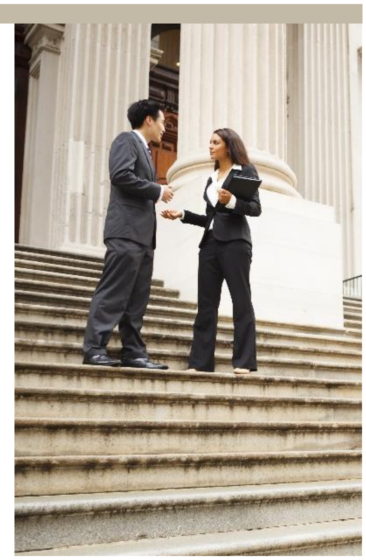
Striving Towards a Canadian Advantage – Steps Toward Competitiveness and Affordability

MNP 2019 Submission to the House of Commons Standing Committee on Finance

Tuesday May 7, 2019



We are pleased to make a submission in response to the House of Commons Standing Committee on Finance invitation to provide our views on Bill C-97, an *Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 19, 2019 and Other Measures.*

We are Canada's third largest tax filer. At MNP, we proudly serve and respond to the needs of more than 180,000 businesses, over 19,000 food and agriculture producers and thousands of private enterprise business owners from coast to coast. We pride ourselves on listening to our clients, and we know they are concerned with how their businesses can stay competitive as they struggle to cope with the increasing complexity and administrative burden of the tax system. From an individual taxpayer's perspective, they are worried about how affordable Canada will be, especially for the next generation.

We presented to the Standing Committee on Finance in September 2018 on the topic of Economic Growth and Ensuring Canada's Competitiveness and appreciate the opportunity to appear again today to offer feedback on tax measures presented as part of Bill C-97. The Fall Economic Statement and Budget 2019 introduce several measures to address competitiveness and signal that the Government has taken essential first steps to addressing taxpayer concerns. We believe, however, that Canada must do more.

HOW DOES BILL C-97 SUPPORT CANADA's COMPETITIVENESS?

A. Measures Introduced to Promote Investment and Innovation in Private Enterprise and Canadian Business:

i) **Accelerated Capital Cost Allowance (CCA) measures** – Accelerated Investment Incentives (AII) were introduced as part of the Fall Economic Update and will inspire businesses to make larger capital investments. We commend the Government's actions to provide these incentives to Canadian business.

ii) **Scientific Research & Experimental Development (SR&ED)** - Measures to eliminate the use of taxable income as a factor in determining refundable tax credits of qualifying SR&ED expenditures are a welcome change. Prior to these changes, many businesses maximized their SR&ED refundable credits by drawing additional personal compensation. The changes in Budget 2019 create more sustainable businesses as capital will be retained and reinvested in the business. We commend the actions of the Government as these measures help promote competitiveness and in addition, removes added complexity for Canadian businesses involved in research, development and innovation.

What can we do better? Bill C-97 endeavours to make Canadian businesses more competitive but moving forward, there is more work to do. The new AII lacks parity to the immediate expensing of investments that was provided as part of U.S. tax reform that took effect on January 1, 2018. Further, we continue to recommend lowering the combined corporate tax rate to a more modest rate of 20% and reach a combined personal tax rate that is below 50%. With a marginal tax rate of 53.5%[1] for top earners, Canada's top personal tax rate is the **fourth** highest among OECD countries[2]. Our clients continue to question whether they should relocate their business to the more favorable US business environment; these steps would go a long way in strengthening confidence, ensuring homegrown Canadian businesses stay on Canadian soil.

[1] Federal and Ontario combined rate (2018) including surtaxes.
[2] OECD (2018), Taxing Wages 2018, OECD Publishing: Table 1.7 Top Statutory Personal Income Tax Rate and Top Marginal Tax rates for Employees. https://stats.oecd.org/Index.aspx?DataSetCode=TABLE_I7.

