Conference for Advanced Life Underwriting: 2016 Federal Pre-Budget Submission

Overview

On behalf of the Conference for Advanced Life Underwriting (CALU), we are pleased to provide this submission to the House of Commons Standing Committee on Finance (the "Finance Committee") as part of its 2016 pre-budget consultation process. CALU is a national professional membership association of established financial advisors, accounting, legal, tax and actuarial professionals. For over 20 years, CALU has engaged in political advocacy and government relations activities on behalf of its members and the members of its sister organization, Advocis. CALU represents the interests of more than 11,000 insurance and financial advisors and in turn the interests of millions of Canadians.

In this submission CALU will highlight two important areas of concern for Canadians. The first one relates to Canada's aging population and the issues this raises relating to funding long term care expenditures. It is estimated that approximately 11 million Canadians (23% of the population) will have reached the age of 65 by the year 2036,[1] with the expectation of enjoying longer lifespans. The federal government has recently advanced a number of programs and policies to meet the needs of seniors.[2] However, we believe more is required to support Canadians in saving for their anticipated long term care expenditures.

CALU has been working with leading financial experts to develop options to enable the preparedness and independence of Canada's aging citizens, options that should work within the existing federal tax policy framework. In addition to providing Canadians with the right tools to yield maximum benefits of their retirement savings, our proposals with respect to long term care insurance will preserve government resources through reduced reliance on public programs and institutions for support.

The second area of concern relates to the impact of the aging population on entrepreneurs who have, over many years, built successful family businesses. A significant number of these business owners are approaching retirement age and want to pass on their business to the next generation of family owners.

Unfortunately, the transfer of an incorporated small business to family members may result in the application of tax rules that will penalize the business owner. These tax rules convert a capital gain that would otherwise arise on the sale of shares to an arm's-length purchaser into a taxable dividend. This prevents the owner from claiming the capital gains exemption and subjects any additional gain to a significantly higher overall rate of tax. However, if an owner sells outside the family, the tax situation can be much more favourable. CALU believes these rules need to be modified to ensure that owners are not forced to sell the business outside the family, merely to reduce their overall tax bill.

The following sections will discuss these two areas of concern in more detail, and CALU's

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recommendations as they relate to tax policy formulation for the 2016 federal budget.

Quality Long Term Care Support for Canadians

Providing quality long-term care support is one of Canada's fastest growing priorities. As Canadians live longer, the more likely they will be managing a chronic disease and will need some degree of long-term care support, whether it's in the home or in an institutional setting.

According to Statistics Canada, the chances of requiring long-term care are one in 10 by age 55, three in 10 by age 65 and one in two by age 75.[3] It is estimated that by 2036 more than 750,000 Canadians over the age of 65 will reside in health care institutions (compared to about 300,000 today).[4]

Many Canadians have the mistaken belief that their long-term care needs will be met through programs and services funded by provincial governments. However, long term care is not included under the Canada Health Act and, therefore, is not available to Canadians on a universal basis. While government programs aimed at assisting Canadians with long term care needs currently exist, these programs vary by jurisdiction. Based on future funding requirements for long term care, it is anticipated that Canadians will be responsible for an increasing portion of the overall costs, either directly or through increased taxes.

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A 2014 report by the C.D Howe Institute provides an excellent overview of the long term care situation in Canada and explores several avenues to addressing this complex issue. To varying degrees, provincial and federal governments are also reviewing solutions in a number of key areas.

CALU believes that greater ownership by Canadians of individual long term care insurance (LTCI) is an important solution to this growing funding problem. LTCI is designed to help cover the cost of care for individuals who have lost the ability to care for themselves, allowing the option to stay at home with appropriate nursing care, or to seek out care in a long term care facility. LTCI typically provides a daily or monthly cash benefit which can be used at the discretion of the policyholder to fund costs associated with their care.

Despite the growing number of studies documenting the concerns of Canadians about their ability to afford future long term care needs,[5] ownership of LTCI is low. One of the reasons for this is a general lack of awareness relating to the extent of the long term care costs and who is responsible for funding these costs. On the other hand, in the United States the percentage of LTCI ownership, and hence the ability of individuals to self-fund their long term expenditures, is much higher.

CALU is therefore recommending that the federal government consider one of the following tax policy options:

- *Permit LTCI to be a qualified investment for an RRSP or RRIF; or*
- *Permit RRSP annuitants to withdraw up to $2,000 per year from their RRSP or RRIF (to lifetime limit of $24,000) on a tax-free basis to fund the purchase of qualifying LTCI.*

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CALU further recommends that the federal government work with the provincial and territorial governments to develop a national approach to informing Canadians as to the need to plan for their long term care funding expenses, and developing a more unified approach to determining subsidized access to long term care services.

