HENDRY WARREN LLP
CHARTERED PROFESSIONAL ACCOUNTANTS

Daniel B. Warren, CPA, CA, TEP
Ext. 234
dan.warren@hwllp.ca

200-881 Lady Ellen Place
Ottawa, ON K1Z 5L3
(613) 235-2000
www.hwllp.ca

September 29, 2017

The Honourable Bill Morneau
Minister of Finance
House of Commons
Ottawa, ON K1A 0A6

via email: fin.consultation.fin@canada.ca

Dear Mr. Morneau:

Re: July 18, 2017 Income Tax Proposals

I am writing to provide comment with respect to the July 18, 2017 legislative tax proposals relating to tax planning with private corporations pursuant to the current public consultation process.

One of my partners, Ian Hendry, has already written to Finance on behalf our Firm. While following commentary from the Government and Department of Finance in recent days, I felt compelled to write this follow-up letter to address a specific aspect of the Income Sprinkling proposals. Such commentary includes:

- Minister Morneau's attendance at the CPA Canada The One Conference held in Ottawa on September 18, 2016,
- The symposium held by the Canadian Tax Foundation on September 25, 2017 at which members of the Department of Finance spoke, and
- The panel discussion sponsored by CPA Ottawa on September 27, 2017 at which Mr. Ted Cook, representing the Department of Finance, spoke. Indeed, it was Mr. Cook who encouraged me to write this follow-up letter.

All statutory references are to the Income Tax Act (Canada) ("ITA").

Retirement Funds Accumulated in Private Corporations

The Department of Finance discussion paper as well as comments made by Minister Morneau and officials of the Department of Finance have indicated that private corporations are an inappropriate vehicle within which to save for retirement. Mr. Morneau and representatives of the Department of Finance clearly stated that the small business deduction was implemented years ago to encourage private business to reinvest in their businesses and not to accumulate funds for retirement.

With respect, I have to disagree. This may have been the original intent of introducing the small business deduction, but the Department of Finance, through successive Liberal and Conservative governments, have not acted in this fashion. Until now, there has been no legislative prohibition against accumulating wealth inside a private corporation. Indeed, there was an advantage to doing so. Your own discussion paper enumerated several of these including the ability to defer personal income tax and the sprinkling of dividends to family members.

By following your tax rules, many Canadian private businesses chose to save for retirement in their corporations rather than RRSP. They also chose to remunerate themselves by way of dividends which did not create RRSP room. The government is culpable in where Canadian private corporation shareholders find themselves today – having their retirement funds inside private corporations rather than RRSP or non-registered investment portfolios. The government should be as concerned about preserving retirement funds held inside private corporations as they with Canadians RRSPs and pension plans.

Lack of Transitional Relief for Retirement Funds in Private Corporations

While I do not necessarily agree with the policy direction, I understand the government's desire to prevent the sprinkling of dividends in the future. You are the government and that is your legislative right. However, existing retirement funds held inside private corporations should not be targeted for punitive taxation. It would be inappropriate to do so for RRSPs and pension plans and I submit that it is equally inappropriate for private corporations.

The proposed amendments to ITA 120.4 do not provide transitional relief for existing retirement funds in private corporations. This will subject a dividend that is paid after 2017 from investment funds of a holding corporation, that no longer operates an active business, to a non-active spouse shareholder to top marginal rate taxation. This dividend is intended to fund retirement and is paid from funds accumulated prior to July 18, 2017. It does not represent the splitting of business or professional income that would otherwise have been earned by the active spouse. This is bad policy and punitive.

Canadians need certainty concerning the manner in which they will be taxed as they plan their affairs. Canadian business owners have accumulated funds for retirement in private corporations based upon rules that existed at the time. Their expectation was that these funds could be withdrawn as a dividend by both spouses in retirement and be subject to graduated rate treatment. You may disagree with this form of planning but you should not penalize Canadians for following your rules. You helped create this problem, you need to be part of the solution.

Minister Morneau in his open letter to Canadians which was published in the Globe and Mail on September 5, 2017 stated "*For those business owners and professionals who have saved and planned for their retirement under the existing rules, I want to be clear: We have no intention of going back in time. Our intent is that changes will apply only on a go-forward basis and neither existing savings, nor investment income from those savings, will be touched.*"

With respect, the proposed changes to ITA 120.4 will impact existing retirement savings of Canadians. Consider for a moment a plumber who has accumulated $500,000 of passive assets in his corporation. He and his non-active spouse are equal shareholders. If they planned to withdraw $25,000 each for the next ten years to fund retirement, the income tax that each would pay under the existing rules would be nominal. Under the proposed TOSI amendments, the non-active spouse would pay approximately $11,250. Over the ensuing 10 years, that would represent approximately $112,500 of tax paid which would be equal approximately 22.5% of the initial retirement fund. This is a substantial change in taxation and would most definitely jeopardize their retirement. The punitive results of this example are replicated at all levels of dividend payments.

I submit that transitional relief from TOSI should be provided for existing corporate retirement funds as of December 31, 2017 by exempting dividends paid to non-active spouses from such funds.

You have provided transitional relief with the lifetime capital gains exemption ("LCGE") by providing an election in 2018 to use the LCGE. Further, you have committed to exempt existing corporate wealth from the passive income rules. Extending such relief to an exemption from TOSI for existing corporate retirement funds is equally fair and appropriate. Further, it would illustrate that Minister Morneau was sincere in his commitment to Canadians to only apply the new rules on a go-forward basis and not touch existing savings.

It may be that you were intending to provide such transitional relief in the upcoming passive income rules. I submit that Canadians cannot wait for transitional relief from TOSI. Your current draft legislation will subject dividends paid out of retirement funds to non-active spouses to top marginal rate taxation as of January 1, 2018.

I appreciate that designing this transitional relief may be complex. However, that is not an excuse to punitively tax the retirement funds of Canadians. It is critical that you get this right.

Possible Application of TOSI to Active Spouse

As I read the draft amendments to ITA 120.4, I am concerned that these amendments could be read in such a fashion the active spouse could be subject to TOSI on dividends received to fund retirement after the active business has ceased. The relevant contributions made by a shareholder contained in the definition of "split portion" in proposed amendments to ITA 120.4(1) suggest that these will not apply to an investment business. Once an active business ceases the corporation becomes a passive investment corporation. The proposals seek to exclude an investment business from a business for purposes of these rules. This appears to suggest that the past contributions of the active spouse would not be considered thereby subjecting a dividend from a holding corporation to top rate taxation under TOSI. This by any definition of the word, is not fair and creates an unacceptable result.

I therefore submit that you need to clarify the proposed amendments to ITA 120.4 to ensure that this will not be the case. This is not an issue that should be left to the interpretation of the Canada Revenue Agency.

As requested on page 17 of the Tax Planning for Private Corporations discussion paper, please be advised as follows:

- This submission is made on behalf of Hendry Warren Chartered Professional Accountants;
- We consent to the disclosure of our submission and would actively encourage its dissemination; and
- We do not wish you to reserve the identity of myself or our firm nor is any of the content of this letter considered to be confidential.

Yours very truly,

Daniel B. Warren, CPA, CA, TEP

DBW/sd

c.c. The Honourable Justin Trudeau, Prime Minister: justin.trudeau@parl.gc.ca
The Honourable Wayne Easter, Finance Committee Chair: wayne.easter@parl.gc.ca
The Honourable Pierre Poilievre, pierre.poilievre@parl.gc.ca