B. Measures Introduced to Assist Farmers and Fishers

i) Small Business Deduction (SBD) Relief for Farming and Fishing Businesses - Bill C-97 proposes relief for farming and fishing businesses by eliminating the requirement that sales must be to a farming or fishing co-operative in order to be excluded from specified corporate income. It also allows sales to unrelated purchaser corporations to be considered active income to the farming and fishing business. This clarification will provide greater certainty to agricultural producers as well as related businesses in the agricultural sector and ensure that small ownership percentages in farming and fishing buying groups does not eliminate access to the SBD. Specifically, producers will be able to market their grain and livestock to the purchaser that makes the most business sense without concern for potential income tax consequences. The expansion to include any unrelated corporation as opposed to solely agricultural co-operative corporations should incentivise new producer owned agribusinesses to emerge and allow existing farming and fishing corporations to continue to operate in a manner that makes the most business sense.

What can we do better? We are pleased that the Government acknowledged the concerns raised by the agriculture industry. However, there are other industry groups that were also negatively affected by recent changes to the SBD legislation which can severely impact Canada's competitiveness. The SBD changes demonstrate the increasing complexity of the tax system that can create adverse tax consequences for certain taxpayers. For example, medical physicians working in Academic Health Science Centres (AHSCs) are often required to hold an interest in a partnership to accommodate provincial funding models. Just like the farmers that were impacted in an unintended manner, so too are these specific physicians (it is simply a matter that their revenue is from an intermediary between the province and their corporation, as required by the province). Physicians working in AHSCs were impacted by the SBD changes simply due to the requirements of their funding model, whereas their counterparts working outside of AHSCs were not affected, thus creating a disincentive for physicians to work within AHSCs. AHSCs are vital to the medical profession to ensure leading edge medical research and education continues in Canada. While there is a broader issue of Canada's competitiveness on recruiting talent and ability to attract and retain physicians, the impact of the complex changes to the SBD rules negatively influences medical innovation in Canada as these individuals are now choosing private practice over medical research. In addition, we encourage the Government to continue access to refundable tax credits for Medical Professional Corporations that will fund ongoing research initiatives with the overall goal to improve healthcare in Canada.

ii) Other Measures - We thank the Government for listening and making legislative changes to ITA section 143 that promote tax fairness.

C. Continued Consultation to Ease Succession Anxiety for Entrepreneurs

While not specifically addressed in Bill C-97, Budget 2019 indicated that the Government will continue consultations with farmers, fishers and other business owners throughout 2019 to develop new proposals to facilitate the intergenerational transfers of businesses while protecting the integrity and fairness of the tax system.

What can we do better? In our previous submission to the Standing Committee on Finance, we asked the Government to consider expanding provisions of the Income Tax Act (ITA) to allow families to use their Lifetime Capital Gains Exemption (LCGE) in a bona-fide succession, while preserving capital gain treatment in other situations where full succession is not imminent, but there is a transition in ownership. This will provide a more equitable result, as currently Canadian business owners experience a penalty for succession of a business within their family, such that there is often a double tax component – the vendor parent must pay tax to transition the business and the successor must also have after-tax dollars to fund the purchase. This penalizes family succession planning and can lead to the transfer of a business outside the family unit, which is highlighted in the illustrative case study attached in Appendix A. We are encouraged that this has become a priority for the Government to review.

D. Employee Stock Options

Budget 2019 indicated that the Government intends to move forward with changes to limit the benefit of the current employee stock option deduction for high-income individuals employed by large, long-established, mature firms. This is not specifically mentioned in Bill C-97 and the legislation is to be released in the future. However, a number of questions remain, specifically how will we differentiate "start-ups and rapidly growing Canadian businesses" which are not subject to the $200,000 cap? Will this refer to Canadian-Controlled Private Corporations (CCPCs), or would it be restricted to an even smaller group?

