for fairness. By the way, do not under any circumstances send me any of the content from that insulting and condescending letter which is light on relevant facts and crafted by the Liberal Party spin doctors.

ECONOMIC AND POLITICAL POWER

Small and medium businesses having fewer than 500 employees employ more than 90% of Canada’s private sector employees and account for 95% of net job creation (Chamber of Commerce Website). From Innovation Canada ([Innovation Canada Website](#)) we can see that SMEs employed about 10,500,000 people. The public sector employs about 3,600,000 people ([Statistics Canada Website](#)) and large enterprises employ approximately 1,100,000 ([Innovation Canada Website](#)). Through various means of extrapolation, we can project that SMEs are in a position to directly or indirectly influence at least 20,000,000 people in Canada. For this country to remain competitive and for our productivity to be maintained or improved, we need to keep the SMEs here, not drive them away.

The Proposed Measures are going to negatively impact the after-tax incomes of many SMEs. When looking at ways to increase our after tax incomes, we will look to our expenses first. Generally, our largest expense is salaries and wages, which we will reduce by way of wage

freezes and wage rollbacks if we cannot move jobs to lower cost countries. We will blame the wage reductions on these tax changes and the Liberal Party. We will be telling our families and our employees that the Liberal Government has imposed significantly more taxes on us and unfortunately, we need to share the pain with our employees. We will be telling our employees that these wage freezes and reductions will be reversed when the tax changes are reversed, either by reconsideration on the part of the Liberal Government or, if necessary, by a change in government. We will suggest that they share this information with their friends, with their spouse, with their children, with their parents, with their aunts and uncles and cousins. We will aggressively donate funds to a political party which seeks to acknowledge and compensate us for the unfair costs, risks and taxes which we bear and the party which promises to take steps to introduce fairness back into the system.

JOBS AND BUSINESSES LEAVING CANADA

Human, intellectual and financial capital are extremely mobile. These tax measures create incentives for our most well-educated and most well-capitalized citizens and taxpayers to leave Canada, take their skills and capital and move to more tax-friendly environments. Directly to the south of us is our biggest ally but also our biggest competitor with respect to putting capital and intellect to work – the USA. The US will take any and all doctors you drive away, they will take our software engineers, our film studios, our entrepreneurs, our angel investors and the others who create 95% of the new jobs in Canada. This will not only reduce job creation (remember we create 95% of net jobs in Canada) it will also have the effect of reducing the tax base resulting in reduced tax revenues for the Government. Many aspects of our businesses can be outsourced to places like India and the Philippines. These countries have well educated, English speaking populations who are happy to take over call centre work, small manufacturing projects, accounting, bookkeeping, legal research, medical and legal transcription, etc. at a fraction of the cost of having employees do that work in Canada. These measures will kill Canadian jobs, eliminate job advancement opportunities and reduce wages in Canada while the business owners and professionals seek alternative means to replace their lost after-tax income.

GENDER BIAS

Approximately 89% of stay-at-home parents are women. Each of the Tax on Split Income and the practical impact of the supertax on corporate investment income have the effect of reducing the income and implied worth of stay at home parents who are primarily women. Members of the Royal Commission on the Status of Women (1970) were critical of the government's change to the rules with respect to what today is called the Spouse or common-law partner amount. This credit, in effect, provides a fixed (and negligible) tax credit where there is a low income spouse which has much the same effect (though smaller) as does income splitting. The government of the time had reduced this benefit and one of the commissioners stated: "I cannot escape the conclusion that the assumption on which it [the reduction in the benefit] is based is that the childless wife who prefers to remain at home is a parasite. It is calculated to force her

out of the home into the labour market.” So, is the government’s view of women? Surprisingly, another of the commissioners (John Humphrey) made a much similar comment stating that a stay at home woman “is made to appear a social parasite” by the government’s policy. Income splitting is egalitarian and empowering to stay at home parents (primarily women) and it recognizes many of the other contributions which Spouses/common-law partners and families make to a business. Mr. Humphrey went further to state, “She should be free to decide whether or not she should work outside the home; and it is the duty of society to remove any barriers to her free choice. But we cannot support any attempt to force her out of the home and into the labour market. We object, moreover, to the implication that the contribution of the wife to the family and society should be calculated by reference to the wages she would be paid had she been hired as a servant. Marriage should be a partnership and a wife has a right to be treated as a partner, not as a servant.” Incidentally, our tax credit system implies that the value of a stay at home Spouse or common-law partner is \$11,474 per year which far less than the cost of even the most incompetent nanny.

