CHARTERED PROFESSIONAL ACCOUNTANTS CANADA
COMPTABLES PROFESSIONNELS AGRÉÉS CANADA

Chartered Professional Accountants of Canada
277 Wellington Street West Toronto ON CANADA M5V 3H2
T. 416 977.3222 F. 416 977.8585
www.cpacanada.ca

Comptables professionnels agréés du Canada
277, rue Wellington Ouest Toronto (ON) CANADA M5V 3H2
T. 416 977.3222 Téléc. 416 977.8585
www.cpacanada.ca

October 2, 2017

Paul Rochon
Deputy Minister
Department of Finance Canada
90 Elgin Street
Ottawa, ON K1A 0G5

Dear Mr. Rochon:

Re: Federal Consultation: Tax Planning Using Private Corporations

The enclosed submission sets out the views and recommendations of Chartered Professional Accountants of Canada (CPA Canada) in response to the Government of Canada's consultations on tax planning using private corporations.

CPA Canada is one of the largest and most respected national accounting organizations in the world, representing more than 210,000 Canadian chartered professional accountants (CPAs) at home and abroad. CPAs work in every sector of the economy. They are the business and accounting leaders that Canadian taxpayers count on to represent their interests with integrity and competence, and to help them comply with Canada's complex tax laws. CPA Canada also works collaboratively with the Government of Canada, including the Canada Revenue Agency and Finance Canada, with a view to improving the tax system for all Canadians.

In this submission, we present our serious concerns with the consultation process. When any new tax law is proposed, there should be a detailed, constructive, two-way consultation with all parties affected. In this case, the short consultation period, its summertime launch and the release of draft implementing legislation lead CPA Canada to believe such consultation has not occurred.

In CPA Canada's view, the July 18 proposals are contrary to the public interest due to the unintended consequences they would produce for small business owners and for all classes of Canadians. This package of proposals is so complex and so broadly targeted that it would be unworkable. Other, similarly complex, broadly applicable changes affecting small businesses were recently enacted. When you consider those changes in combination with the current proposals, significant risk is created to the integrity of the tax system, to the financial prospects and competitiveness of Canadian private businesses, and to the Canadian economy overall.

This submission advances many suggestions on how to improve the simplicity, certainty, efficiency and effectiveness of the proposals, as released on July 18, 2017, focusing primarily on tax policy matters. Submissions of the Joint Committee on Taxation of the Canadian Bar Association and CPA

Canada, which run well over 100 pages in total, raise a high number of technical concerns. These submissions highlight significant flaws in the proposals and, in some cases, put forward constructive suggestions to resolve these concerns.

In the almost half-century since Canada's last major tax reform initiative, the tax laws have seen layer upon layer of complex tax changes made without consideration of the impact on the tax system as a whole or on the public interest. As CPA Canada has expressed in numerous representations to government, a comprehensive tax review is long overdue. This review is urgently needed to ensure Canada's tax system is sustainable and competitive for the 21st century.

We therefore believe the government should consider setting aside these proposals pending a comprehensive review of the income tax system.

We would welcome the opportunity to discuss this issue and the comments throughout this submission with you further.

Yours truly,

Original signed by

Joy Thomas, MBA, FCPA, FCMA, C. Dir.
President and CEO
CPA Canada

c.c.: Ted Cook, Tax Policy Branch, Finance Canada
Brian Ernewein, General Director, Tax Policy Branch, Finance Canada
Andrew Marsland, Senior Assistant Deputy Minister, Tax Policy Branch, Finance Canada

CONSULTATION: TAX PLANNING USING PRIVATE CORPORATIONS

CPA CANADA'S RESPONSE TO THE DEPARTMENT OF FINANCE CANADA

EXECUTIVE SUMMARY

Chartered Professional Accountants of Canada (CPA Canada) welcomes the opportunity to comment on the government's consultation document *Tax Planning Using Private Corporations*[1] and draft legislation released on July 18, 2017 ("the July 18 proposals").