It is also unclear at this time whether the limit will only apply to the ITA paragraph 110(1)(d) deduction or whether it would also apply to the ITA paragraph 110(1)(d.1) deduction for options granted or shares issued by a CCPC to unrelated employees. If particular companies don't qualify, an individual will need to track each stock option grant to determine the amount that will be eligible for the stock option deduction.

What can we do better? To ensure CCPCs and new start-up companies remain competitive, Canada must ensure that they are not subject to these proposed changes.

E. Broadening of the Foreign Affiliate Dumping Rules

Also announced in Budget 2019 but not yet legislated are the upcoming changes to expand the reach of this section of the ITA. While many practitioners do not deal with these rules on a regular basis, there is concern within the tax community that the broadened reach of the foreign affiliate dumping rules could inadvertently catch some common domestic scenarios. For example:

1. A Canadian individual controlling a Canadian corporation who later becomes a non-resident of Canada;
2. A Canadian trust with a trustee that controls a Canadian corporation who departs Canada, resulting in the trust becoming non-resident; and
3. A Canadian resident trust or estate that controls a Canadian corporation who has a non-resident beneficiary.

What can we do better? While there is a need to preserve the policy intent behind the amendments, we urge the Government to address these problematic situations by providing for specific exemptions (for example, consider exemptions for non-resident beneficiaries of Canadian resident inter-vivos and testamentary trusts).

HOW DOES BILL C-97 SUPPORT AFFORDABILITY FOR CANADIANS?

A. Providing Tax Incentives to Canadian Families to Make Canada More Affordable

i) Housing Affordability Measures: Enhancements made to the Home Buyer's Plan to allow for inflation adjustments and targeted support for first-time home buyers through Budget 2019 will help address housing affordability in Canada. We commend the Government for taking the necessary steps to address the issue of affordability.

What can we do better? With the rising costs of housing many parents are trying to help their children with the purchase of their first home. We suggest that incentives should be contemplated to provide relief for parents in this regard or, alternatively, one can consider simplifying related party loans specifically tied to the purchase of a house.

In conjunction with introducing housing affordability measures we also strongly urge the Government to ensure tax compliance remains simple – for example the new reporting rules for the disposition of a principal residence after October 2016 added an extra level of complexity and ultimately additional cost to taxpayers as they struggle to complete the tax return forms on their own.

ii) **Canada Training Credit:** This new credit will help build our future workforce and help current workers get the training they need to keep their existing jobs or prepare for new ones. Upgrading skills and education will allow access to higher-paying jobs for many individuals.

    What can we do better? Families are struggling to fund the increasing costs of their children's education while the requirements for higher education in the new economy continue to escalate. Consideration should be given to allow full tuition credit transfers to parents of children in post-secondary institutions rather than the current $5,000 annual cap. Additionally, the Government could consider the introduction of personal grants or additional credits to incentivise students to enroll in programs that are aligned with the Government's planned investments.

iii) **Digital Media Credit:** This new credit will help subscribers of digital media defray costs through tax credits and will help Qualified Canadian Journalism Organizations (QCJO) by way of a 25% refundable credit on salaries.

What can we do better? This new credit increases complexity in the tax system as media outlets must be approved by an independent administrative panel. Further, with the need to have at least two unrelated employees, many small, family-run local newspapers will not be able to benefit from the credit. Rather than implementing tax credits that will require additional costly administration and oversight, the Government could consider aiding the industry and the users of digital media by allowing the digital media to be zero rated for GST purposes.

iv) **Making Zero Emission Vehicles More Affordable:** Budget 2019 proposes a new incentive of up to $5,000 for electric battery or hydrogen fuel cell vehicles with a manufacturer's suggested retail price of less than $45,000. Further incentives provided to support businesses to make a commitment to renewable energy and invest in zero-emission vehicles are welcomed to help transition Canadians to a low carbon economy and reduce transportation costs. In addition, businesses will be encouraged to acquire zero emission vehicles for the preferential CCA rates noted earlier; a win-win for them and for the environment.

