calu

May 17, 2018

The Honourable Percy Mockler
Chair, Standing Senate Committee on National Finance
The Senate of Canada
Ottawa, ON K1A 0A4

Dear Senator Mockler:

Re: Senate Finance Committee Review of Bill C-74, Budget Implementation Act 2018, No. 1 ("Bill C-74")

We are writing on behalf of the Conference for Advanced Life Underwriting (CALU). CALU is a national professional membership association of established financial advisors (life insurance, wealth management and employee benefits), and accounting, legal, tax and actuarial professionals. For over 25 years CALU has engaged in public policy advocacy on behalf of its members, and its sister organization, Advocis. Through these efforts, CALU represents the interests of more than 13,000 insurance and financial advisors. The members of our two organizations provide financial, tax and estate planning advice to millions of Canadians from all walks of life and across a broad economic spectrum, including shareholders of private corporations.

We are pleased to provide our comments to the Standing Senate Committee on National Finance ("Senate Finance Committee") relating to certain legislative proposals contained in Bill C-74. In particular, we would like to comment on the tax on split income ("TOSI") rules and the legislation that will limit access to the small business deduction ("SBD") where passive investment income within a Canadian-Controlled Private Corporation ("CCPC") exceeds $50,000 in a year (the "passive investment rules") (collectively the "two legislative proposals"). While our comments have been provided in summary format, we would be pleased to provide further details upon request.[1]

1. General Comments on the Two Legislative Proposals

Despite changes made to the TOSI and passive investment rules between December 2017 and the introduction of Bill C-74, we continue to believe that the Senate Finance Committee's recommendations in its December 2017 report entitled "Fair, Simple and Competitive Taxation: The Way Forward for Canada" continue to have strong merit.

[1] We also reference CALU's letters to the Senate Finance Committee dated November 7, 2017 and to the Honourable Bill Morneau dated February 12, 2018 (attached), which provide more details on our views and positions relating to the two legislative proposals.

Conference for Advanced
Life Underwriting
Suite 600 – 170 Laurier Ave, W
Ottawa, ON K1P 5V5
613.505-9632 www.calu.com

Our members share the view of the Senate Finance Committee that the two legislative proposals will have the following negative implications for the owners of private corporations. They will:

- Substantially increase taxes payable by a number of private corporations and their shareholders now and in the future, despite the reduction in small business tax rates;
- Significantly increase compliance costs for small business owners, including the additional risk of CRA tax audits, reassessments and Court proceedings;
- Create unintended and negative distortions in business and other investment decisions undertaken by small business owners to avoid the application of the two legislative proposals; and
- Create tax winners and losers which don't properly reflect the realities of how small businesses are structured or operate in Canada, nor properly consider the costs and risks that are assumed by small business owners in relation to public companies and employed individuals.

We therefore recommend that the two legislative proposals be deferred for a period of one year to facilitate further consultation and analysis, as well as allow sufficient time for business owners to consult with their advisors and make any required adjustments to their business operations, investment arrangements and corporate structures.

2. Specific Comments on the TOSI Rules[2]

We would like to reaffirm our earlier recommendation to the government that instead of proceeding with the TOSI rules contained in Bill C-74, the scope of the current TOSI rules only be expanded to apply to adults who are under the age of 25 throughout the year. This would clearly target the application of these rules[3] and provide greater tax certainty, while addressing the main income splitting opportunities that we believe the government is concerned with. Alternatively, we would recommend that spouses over the age of 24 be fully excluded from the application of the TOSI rules.

Further, should the TOSI rules proceed as proposed, we recommend the following amendments be made to the "excluded shares" definition to reflect a broader range of corporate ownership arrangements:

- Permit the exemption to apply where a specified individual owns shares in the related business through a holding company, provided the shares in the operating company would have been excluded shares had a portion of the shares been owned directly by the specified individual based on the specified individual's percentage ownership interest in the holding company;
- Provide a rule which would permit an inter vivos or testamentary trust to be designate a beneficiary who is a specified individual to be the owner of the trust's shares for purposes of the excluded shares definition; and

[2] This section assumes that the government ultimately decides to proceed with the TOSI rules rather than withdraw or delay the implementation of these proposals.

[3] We note that the Parliamentary Budget Officer (PBO), in a report entitled "Income Sprinkling Using Private Corporations" dated March 8, 2018, was unable to clearly identify the individuals who would be subject to the TOSI rules. The PBO instead provided three different estimates of tax revenue outcomes from the TOSI rules, with its preferred estimate based on the assumption that spouses would not be subject to these rules. If this is the most likely result under the TOSI rules, then we question why spouses are not expressly exempted from the application of these rules.