One of the proposed extensions to the income splitting rules would see the spouse subject to tax at the highest rates of tax on income from property. This would occur where the higher income earning spouse loaned money to the lower income earning spouse (bearing interest at the prescribed interest rates) and even where the higher income earning spouse has simply provided a guarantee on a loan from a bank or other third-party to their spouse so that they could purchase investments or start a business in their own right. This is an attack on the ability of stay-at-home parents (primarily women) to obtain financial independence and is an insult to their value and the worth of their efforts in the home and in business. In many cases, a stay at home parent will have been out of the workforce for many years and therefore need some sort of financial assistance in order to start a business or make an investment on their own. Commissioner Humphrey would certainly not approve.

ATTACK ON THE TRADITIONAL ONE INCOME FAMILY

These provisions also represent an attack on the traditional one income family. The same argument can be made as in the previous section on Gender Bias for the impact of these proposals on the traditional, one income earner family. The proposals penalize single earner families by denying income splitting tax savings that would be realized by double income families. This differentiation is completely arbitrary and unfair. It basically implies that your tax situation is dependent on your choice of a mate. It also implies that the government rewards families who choose to hire a nanny to raise their children because they can benefit by paying less tax than a single earner family making exactly the same total income. It suggests religious discrimination for those religious groups where it is forbidden for one of the spouses to work. It further discriminates against parents who have an obligation to stay at home and look after a disabled child or other family member and discriminates against families who choose to homeschool their children.

From the Carter Commissions report: *We conclude that the present system is lacking in essential fairness between families in similar circumstances and that attempts to prevent abuses of the system have produced serious anomalies and rigidities. Most of these results are inherent in the concept that each individual is a separate taxable entity. Taxation of the individual in almost total disregard for his inevitably close financial and economic ties with the other members of the basic social unit of which he is ordinarily a member, the family, is in our view another striking instance of the lack of a comprehensive and rational pattern in the present tax system. In keeping with our general theme that the scope of our tax concepts should be broadened and made more consistent in order to achieve equity, we recommend that the family be treated as a tax unit and taxed on a rate schedule applicable to family units. Individuals who are not members of a family unit would continue to be treated as separate tax units and would be taxed on a schedule applicable to individuals.*

Instead of restricting income splitting for some, the Government should consider making it available to all allowing employees to income split with their spouses as that will level the playing field without increasing taxes. This is consistent with recommendations by the 1966 Royal Commission on Taxation and with various legal principles including Family Law.

FAIRNESS

We note with puzzlement that application of the proposed supertax on investment income will only apply to small business corporations and not on public companies and income trusts – is this fair? We are also puzzled why the pension income splitting provisions for seniors have not been affected. This seems very two faced on the part of the Liberal Government – is ageism part of the Government’s fairness agenda? Similarly, the ability to contribute to a spousal RRSP is an income splitting measure which exists within the Tax Act – should that not also be removed? Perhaps the Liberal Government is only interested in Fairness where it involves a relatively small group who are poorly organized and whom the Government believes they can vilify as the undesirable and uncaring “rich.”

A strong argument can be made that income splitting enhances fairness. Consider the economic circumstances of a family of one making \$50,000 per year, paying \$8,200 in tax (\$41,800 after tax per person) compared to a family of five with one income earner, paying the same amount of tax leaving just \$8,360 after tax per person; compared further to a family of 5 able to income split evenly which would result in no tax and after-tax income of \$10,000 per person. Perhaps this is only appropriate for pensioners and not for families and business owners. We have read some excellent pieces illustrating the disparity between the retirement funding options for business owners in comparison to the pension entitlements of MPs (funded by taxpayers), top tier executives of banks and public companies (funded by completely tax deductible contributions) and government employees (again, funded by taxpayers) [See article by John Nicola in the Appendix to this letter]. In contrast, the proposed supertax on corporate investment income applies to income invested after taxes have already been paid and the funds and which

come entirely out of the earnings made by the business owner – not from the government portion of employee pension matching, not from the tax deductible pension contributions by a large public company and not from the government in the form of a defined benefit pension plan calculated on the highest years of earnings of an employee who earns on average between 18% and 37% more than the average private sector employee or business owner. Let's level the playing field and levy a supertax on those pensions where they exceed the amount which could be accumulated under the historical RRSP limits. That would be fair. We could go on; however, it would appear that the point is made. These Proposals are an attack on small and medium sized businesses and their owners. They are not an attempt to level the playing field, because if they were they would be looking far more broadly than simply going after private corporations and their owners.