What can we do better? We need to address the consequential increase in standby charges on these zero emission vehicles as the current incentive could make it more expensive for employees and owner-managers who use these vehicles. As these electric vehicles often cost more than a gasoline engine vehicle, the employees who are subject to a stand-by charge will have a higher taxable benefit, which increases their personal taxes for driving these vehicles.

Concluding Remarks

Bill C-97 and Budget 2019 makes steps towards a Canadian competitive advantage, and we need to strive to do more. We recommend:

1. The Government should continue its path to introduce measures to make Canadian businesses more competitive and improve affordability for Canadians.
2. At the same time any measures implemented by the Government need to ensure simplicity and that the cost of doing business for any Canadian does not increase as a result.

MNP is pleased to continue to work with Parliament and the Government through some of the competitiveness and affordability issues identified today that are confronting Canadians.

Appendix A

Tracy and Marc run Éclair, a local bakery in Waterloo, Ontario. Prior to purchasing the bakery from her parents in 1982, Tracy had worked in the family business throughout her teenage years and later attended the Culinary Arts School of Ontario. It was while attending this school that she met Marc, and together they returned to Waterloo to work in the family business.

Over time, they worked into management roles and upon her parents' retirement, acquired the business.

The couple has grown the business, and now have a staff of 30 people, including their part-time lunch hour servers. Éclair is a specialty bakery with a flair for French pastries, cakes, breads, bagels and desserts. They also have a lunch time crowd that frequents the bakery for their homemade daily soup and sandwiches.

Today, their two daughters are involved in the business and have both attended culinary school, but they have differing goals with respect to the family business. Their eldest daughter, Adele, is a skilled baker that would rather create beautiful pastries and elaborate wedding and specialty cakes than work on the business. Their second daughter, Jeanette, has a keen business interest and is taking classes working toward a business degree to help grow the family business. Her parents see her as their successor.

Being in their early 60s, Tracy and Marc are considering the transition of their business to their children. Through their succession conversations, they discovered that Adele is content working in the business but doesn't want to be bothered with having to buy her parents out. Jeanette intends on keeping the business in the family, and together with her partner, would like to buy Éclair. Today Éclair is worth between \$2.5M to \$3.0M.

At the same time, Tracy and Marc have also been approached by Pastry King, a specialty bakery in the Greater Toronto Area (GTA) who has expressed interest in buying Éclair. Pastry King would like to expand their product line into smaller towns outside of the GTA. They figured they could transport the baked goods to Waterloo from their large Mississauga bakery, like they do with all their other GTA locations.

Tracy and Marc have a bias to keep the business in the family but are also concerned with ensuring they have enough after-tax funds for their retirement. Like many small business owners, they have not saved in their RRSP or other tax-sheltered retirement accounts, as they have always been working hard to make the business succeed.

The family had their accountant run a few planning scenarios and they discovered that if they sold to Pastry King, they would have an effective tax rate of approximately 10% after using their LCGE. They were shocked to realize that if they sold to Jeannette, she would be obligated to repay their loan with personally taxed dollars, a significant penalty compared to a sale to Pastry King (rendering the effective tax rate to vary between 27% and 67% - see below). They had a family meeting to discuss the options and are seriously considering selling the business outside the family, as they do not want to burden their daughter with a tax obligation that will inhibit her ability to make a living and grow the business.

On the sale of shares of Éclair, Tracy and Marc should be indifferent to selling shares to their daughter or to Pastry King. Their daughter should not be penalized for purchasing shares from her parents and should be able to fund the purchase with corporate funds, as she would if she were to purchase a business from an unrelated party. This allows children to become entrepreneurs, continue to grow local businesses and diversify their local economies while protecting existing jobs.

