September 7, 2023

Trevor McGowan
Associate Assistant Deputy Minister
Finance Canada
90 Elgin Street
Ottawa, Ontario
K1A 0G5
Via email: **Trevor.McGowan@fin.gc.ca**

Dear Trevor:

Re: August 4, 2023 draft legislation relating to the Alternative Minimum Tax (AMT)

The Conference for Advanced Life Underwriting (CALU) is pleased to make this submission to the Department of Finance (Finance Canada) relating to draft legislation released on August 4, 2023 (the draft legislation) relating to the application of the Alternative Minimum Tax (AMT) rules.

As indicated in CALU's earlier **submission**[1] on the AMT proposals announced in the 2023 federal budget[2], we are generally supportive of the stated intent of narrowing the application of the AMT to wealthy Canadians. However, we continue to be concerned with the potential adverse impact of the AMT on select taxpayers which have not been addressed in the draft legislation.

In this submission we will highlight those concerns and put forward modified recommendations for your consideration. **Briefly, our three concerns relate to taxpayers with a "one-time large income event", the application of AMT to trusts, and limitations on deductions/credits for CPP/QPP contributions.**

CALU is Canada's national association for leaders in the life insurance and financial advisory industry. Our members include insurance and financial advisors as well as accounting, tax, legal and actuarial experts. Along with our partner organization, Advocis, we speak for more than 17,000 insurance and financial advisors in every part of Canada to grow and preserve the financial well-being of Canadians and family businesses.

Background

The draft legislation generally reflects the changes to the AMT rules that were outlined in Budget 2023. We are pleased to note the following positive changes from the original proposals:

[1] Dated June 8, 2023, and included with this submission (herein referred to as the June AMT submission).
[2] Released on March 28, 2023. Herein referred to as Budget 2023.

- Qualified disability trusts (QDTs) will qualify for the exemption of approximately $173,000 in 2024;[3]
- Employee ownership trusts are exempt from the restriction on certain deductions relating to borrowed funds where the amounts borrowed are used to acquire a qualifying business pursuant to a qualifying business transfer;[4]
- Several new items have been included in the list of eligible credits (at the reduced 50 per cent rate);[5]
- Graduated rate estates (GREs) are exempt from AMT[6]; and
- A number of other trusts that are otherwise exempt from Part I tax are specifically exempt from AMT. [7]

However, the draft legislation does not contain any changes which reflect the concerns expressed by CALU relating to particular taxpayer situations where the new AMT rules can result in adverse and what we consider to be unfair tax results. In this submission we restate concerns outlined in the June AMT submission and recommend alternative approaches which we believe will address most of our concerns while achieving the government's stated goals in revising the AMT rules. We have also identified another concern that will be discussed in this submission.

Concerns with the proposed AMT changes

1. **Potential impact on taxpayers with a "one-time large income event"**

While we agree that the increased AMT income deduction of approximately $173,000 in 2024 will ensure most Canadians do not pay AMT, as indicated in the June AMT submission, we are concerned that the other proposed changes to the AMT rules could adversely taxpayers who later in their life have a sudden and one-time wealth event. This situation can arise with some frequency for farmers, fishers and small business owners who have built up the value of the business over their lifetime (or the value of real property owned by the business), which is then monetized as part of their retirement planning. There may however be additional situations (such as where an individual owns a secondary property that has significantly increased in value) where similar concerns can arise.

In our June AMT submission, we considered the following example:

> Sally is widowed and owns shares in a farming corporation that qualifies for the life-time capital gains exemption of $1 million. Sally has been receiving a salary of $100,000 per year and declares additional dividends when the profitability of the farm business permits. She has been able to accumulate $200,000 in a registered retirement saving plan (RRSP) and also has unused RRSP contribution room of $240,000. Sally also has $100,000 in a tax-free savings account (TFSA) and $200,000 in GICs earning a four per cent rate of return. Sally turned 62 in early 2024 and received an unsolicited offer of $1.5 million for her shares in the

[3] Revised paragraph (a) of the description of C in section 127.51.
[4] Revised clause 127.52(1)(k)(ii)(B).
[5] Revised paragraph 127.531(a).
[6] Revised clause 127.55(f)(i)(A).
[7] New subparagraphs 127.55(f)(iii) and (iv).

farm corporation from an arm's length person, payable in full on closing. Sally decides to accept this offer and the share sale is completed by mid-year 2024.

Sally uses $250,000 of the net after-tax proceed to renovate her home. The remaining after-tax proceeds of approximately $1.1 million are invested in equities that generate an average seven per cent return (of which four per cent is capital gains and three per cent is dividend income). She does not plan to trigger income from her RRSP until age 71 and will withdraw funds from her TFSA if required for unexpected expenses.