It is very likely that most small and medium business owners would be fine with the proposals if the government were to impose the same obligations faced by an employer on the employees who are being used to benchmark the fairness of the tax system. We would consider it fair if the government required every employee to guarantee the loans of the business and put some or all of their net worth into the business where it could be lost (83,240 businesses closed in 2013), or use their home for security, or mortgage their house to put the funds into the business. Perhaps, for that same wage, you could make the employees work evenings and weekends doing the books for the company, completing the tax returns for the company, completing the Statistics Canada forms, the provincial and municipal filings and to pay the fees for accountants and lawyers. Then you could make the employees subject to tax audits on those forms and have them pay the related fees and expend the time commitments to defend their unpaid work against petty and unreasonable auditors. To be fair, the employee should also be required to pay the employer portion of CPP and EI, and while you are at it, deny the employee EI coverage – especially if he/she/they are one of the 83,240 businesses who closed their doors in 2013.

Fairness cannot be evaluated without looking at the situation as a whole, from both sides. SMEs already see the situation as being unfair. In some cases, the tax benefits from being self-employed helped balance against the risks and costs borne by businesses but in many cases they do not, they are not nearly enough.

SMEs have options. We can speak with our feet and leave Canada, take jobs, our capital, our knowledge and economic activity with us. The USA is clamouring for manufacturing and service jobs, perhaps they will offer us some tax incentives to move there.

RETIREMENT FUNDING

Almost all small business owners and professionals spend many years of their working lives earning little or no income in contrast with a typical employee. Many specialist medical doctors may spend 12 to 14 years after graduating from high school doing further education and come

out of that process with student loans and other debts often exceeding \$400,000. They have spent many years without generating any RRSP room which puts them at a significant disadvantage compared to an employee who started working right out of high school and has generated RRSP room and/or possibly pension contributions. Business owners and professionals then spend many years paying off business debts and/or student loan debts to get themselves started. As a result, they often get a very late start putting money aside for their retirement. The only practical way under the current system for them to “catch up” is for them to aggressively accumulate passive investments in their holding companies. If the government intends to carry on with the proposed supertax on passive investment income earned by private corporations they will need to make some sort of accommodation for these types of high-value (to Canada), late start retirement funding entrepreneurs and professionals.

The proposed supertax applicable to passive income earned by private corporations will likely lead to an exodus of capital. We believe that wealthy retirees will leave Canada to live in tax-free countries in order to bring their after-tax income levels up to what they would have been had the supertax not been imposed. One of the unintended consequences of allowing private corporations to accumulate capital at low tax rates is that the owners of those companies get “trapped” in Canada in order to maintain their standard of living. If they were to leave Canada, they would be subject to a large capital gain and their after-tax income after departing Canada would only be modestly higher by moving to a tax free country. The proposed changes to the taxation of passive income earned by private corporations removes the tax deferral benefit which currently keeps these wealthy retirees in Canada. Under the proposed regime a retiree would be best to pay the dividend tax to eliminate the Corporation and receive all of its after-tax assets personally. They can then leave Canada without departure tax and invest those funds offshore with zero income tax thereby doubling their after-tax income. This will cause Canada to lose this tax base consisting of moderately wealthy retirees.

EDUCATION FUNDING

Many SME owners made plans to pay for their children’s educations through income splitting instead of through the use of RESPs. In most of those cases, those owners have forgone contributing to RESPs because it was slightly more beneficial to just use income splitting. Therefore, some of the “cost” calculated as coming from income splitting with young adults is not “lost,” it would otherwise have been “spent” by the government if those owners had participated in the RESP program, earned income inside of the RESP without tax being assessed and received the maximum education grant. Taking income splitting away now has retroactive effect for those owners. The time lines and RESP limits on the government grant programs make it impossible for these families to catch up on properly financing their children’s educations through RESPs now. This is another instance where these proposed Tax On Split Income rules effectively have retroactive application. The phase in period for application of the Tax On Split Income should, at the very least, be extended to allow these families to plan ahead in a manner to fund their childrens’ educations through RESPs or the RESP program should be

modified so that these families have an opportunity to “catch up” to where they would have been if they had known that these provisions were going to be imposed beginning in 2018.