Illustration of Tracy and Marc Selling Bakery Business to Child vs 3rd Party (using Ontario rates)

	Sell to Child Personally	Sell to Child's Corporation	Sell to 3rd Party	2017 Draft Legislation *
Proceeds	2,750,000	2,750,000	2,750,000	2,750,000
Use Lifetime Capital Gain Exemption	Yes	No	Yes	Yes
IMPACT TO PARENT				
Tax Paid	271,983	736,175	271,983	271,983
Cash Available for Retirement	**2,478,017**	**2,013,825**	**2,478,017**	**2,478,017**
IMPACT TO PURCHASER				
Tax Paid	1,562,578	-	-	2,478,137
Corporation's Cost to Fund Purchase	**4,312,578**	**2,750,000**	**2,750,000**	**5,228,137**
TOTAL TAX				
Parents	271,983	736,175	271,983	271,983
Purchaser	1,562,578	-	-	2,478,137
Total Tax	**1,834,561**	**736,175**	**271,983**	**2,750,120**
Effective Tax Rate as Percentage of Proceeds	66.71%	26.77%	9.89%	100.00%

*** Sale to child personally under ITA s. 84.1 as previously proposed; however the Government of Canada has indicated that it would not proceed with these changes.**

Amanjit (Am) Lidder, CPA, CA

Senior Vice President, Tax Services	T: 778.571.3535	E: amanjit.lidder@mnp.ca

Am is the Senior Vice President of Tax Services with MNP. As the leader of MNP's Tax Group, Chair of MNP's Tax Executive Committee and a member of the firm's management team, she oversees all facets of the firm's tax practice providing management and strategic guidance to tax specialists across Canada.

Am has extensive expertise in Canadian taxation, providing a wide range of tax planning and compliance services to mid-market organizations and their shareholders. Working one-on-one with clients, she delivers effective advice and strategies for corporate and personal tax planning, estate and succession planning and corporate reorganizations, as well as merger and acquisition planning. Am strives to fully understand her clients and their businesses, allowing her to tailor solutions to their objectives.

Am has been involved in and presented at numerous tax conferences hosted by CPA Canada and the Canadian Tax Foundation. She is also active in the tax education community, previously serving on the CPA Canada Education Committee, the Advisory and Planning Committee for CPA Canada's National Conference on Income Taxes and on the CTF British Columbia Tax Conference Program Committee. Currently Am is an active member of the CPA Canada Tax Advisory Committee.

Am is a Chartered Professional Accountant (CPA), qualifying as a Chartered Accountant (CA) in 2001. She received a Bachelor of Commerce degree from the University of Northern British Columbia in 1998. Am previously served as a Director on the MNP Board.