For 2024, under the regular tax system Sally will report $50,000 of salary, $500,000 in capital gains from the sale of her shares plus $22,000 in other capital gains, $16,500 in dividends, and $8,000 of interest income, resulting in a Part I federal tax payable of approximately $83,000.[8]

Sally's income for AMT purposes would be equal to $896,500 (consisting of $50,000 (salary) + $8,000 (interest income) + $800,000 ((80 per cent x $1 million capital gain eligible for the LCGE and 100 per cent x $500,000 for the remaining capital gain) - $500,000 (capital gains deduction)) + $22,000 (capital gain) + $16,500 (dividends)). This would result in AMT of approximately $148,000.[9] Sally would therefore have to pay an additional $65,000 in federal taxes in 2024.[10]

In future years, based on an annual income from her investments (approximately $85,000 – mix of interest income, capital gains and dividend income) and an annual RRSP deduction of $10,000,[11] Sally would have Part I tax of approximately $1,500 per year over the next seven years (total of $10,500).[12] The result is that Sally cannot recover approximately $54,500 in AMT.

In our view, Sally is penalized under the revised AMT rules due to her experiencing a significant one-time income event as she is entering her retirement years, which in turn exposes her to a significantly higher amount of AMT than under the existing rules because she is unable to reclaim most of the AMT paid in 2024 over the following seven taxation years.

To deal with this concern we have revised the recommendation in our June AMT submission such that taxpayers (other than trusts) be provided with *a one-time option to* "look-back" for up to *three preceding taxation years* and obtain a credit against their current AMT to the extent that Part I federal tax exceeds AMT in any of the three preceding taxation years.[13]

If this option is exercised, a taxpayer will be limited to a five-year carry forward of AMT paid in that particular year rather than the existing seven year carry forward. As well, the calculation of AMT in any prior taxation year

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[8] Using 2023 federal tax rates.

[9] The AMT payable under the current rules applicable in 2023 would be approximately $113,000 calculated as follows: (($50,000 (salary) + $8,000 (interest) + $700,000 ((80 per cent x $1.5 million - $500,000 capital gains deduction) + 17,600 (80 per cent of $22,000) + $16,500) - $40,000) x 15 per cent. This ignores the value of personal tax credits.

[10] This is calculated as ($896,500 - $173,000) x 20.5 per cent (ignoring personal tax credits).

[11] From her unused RRSP contribution balance of $240,000.

[12] Using 2023 federal tax rates.

[13] This is similar to the approach taken in the draft legislation relating to the exemption from section 84.1 (see new subparagraphs 84.1(2.31)(a)(ii) and (2.32)(a)(ii).

would be based on the greater of the AMT calculated under the rules applicable in the three preceding taxation years and the AMT rules applicable in that particular taxation year.[14]

For example, assume Sally had salary of $100,000, taxable dividends of $50,000[15] and $8,000 of interest income in 2023. Her regular Part I federal tax for the year would be approximately $24,000 and her AMT would be $18,000 (($158,000 – $40,000) x 15 per cent).[16] However, applying the revised AMT rules in effect in 2024, Sally's AMT liability in 2023 would be nil due to the higher exemption. Thus, the difference between Part I tax and AMT payable in 2023 of approximately $6,000[17] could be credited against her AMT payable in 2024. She could also claim credits for her 2021 and 2022 taxation years assuming Part I federal tax was higher than AMT payable in those years. However, as noted, the look-back rule can only be relied upon in a single taxation year. Therefore, if Sally became subject to AMT in a subsequent taxation year, she would only be eligible for the seven-year carry forward of AMT in that subsequent taxation year.

We believe the revised three year "look-back" rule would help address situations where a taxpayer may have an unusual and significant taxable event in one particular taxation year and would not otherwise be in a position to recover the additional AMT that arises under the revised rules.

2. Application of AMT to trusts

Despite proposed changes that will permit QDTs to qualify for the deduction in calculating income subject to the AMT, and the exemption of GREs from AMT, most taxable *inter vivos* and testamentary trusts will remain subject to the AMT,[18] but will not be entitled to claim the deduction in calculating income subject to AMT. This currently does not result in a significant impact on the AMT payable by a trust, as the $40,000 deduction only represents a potential AMT saving of $6,000 in any particular taxation year.[19] As well, in many situations taxable trusts will typically distribute all of their income (including capital gains) to beneficiaries to avoid paying tax at the top marginal tax rate on such income.