CPA Canada believes Canada's tax system should support sustainable economic growth in the public interest, reinforce our country's competitive position in the global economy and provide incentives for business owners to take risks and invest in our economy. CPA Canada fully supports the goal of an efficient and effective tax system that ensures abuses to the system are reduced or eliminated. CPA Canada also recognizes the Government of Canada's responsibility and right to make changes as it considers appropriate.

The numerous technical concerns and inappropriately targeted tax consequences of these proposals have been discussed by many other stakeholders in detail, including in the submission of the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada ("Joint Committee"). In these pages, CPA Canada focuses on the tax policy aspects of the proposals.

Based on our initial analysis of the July 18 proposals and consultations with members and other stakeholders, CPA Canada believes the proposals would have far-reaching impacts that extend beyond Canada's top income-earners, and would adversely affect many middle-class taxpayers. If implemented, the proposals would create complexity and raise the cost of doing business in Canada, creating barriers to business investment and job creation, and diminishing competitiveness.

[1] Department of Finance Canada, *Tax Planning Using Private Corporations*, July 18, 2017.

Further, a 75-day consultation period does not provide enough time to properly evaluate the broad tax policy changes set out in the consultation paper. CPA Canada believes additional time is needed – for the issues to be considered and assessed and for the relevant economic data to be gathered and analyzed – so that all of the potential impacts on Canadian individuals and businesses can be identified and estimated. CPA Canada previously expressed the need for the government to consider extending the current consultation beyond October 2, 2017 in a letter to Finance Canada dated August 17, 2017 (see Appendix 1).

Extending the consultation would permit a more in-depth review of whether and to what extent the proposals adhere to the principles of a sound tax system. Under these principles, any changes to tax policy should be designed to achieve an equitable, efficient and effective tax system that ensures abuses to the system are reduced or eliminated while avoiding undue complexity. Tax system changes should also promote and support economic growth and competitiveness in Canada.

Tax, financial and economics experts and other stakeholders have observed that, in contrast to these principles, the proposals would add even more complexity and uncertainty to Canada's tax legislation than already exists. On top of the extra tax costs for affected taxpayers, the added complexity would raise the costs of compliance for all private corporation owners, given the time and effort required of tax advisers to determine their clients' obligations under the new rules.

Small business owners, their advisers and Canada Revenue Agency auditors are already challenged to deal with other recent and highly complex changes (e.g., to subsection 55(2), the small business deduction and the principal residence exemption). The July 18 proposals would magnify these challenges significantly, raising serious concerns over taxpayers' ability and willingness to comply with the tax system and whether the system is becoming unworkable.

Instead of layering on additional tax complexity by changing the tax system on a piecemeal basis with proposals like these, such changes need to be considered in the broader context of Canada's tax system overall.

"The last major overhaul was the result of a consultation process that took many years, being the Carter Commission (started in 1962 with a White Paper released in 1969). I caution our government against adopting the July 18th proposals without real and meaningful studies and a thorough consultation process."

– Comment from a CPA in New Brunswick

It has been more than 50 years since the last major tax system review. CPA Canada and many other national organizations, leading think tanks, economists and academics agree that a comprehensive review to improve the tax system's simplicity, efficiency, fairness and competitiveness is long overdue. In addition, for the last four years and through its pre-budget consultation process, the House of Commons Standing Committee on Finance has recommended that the federal government should simplify the *Income Tax Act* and launch a national consultation process to accomplish this important task.

In addition to concerns with the proposals themselves, CPA Canada believes that the manner in which they have been presented is contrary to the public interest and the Canadian ideal of good business. CPA Canada believes the government should be more transparent with Canadians.

In its consultation paper, for example, the government suggests it is "…taking steps to address tax planning strategies and close loopholes that are only available to some—often the very wealthy or the highest income earners—at the expense of others."[2] We have concerns with the suggestion that some Canadian taxpayers have been inappropriately taking advantage of these tax provisions. Characterizing the use of legally sanctioned tax planning by compliant taxpayers as making use of "loopholes" is inaccurate and unfair.

Rather, CPA Canada believes the government should acknowledge and explain the material shift in tax policy regarding the taxation of private corporations that these proposals actually represent.