- Eliminate or more fairly target those situations where shares of a corporation engaged in the provision of services will not qualify as excluded shares.[4]

We are also of the view that the TOSI rules should not apply in a year where the specified person is already subject to tax at the highest marginal tax rate.[5] We therefore recommend that an exception be provided from the TOSI rules where a specified individual is already subject to tax at the top marginal rate in the year.

And finally, we believe there should be a special deeming rule which contemplates situations where a business is incorporated, sold or amalgamated with another business, with an individual becoming a specified individual in relation to that business. The rules should deem an individual's contribution to the former business, where such business continues to be operated by a successor business, to be a contribution to the successor business for purposes of determining if an amount is a "reasonable return" in respect of that specified individual.

3. Specific Comments on the Passive Investment Rules[6]

CALU would like to acknowledge that the revised approach to the passive investment rules as set out in Bill C-74 is a far simpler and more rational approach to the issues identified by the Department of Finance ("Finance Canada") in its July 2017 consultation paper. However, we continue to have the following concerns with the passive investment rules:

- While the claw back of the small business deduction only takes effect in 2019, the amount of the claw back for 2019 is in general based on the passive investment income of the corporation earned in 2018. Given these rules are a total departure from those discussed in the 2017 consultation paper and will have a dramatic tax impact on affected CCPCs, we believe this provides further impetus for deferring the effective date of the passive investment rules until at least 2020.
- A number of concerns have been expressed with the new approach for dealing with passive investment income, including the lack of promised grandfathering for existing passive investments, the inability of capital intensive businesses to accumulate savings without tax penalty and the adverse impact on retirement savings for business owners. In the absence of full grandfathering for existing passive investments, CALU is of the view that the proposal to claw back the SBD would be more acceptable to the small business community if it took place on a more graduated basis. For example, the reduction in the SBD based on taxable capital in Canada starts at $10 million, with the SBD being eliminated when taxable capital reaches $15 million. Applying a similar scale, and still allowing for a $50,000 passive income exemption, we feel it would be more appropriate for the SBD to be eliminated when passive investment income exceeds $250,000.[7]

---

[4] The excluded shares exemption is not available where 90% or more of a corporation's income is from the provision of services. We note that Canada's small business sector is comprised, in large part, of services businesses. CALU questions whether there is a rational policy for treating these important businesses differently from those businesses that produce or manufacture goods.

[5] This would permit the individual to claim deductions as well as applicable tax credits (such as the charitable donation credit) on such income.

[6] This section assumes that the government ultimately decides to proceed with the passive investment rules rather than withdraw or delay the implementation of these proposals, and/or provide grandfathering for existing passive investments. CALU questions whether there are significant tax deferral opportunities relating to passive investment income as identified by Finance and believes that further study is warranted to confirm these advantages do exist and warrant the proposed legislative response.

[7] In effect, a reduction in the SBD of $2.5 for every $1 of passive investment income, rather than the proposed reduction of $5 for every $1 of passive investment income).

Finally, we note that debate on the passive investment rules have also served to highlight the fact that members of defined benefit pension plans are able to accumulate substantially higher pension values than members of RRSPs or defined contribution retirement plans. This discrepancy can be even greater for business owners who are not able to maximize RRSP contributions due to the additional costs associated with operating a business (group benefits, statutory benefits, legal, accounting, office, etc.) or who chooses to take income in the form of dividends.

CALU believes that the combination of the two legislative proposals will increasingly encourage younger and more mobile entrepreneurs to leave Canada to start up a business; or seek out employment rather than assume the risks of operating a start-up business. We don't believe this is the message that the government wants to send to existing and future Canadian entrepreneurs.

Summary

We want to thank the Senate Finance Committee for undertaking this important review of Bill C-74 relating to the taxation of private corporations. We also greatly appreciate this opportunity to provide further feedback for your consideration.

CALU remains committed to ongoing dialogue with the government and Minister of Finance's office to ensure that that the tax system is fair and equitable to all taxpayers including the shareholders of private corporations.

Yours truly,

Marty McConnell
Chair of the Board

Guy Legault
President

cc. Gaëtane Lemay, Clerk of the Committee, Senate of Canada, Room 1047, Chambers Bldg.