However, the inability to apply the proposed increased deduction could have a significantly greater impact in situations where a taxable trust does not, or is not permitted to, distribute all its income (including capital gains) to the beneficiaries.[20]

For example, a trust may have been established for the spouse of a second marriage, with the intent that on the death of the spouse, any remaining capital will be distributed to children of the first marriage. In these circumstances the trust may include terms that restrict the distribution of capital gains to the spouse beneficiary to protect the interests of the children as residual beneficiaries. As a result, while the spouse beneficiary is alive,

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[14] This would ensure over that for the 2024-2027 taxation years high income taxpayers could not benefit from the AMT rules in effect prior to 2024.
[15] Paid to her by the farming corporation.
[16] The calculation ignores the value of personal tax credits.
[17] The "greater amount" of AMT payable will be $18,000.
[18] There is also an exception under paragraph 127.55(e) for life interest trusts in the year the life interest beneficiary dies, which event triggers a deemed disposition of certain capital property to the trust.
[19] This is calculated as 15 per cent of $40,000.
[20] The inability to apply the deduction can result in additional AMT of up to $35,465 in 2024 ($173,000 x 20.5 per cent).

all the capital gains must be taxed in the trust. Without the $173,000 (in 2024) deduction, the trust would be subject to AMT each year on its capital gains[21], however small, and will not have other income to utilize the AMT deduction from regular Part I income tax in future years because the conditions under the Act for such a trust require that all income be payable to the spouse each year.

To mitigate this concern, while also addressing possible concerns that certain trusts might be used to multiply access to the increased AMT exemption, **we are recommending that the settlor of an alter ego, joint partner or *inter vivos* spousal/common-law partner trust[22]** (and upon the death of the settlor under a joint partner trust, the surviving spouse/common-law partner who is a beneficiary of the trust) **be entitled to make an election to allocate a portion of their AMT deduction in any particular taxation year for use by the *inter vivos* life interest trust[23] in that particular year. Similarly, where the trust is a testamentary spouse/common-law partner trust, the surviving spouse/common law partner be entitled to make an election to allocate a portion of their personal AMT deduction in any particular taxation year for use by the testamentary spouse/common-law partner trust.**

Thus, to the extent that capital gains are retained in a life interest trust and the settlor (or surviving spouse/common law partner beneficiary) is alive, there is the ability for that person to share their AMT deduction in any particular year with the life interest trust in determining the trust income that is subject to AMT.

CALU has also had the opportunity to review the submission by STEP Canada dated September 7, 2023 relating to the application of AMT to various types of trusts. We share their various concerns and are supportive of their recommendations.

3. 50 per cent denial of Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) deduction and credit

The revised AMT rules will only permit a deduction from income equal to 50 per cent of certain amounts that are otherwise fully deductible from regular Part I income. In addition, the revised rules will place a 50 per cent limit on claiming certain tax credits that are otherwise fully creditable against regular taxes. CALU is in particular concerned with the 50 per cent reduction to the deduction for CPP/QPP contributions on self-employed earnings[24] and the employee tax credit for CPP/QPP contributions.[25]

We do not believe there is a good tax policy reason for limiting the deduction/credit for CPP/QPP contributions, for the following reasons:

- Both contributions to the CPP/QPP, and the amount of such contributions, are generally not at the discretion of the employer or the employee but are instead mandated under specific federal and provincial legislation;[26]

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[21] And would be limited to applying only 50 per cent of capital losses in other tax years.
[22] Such trusts are described in paragraph 104(4)(a), herein referred to as a an *inter vivos* life interest trust.
[23] Collectively with testamentary spouse trusts referred to as life interest trusts.
[24] New subparagraph 127.52(1)(k)(iii) and paragraph 60(e).
[25] Revised description of D in section 125.51, paragraph 127.531(a) and section 118.7.
[26] For example, see subsections 8(1) and 10(1) of the Canada Pension Plan, R.S.C. 1985, c. C-8.

- The CPP/QPP is analogous to a defined benefit pension plan, under which both required employer and employee contributions (within prescribed limits) are fully deductible under both the regular tax system and AMT;[27]
- Benefits received under the CPP/QPP are fully taxable to the recipient individual; and
- Self-employed individuals are in effect required to make the employer portion of CPP contributions but will be denied comparable tax treatment for AMT purposes.

We are therefore recommending that CPP/QPP contributions be exempt from the 50 per cent limitations imposed by the revised AMT legislation.

In summary

While CALU is generally supportive of the stated government intent of narrowing the application of the AMT to wealthy Canadians, we have concerns relating to the application of these changes to certain individual taxpayers and trusts and believe our recommendations will help manage these concerns while meeting the government's stated goals in amending the AMT rules.

Once again, we appreciate this opportunity to provide input on the proposed AMT rules and would be pleased to engage in further dialogue on this issue.

Yours truly,

Robert McCullagh　　Guy Legault

Robert McCullagh	Guy Legault
Chair	President & CEO

cc.
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[27] Subsection 147.2(4) and paragraph 8(1)(m).