OTHER POLICY RATIONALE FOR THE TAX PROPOSALS

Clearly, one of the policy rationales for bringing in these tax proposals is an attempt to remedy the income inequity between the top 1% and the 99%. Given that our closest neighbour and biggest competitor for our human capital and/or monetary capital we should compare our situation to theirs: Canada top 1% income level started at \$227,000 (2014) while that in the USA started at \$475,000 Cdn. (\$389,436 US (2013) at an exchange rate of \$0.82). In Canada, the top 1% earned 10% of the country’s income while in the USA the top 1% earned 20% of the country’s income.

KEY RECOMMENDATIONS

You have asked for recommendations in relation to the Proposals. Unfortunately, the Proposals themselves cannot be looked at in isolation because there are many elements of them which interact with concept of equity, their impact on financial and economic plans previously undertaken by businesses and families and existing elements of the Income Tax Act.

1. We recommend that the Government cancel these Proposals in their entirety and commission a study (like the Carter Commission) to complete a full review of our taxation system including the use of income splitting to achieve better tax fairness.
2. In the event that the Liberal Government feels it is unable to properly fix the problems in our tax system as recommended above, we recommend that they extend the time period for study and consultations on these Proposals so they can be implemented in a manner which SMEs also consider to be fair and reasonable.
3. The Department of Finance (“Finance”) has had a history (especially recently) of using extremely blunt instruments to solve very narrow problems. In this regard, we have three recommendations:
 - a. The proper solution for many of these problems would involve crafting tax provisions with surgical precision instead of provisions with unintended broad and far-reaching consequences. If another problem or variation arises in the future with respect to those tax measures, Finance can craft another provision or adjust the previously released measures with surgical precision again. Instead,

what has been happening is that clumsy far-reaching provisions have been introduced without consideration for the practical impact these provisions have in the business world and tax community. This needs to change.

- b. It appears the Department of Finance has not been made accountable for the tremendous compliance costs and negative economic consequences to businesses which arise from many of these legislative changes. The members of the Finance Committee do not have the requisite background in the practical application of tax measures as they apply to the businesses affected. We recommend that an oversight committee be created consisting of SMEs, tax lawyers and tax accountants be credited to help direct the efforts of the Department of Finance in creating new tax legislation. The members of this committee should properly represent the concerns of large, medium and small businesses, including professionals. The objective of this committee should be to ensure that tax changes which are proposed and/or implemented achieve their objectives with the minimum disruption to common business practices; with a minimum of compliance costs to businesses; and, in a manner which allow businesses and tax professionals to be certain as to how the resulting tax measures will apply.
 - c. I further recommend that previously released and implemented tax provisions throughout the Income Tax Act be analyzed for compliance with the objectives described above and modified as necessary under the supervision of the committee described above.
4. In the event the Liberal Government wants to reduce the sense of disillusionment and disenfranchisement which SMEs and their employees feel about the current government the following revisions should be made to the Income Tax Act and to the Proposals:
 - a. Recent changes to Section 55 should be modified so that taxpayers can have certainty that normal course transactions such as regular dividends paid between companies under common control can be paid without risk of the punitive provisions of this Section applying. Basically non-arm's length intercompany dividends paid for the purpose of capital gains purification, creditor proofing, segregating investment from business assets, etc. should be clearly allowed without the risk and uncertainty created by the recent changes to Section 55.

- b. The Income Splitting Provisions should be modified:
 - i. The efforts of families involved with operating SME's should be recognized broadly rather than restrictively.
 - 1. The value of work done and contributions by spouses, including not only physical, financial and intellectual work but also through ad hoc consultations and moral/emotional support is almost impossible to value. These contributions add an incredible amount of value and greatly enhance the likelihood for success for all SMEs.
 - 2. The value of the work done by children can similarly be difficult or impossible to value. They are often asked to contribute at odd or unusual hours and in some cases, their contributions grow from modest to tremendously valuable over time as they continue to work in the business.
 - 3. The burden of proof for all reasonableness tests in the Income Tax Act, and especially any Tax on Split Income assessments should fall on the CRA and not on the taxpayer. As outlined above, it is extremely difficult to quantify the value of some of the contributions made by spouses and children. Surprisingly, under tax law, the taxpayer is presumed guilty until proven innocent. The disparity in power and resources between CRA and the taxpayer and the nebulous nature of these reasonableness tests leave the taxpayer at a tremendous disadvantage in attempting to prove themselves innocent. A more fair approach would be to make CRA accountable for proving the results of their reasonableness reassessments.
 - 4. Spouses, children and other family members should be able to participate in share ownership in proportion to the value of their contributions as described above. In addition, some significant recognition for the provision of risk capital by the family must be recognized. It is not just the principal shareholder who has assets