Summary of recommendations

CPA Canada believes that the public interest would be best served by setting aside these proposals pending a more comprehensive tax system review. The goal of this review should be to ensure Canada has an efficient and effective tax system that supports sustainable growth and the competitiveness of Canadian businesses, now and in the future.

Below are CPA Canada's recommendations in response to Finance Canada's specific requests for responses on the July 18 proposals. These recommendations are discussed in more detail in the body of this paper.

---

[2] Ibid., at p. 3.

Even though Finance Canada has released draft legislation to implement some of these proposals, we have assumed that Finance is interested in hearing the views of Canadians on all of the proposals discussed in the consultation paper.

In addition to the recommendations below, CPA Canada supports the technical recommendations of the Joint Committee in its submissions on the July 18 proposals.

Income sprinkling

RECOMMENDATION: CPA Canada recommends the government provide data and analysis regarding the use of income sprinkling through private corporations to ensure the issues are well understood by stakeholders and the best solutions can be developed.

RECOMMENDATION: CPA Canada recommends that, in order to reduce subjectivity and improve certainty, the federal government should consider:

- **abandoning the highly subjective "reasonability" test for compensation paid to family members**
- **consulting further with stakeholders to determine whether a simpler method could be employed to meet the government's objectives, such as extending the tax on split income (TOSI) to children up to age 24 and not applying the rules to older family members**
- **if the reasonability test is maintained:**
  - **providing greater certainty through de minimis exceptions for smaller split income amounts that would exempt taxpayers below certain income levels or other thresholds and thereby reduce complexity and the potential for disagreements resulting from honest differences of opinion**
  - **provide clear and detailed administrative guidance when the proposals take effect (or earlier) so taxpayers can know with certainty and minimal cost whether they comply with the rules**
- **review and consult with Canadians on the appropriate taxing unit to achieve consistency in tax treatment of spouses throughout the *Income Tax Act,* including review of whether spouses should be considered a taxing unit, irrespective of whether they are in business or employment**
- **following that review, consider whether spouses should be exempted from the proposed TOSI rules.**

Converting income into capital gains

RECOMMENDATION: CPA Canada recommends that the federal government:

- ensure neutrality and simplicity by reviewing the proposals that aim to prevent the inappropriate conversion of income to capital gains to ensure they would not lead to unexpected, uncertain, inappropriate and onerous tax results (e.g., double taxation on death)
- ensure procedural fairness by considering appropriate transitional periods and grandfathering rules to ensure the rules do not apply retroactively or retrospectively.

RECOMMMENDATION: CPA Canada welcomes the government's intention to engage in separate consultations on the issue of intergenerational transfers and recommends the review be conducted with a view to providing exceptions to ensure tax neutrality for transfers of family businesses to family member versus third parties.

RECOMMENDATION: CPA Canada recommends the government undertake a specific review of the tax issues arising on the death of a shareholder to ensure the taxation is fair and there is a simple and clear path to avoid double taxation.

Holding passive investments inside a private corporation

RECOMMENDATION: CPA Canada recommends that the federal government take steps to minimize complexity as follows:

- If the proposals on income sprinkling and the conversion of income into capital gains are adopted, conduct a more detailed review on whether the passive income proposals are in fact needed when the cost and complications created by those proposals are considered.
- If passive income rules are deemed necessary:
    - undertake further study and analysis to define "small business" for purposes of the passive investment rule (e.g., annual business income under $150,000) and promote simplicity by including a de minimis rule to exclude small businesses from the application of any new rules in this area
    - promote certainty by establishing a safe harbour for companies that maintain a reasonable portion of their assets in passive investments relative to active business assets that are incidental to or necessary for the business, for example, by using a

variation of the current definition of a small business corporation (e.g., a straightforward 80 per cent test)

- promote procedural fairness by providing a reasonable transitional period (e.g., two years) and comprehensive transitional rules for individuals and their companies to plan for the change in this tax regime.

Conclusion

RECOMMENDATION: Instead of layering on ever more complex tax rules, CPA Canada recommends a comprehensive review of the tax system. CPA Canada has recommended such a review for many years, including in our annual pre-budget submissions to the Government of Canada. We are supported in this view by many other national organizations. leading think tanks, economists, academics and the House of Commons Standing Committee on Finance.