Supporting the Transfer of Small Business to Family Members

Small businesses play an extremely important role in the Canadian economy. In 2012 small businesses engaged over 7.7 million employees, representing almost 70% of the total private labour force.[6] In turn, small businesses account for over 25% of Canada's total Gross Domestic Product (GDP)[7] and an estimated 56% of private sector GDP.[8] It is therefore extremely important that federal government policies not only encourage the growth of small businesses, but also support the successful transfer of those businesses to the next generation of owners.

According to a report by the Canadian Federation of Independent Business (CFIB),[9] the boomer generation of small business owners are quickly approaching their retirement years. Close to 50% of these business owners are planning to sell or otherwise exit their businesses in the next five years. Looking further ahead, more than three-quarters of these business owners plan to retire in the next 10 years, and a full third want to pass on their businesses to family members. This is indeed a critical time for owners of small businesses, in terms of realizing the full value on their lifelong efforts while ensuring the successful transition of the business to new owners.

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In turn, it is extremely important that the tax rules applicable on the disposition of the business don't discriminate between who is purchasing the shares from the small business owner. This will ensure that the business is transferred to the purchaser that is best able to operate the business in the future, and can remain in the family where this is the desire of the business owner.

Unfortunately, this is not the case today. Existing tax rules penalize the owners of incorporated businesses who transfer shares to a corporation controlled by other family members. These tax rules generally convert the capital gain that would otherwise arise on this transaction into a deemed dividend.[10] This not only prevents the business owner from claiming the capital gains exemption (which currently exempts over $800,000 in capital gains from taxation), but also subjects any additional gain to the higher rate of tax applicable to dividends. A similar transaction involving an arm's-length purchaser would not result in the application of these rules. As a result, a business owner may be forced to sell the business to non-family members to preserve the more advantageous capital gains tax treatment. Please refer to the example below.

Example: Sale of Shares in a Private Corporation

Dad owns 100% of the common shares of XYZ Co. and plans to sell the company to his children and retire on the after-tax proceeds. The shares are independently valued at $2 million, with a nominal adjusted cost base and paid-up capital. Dad is subject to a 38% tax rate on dividends from XYZ Co. and a 23% tax rate on capital gains. He is entitled to claim a capital gains exemption of $800,000 on the disposition of his shares. If Dad sold his shares to an arm's-length purchaser for $2 million, he would have a capital gain of $1.2 million (after using the $800,000 capital gains exemption) and a resulting tax liability of **$276,000**. If Dad instead sold his shares to his children's holding corporation for $2 million in cash, a deemed dividend of $2 million would arise due to the application of section 84.1. This would result in a tax liability to Dad of **$760,000**, which is over 2.5 times more than the tax payable upon the sale of his shares to an arm's-length purchaser. In turn this would reduce his retirement capital by almost **$500,000**.

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These concerns have been the subject of representations by various organizations including the CFIB and Canadian Association of Family Enterprise. As well, the Quebec 2015 budget announced plans to introduce an exemption from the comparable Quebec Taxation Act rules for certain share transfers that take place after December 31, 2016.

CALU therefore recommends that the existing federal tax rules be modified to support the transfer of incorporated small businesses to family members on a tax neutral basis. Over the coming months CALU will engage in a dialogue with various stakeholder groups with the view to providing more detailed proposals for consideration by the Finance Committee and the Department of Finance.

Thank you for this opportunity to make this submission and we'd appreciate the opportunity to appear before the Finance Committee as part of its pre-2016 budget consultation hearings.

For more information, please contact:
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Endnotes

1 Statistics Canada, Population Projections for Canada, Provinces and Territories (91-520-X) dated May 26, 2015.

2 These include a reduction in the required minimum amount that must be withdrawn annually from a registered retirement income fund; extending compassionate care benefits; and the introduction of the home care accessibility tax credit.

3 Statistics Canada, Health Expectancy in Canada.

4 Canadian Life and Health Insurance Association Report on Long-Term Care dated June 2012.

5 Canadian Medical Association 14th National Report Card on Health Care dated August 18, 2014.

6 Industry Canada, Key Small Business Statistics August 2013.

7 Ibid, for the 2012 calendar year.

8 Statistics Canada, The Distribution of Gross Domestic Product and Hours Worked in Canada and the United States Across Firm Sizes, No 88 Published January 2014, using 2008 data.

9 "Passing on the Business to the Next Generation", November 2012. This report is based on responses from approximately 8300 CFIB members to a survey conducted from March 9 – May 4, 2011.

10 Section 84.1 of the Income Tax Act. This section is an anti-avoidance rule designed to prevent the conversion of the taxable surplus in a corporation into a capital gain that is eligible for the capital gains exemption.

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