on the line, it is the spouse who may lose his/her/their house and whose retirement funds are on the line and the children whose lifestyles, education opportunities and inheritances which are on the line. In contrast to measuring the economic position of an employee, you cannot ignore these financial realities in the assessment and analysis of “fairness” in the context of a family business. These family members should be able to participate in the upside of the business, not just the downside. Remember that 83,240 small businesses closed their doors in 2013 – it would be interesting to know how many family businesses claimed the LCGE in that year in comparison.

- ii. Completely shutting families out of the benefits of the resulting capital appreciation of the business and the related capital gains exemption is unfair and offensive. For example if a spouse worked 10 hours per week for the business and the primary shareholder worked 40 hours per week and if the gain were \$1,000,000 then the capital gain on the sale of shares and the LCGE should be available proportionately \$200,000 available to the spouse and \$800,000 available to the primary shareholder. Similar recognition should be given to the effective risk capital provided by the family in some manner.
- iii. The accrual of gains eligible for the Lifetime Capital Gains Exemption within a trust should not be restricted where the principal shareholder wishes to hold their shares within a trust. This is often desirable for creditor protection where that individual is involved in more than one business where the risks could be borne by the individual personally, where they need to hold those shares in a trust for estate planning purposes (such as protection from a Wills Variation Action) and for other business purposes. The Proposals unfairly and unnecessarily limit the use of trusts further prejudicing business owners from structuring their affairs in a particular manner for non-tax reasons.
- iv. Similarly, the accrual of gains eligible for the Lifetime Capital Gains Exemption within a trust should not be restricted where the spouse and children who are contributing to the business wish to hold their shares within a trust. Use of a trust is often desirable for creditor protection

where that individual is involved in more than one business where the risks could be borne by the individual personally, where they need to hold those shares in a trust for estate planning purposes (such as protection from a Wills Variation Action) and for other business purposes. The Proposals unfairly and unnecessarily limit the use of trusts further prejudicing business owners from structuring their affairs this way for non-tax reasons. A simple “look through” rule could be created to determine the allocation of gains to a beneficiary based on their contributions (including risk capital of the family) to the business as described above.

- v. The Tax on Split Income rules should be modified so that they do not create a penalty on taxpayers but instead calculate the taxes arising from the rules at the marginal rate of the principal shareholder. Where salaries have been used and the amount is determined to be unreasonable in the circumstances, Sections 18 and/or 67 of the Income Tax Act create a penalty in the form of double taxation whereby both the recipient and the payer pay tax on the amount determined to be unreasonable (double taxation). The proposed Tax on Split Income also creates a penalty where the principal shareholder’s income is not already in the highest tax bracket. There are many circumstances where a taxpayer may legitimately and in good faith believe that the amount paid to a family member is reasonable. However, the proposed rules result in one or two penalties on top of the additional tax which is required under the proposals. It is inappropriate for the taxpayer to be subject to two levels of penalties – in fact, in the name of fairness they should at worst, be put in the same tax position they would have been if they had done it in accordance with the reasonableness test, not in a worse position.
- vi. As mentioned in the body of the letter, applies the Tax On Split Income rules [120.4(1.1)d(iii)] who borrows funds from the bank for any business or investment purpose if they need to get a guarantee from their spouse. This would also appear to apply where one spouse loaned money to the other spouse (bearing interest at the prescribed interest rates). This is an attack on the ability of stay-at-home parents (primarily women) to obtain financial independence and is an insult to their value and the worth of their

efforts in the home and in business. In many cases, a stay at home parent will have been out of the workforce for many years and will therefore need some sort of financial assistance in order to start a business or make an investment on their own. This provision should be eliminated.

- vii. There is no clarity as to how the proposed Tax on Split Income will apply to dividends on and redemptions of “freeze shares” owned by the spouse of the primary shareholder. Many holding companies are set up in such a manner as to allow for income splitting in retirement on much the same basis as pension income splitting between spouses. These structures should be explicitly grandfathered from the Tax On Split Income rules. Alternatively, this income splitting should be explicitly allowed without the imposition of Tax On Split Income and/or these split dividends should be deemed to be eligible for the pension income splitting provisions. This would be consistent with a taxpayer’s ability to make spousal RRSP contributions which are not subject to the attribution rules (after 3 years have passed).
 - viii. The Tax on Split income should be gradually introduced over a transitional period. Many business owners have made decisions and have financial commitments in place such as mortgages based on the after-tax funds available to them under the existing laws and they may fail to meet financial obligations which could result in bankruptcy as a result of these changes.
- c. The Proposed changes to Section 84.1 should be revised so that the changes address only the very narrow circumstances which they are intended to catch – the intentional conversion of payments which would otherwise be considered dividends into capital gains. They should be further revised to ensure that they do not apply to punish families for transferring a business between family members, so that they do not apply to create double taxation to estates and so they do not in any other circumstances which are not explicitly being abused to convert dividends into capital gains. The proposed changes to Section 84.1 inappropriately apply retroactively to taxpayers who have never been given the opportunity to plan their affairs to be in accordance with this provision. These

rules can result in tax on private corporations approaching 93% - surely this cannot be within the realm of fairness.

- d. The proposed Section 246.1 is extremely broad and inappropriately captures many legitimate transactions. In addition, it applies on a retroactive basis in direct opposition to the stated objectives and promises made with the Proposals. This Section should be discarded completely or carefully redrafted to apply on a very restricted basis. In its current form it applies to a series of transactions which end in the payment of a capital dividend; however, the series of transactions may have started months or even years ago and taxpayers may have been waiting for a convenient time or because of other time constraints to declare and pay the capital dividend after July 18, 2017. However, if the dividend is paid after the announcement date, it gets captured thereby resulting in this Section applying retroactively. A specific example would be a non-arm's length sale of goodwill occurring in December 2016 in two different companies where one has a June year end and another has a July year end – the company with the June year end can declare and pay the capital dividend on July 1st without the application of S.246.1 but the company with the July year end cannot declare and pay the capital dividend until August 1, 2017 without proposed Section 246.1 applying. Clearly this is arbitrary and unfair and needs to be corrected. A further adjustment to this provision should provide that any capital dividend account addition should only be suspended until an ultimate disposition occurs, not be denied in its entirety.
5. The proposed Supertax on investment income earned by private corporations creates an inequitable result when comparing business owners' retirement situations against those of employees. Many business owners including professionals use these funds as a pseudo-RRSP or IPP. Because of the contribution restrictions in the RRSP/IPP regime, these individuals are unable to ever catch up to where an employee would be in terms of total contributions. In addition, the "miracle of compounding interest" means that their late start on RRSP/IPP contributions leaves them far short of what an employee will have available from an RRSP/Pension Plan. The main difference between business owners/professionals and employees are:
 - a. In contrast to the vast majority of employees, business owners often make little or no income for the first years of their business (often the first 10 to 15 years of a

business the income is very low). As a result, they accumulate very little RRSP room.

- b. For many professionals, they do not start actually making any significant income until they have completed school and other professional designations which can delay their income earning years often by 7 to 14 years during which time they accumulate little or no RRSP contribution room. In contrast, most employees begin earning income either right out of high school or at the end of a 2 year college program or a 4 year university degree.
- c. Many business owners spend the first successful years of their business (often after it is 10 years old or more) paying of debts which they accumulated in the start-up phases of their business and so are not in a position to make RRSP contributions during that time while employees are able to make RRSP contributions or participate in company and government pensions from day one.
- d. Similarly, many professionals emerge from University or articling positions with \$200,000 to \$500,000 in student loans and student lines of credit. They spend their early years in practice paying these debts down and are unable to fund RRSP contributions. In contrast, most employees do not come out of school with these disadvantages and so they have the ability to begin saving for retirement immediately through RRSP contributions or through company pension plans.
- e. Someone making \$100,000 per year who starts at age 20 investing in their RRSP, making a 5% return will accumulate \$3,100,000 by age 65. However, someone starting at age 32 making \$100,000 per year, making a 5% return will only accumulate \$1,570,000 in their RRSP by age 65. This clearly illustrates why professionals and business owners who get a late start in their retirement savings need some sort of vehicle to catch up to their employee peers. To date, this vehicle has been corporate investing which is far less effective than RRSPs or employer sponsored pension plans but it gives them a chance to make up part of the difference.
- f. The Proposed Supertax on Corporate Investment Income should either be:

- i. eliminated/discarded to allow businesses and professionals a means to “catch up” on their retirement funding contributions, revised so that it allows business owners and professionals to use corporate saving and investing to supplement a flawed RRSP/IPP program,
 - ii. revised so that it is less “rich” by taxing earnings otherwise eligible for the Small Business Deduction tax rate at the General Tax Rate where the funds are being applied to investment assets rather than active business assets, or
 - iii. implemented as proposed and the RRSP/IPP system should be modified so that the maximum RRSP/IPP contribution limits accumulate starting at age 18 irrespective of the type and amount of income earned by a taxpayer. In addition, the contribution limits should be inflated or enhanced at a reasonable rate of return for those who have not made past contributions to accommodate significant catch-up contributions for those unable to begin saving for retirement until their later years.
6. The government has made business into unpaid tax collectors and tax reporting officers. Businesses are responsible for both collecting and remitting GST, HST, Provincial Sales Tax, Employee Remittances, Customs and Excise Taxes, etc. In addition, businesses are required to report to the government on employee payroll, contractor payments, Statistics Canada reports, provincial revenue and expense allocations as well as their own income and capital tax reporting. As business grow and expand many of them find that they end up employing one, two or more accounting staff simply to meet the government’s compliance requirements. If a business were employing two people carrying out this task, it could well cost them \$70,000 to \$100,000 per year and the “out of pocket” after tax cost to the business owner of this would amount to \$35,000 to \$50,000 per year. Even if the business does not have staff doing this work, the owner or their spouse are still doing it in the evenings, on the weekend and at times when they could otherwise be earning income or taking the time off which an employee takes for granted. **In effect, this represents an unrecognized government imposed tax on our time and/or on our income which is not similarly imposed on employees.** Businesses are not paid for any of these activities which serve to enrich the government at the expense, in time, money and stress, of the business itself and its owners. We recommend that business be paid for their services in collecting these taxes and for the other reporting requirements which

they are required to bear. Alternatively, these costs should create refundable tax credits on a dollar for dollar basis to remove the government imposed compliance burdens from these businesses. These burdens are in stark contrast to the reporting burdens faced by employees whom these business owners are being compared to. If the Liberal Government is unwilling to compensate businesses for these costs, we recommend that business owners be provided with some other form of a discount in their taxes to compensate them for the costs described above and so that the amount of income they receive for the effort expended is fair when compared with that of an employee.

CONCLUSION

The current system of taxation is certainly flawed. Unfortunately, the Proposed Measures disturb an equilibrium which appears to have been created by the market and then wisely left in place by previous governments to help compensate businesses for other inequities which arise from the numerous costs, compliance burdens and business risks faced by the owners of small and medium sized businesses. The Proposals appear to have been formulated by simply comparing the economic and tax situation of a business owner to an employee. This is inappropriate because financial risks, contributions and opportunities of the business owner and their family are simply not the same as those of the employee and their family.

As disclosed in the numerical example above, business owners and professionals are forced to use corporate saving vehicles for their retirement because they are not fairly served by the existing RRSP/TFSA regime as it leaves them severely disadvantaged compared to the position of an employee. Unfortunately, the “super tax on corporate investment income” in the Proposals seeks to destroy this avenue which allows the self-employed to catch up to employees. Today’s economic realities are far different and, in many ways, more complex than they were when the last major overhaul of the tax system took place in 1972. We strongly recommend that the Proposed Measures be cancelled and that a proper study of the tax system be carried out to provide recommendations for changes, including changes which would eliminate the government imposed compliance burdens faced by business to better accommodate the extremely varied economic situations which business owners and their families (including professionals) face. Our entire population has placed their trust in the Liberal Party to manage the government in a fair manner so as to represent all of our interests. The Proposed Tax Measures represent a breach of that trust. These Measures are divisive, poorly considered, they have been brought out without proper consultation and they are being imposed couched in terms of class warfare. The Liberal Government needs to take a step back on all of these Proposals and instead bring real fairness to the process, not simply by attacking one benefit received, but by providing a holistic solution to the multifaceted economic quandary which is faced by Canada’s self-employed and their families.

Yours truly,

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