Kim Drever, CPA, CA

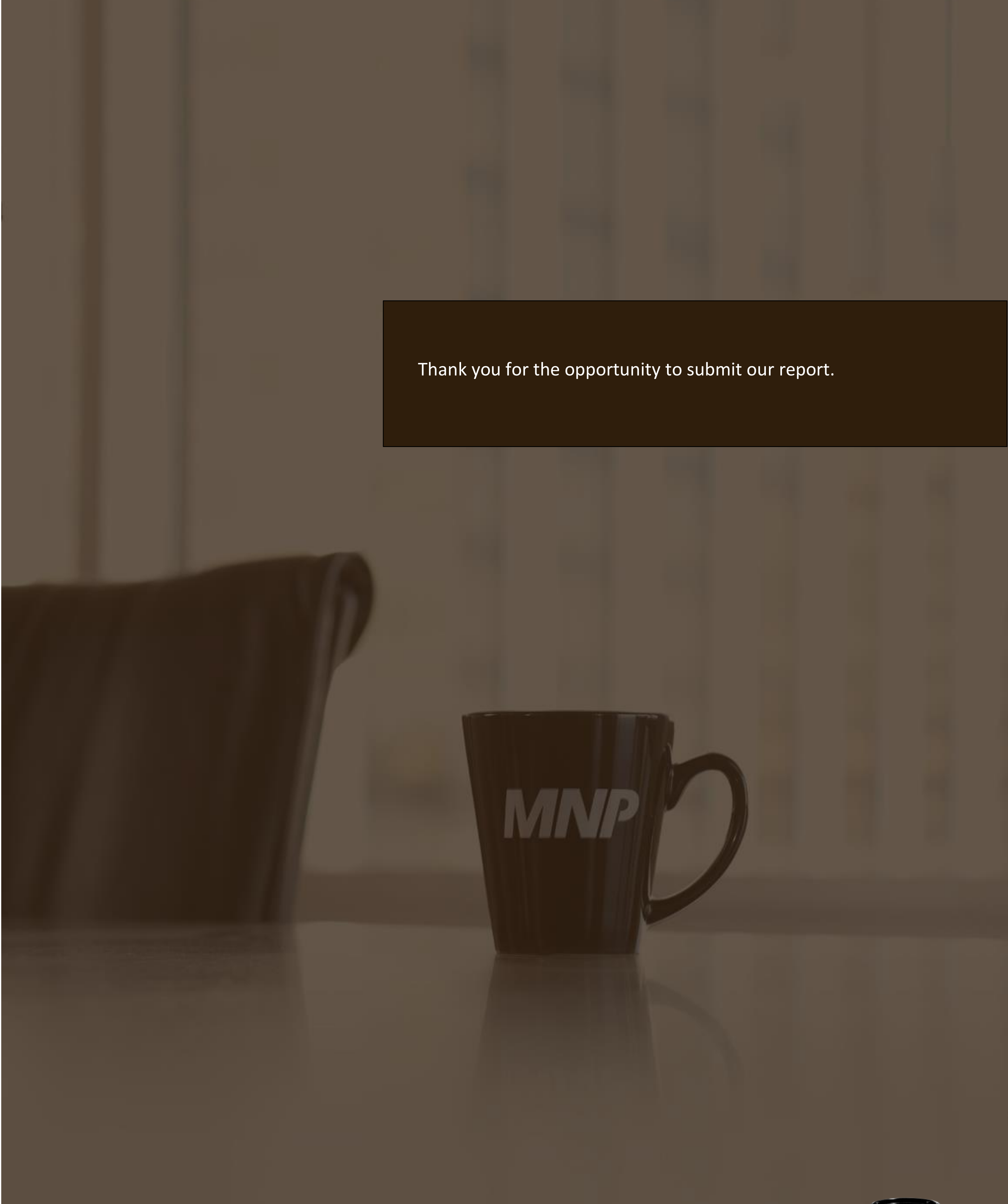
Partner, Tax Services	T: 780.832.4287	E: kim.drever@mnp.ca

Kim is a Partner and the Regional Leader of MNP's Tax Services group for the Peace Region. Working out of Grande Prairie, Kim helps clients of all sizes throughout the region by delivering innovative tax, structure and reorganization solutions tailored to their specific needs.

Working one-on-one with her clients, Kim delivers strong advice and guidance that helps clients with Canadian corporate reorganization tax planning. She plans appropriate business structures while preserving wealth and ensuring the family needs are considered. In addition to internal reorganizations and succession planning, Kim assists in tax and structure planning for purchase and sale of businesses. She has experience with businesses in a broad range of industries, including oilfield services, forestry, construction, hospitality, agriculture and professional practices.

Kim develops and delivers tax education throughout the firm to MNP's specialty tax group and its partners. She also speaks to numerous business groups and is invited to participate in tax or financial panels for conferences. Kim has presented at the Canadian Tax Foundation Prairie Provinces Tax Conference and tutored with CPA Canada for advanced tax courses.

Kim holds the Chartered Professional Accountant (CPA) designation, qualifying as a Chartered Accountant (CA) in 2001, and graduated Beta Gamma Sigma with a Bachelor of Commerce from the University of Calgary in 1999. Kim is involved in her community, previously serving as co-chair Finance for the Arctic Winter Games 2010 and currently the chair for the Grande Prairie Regional Hospital Foundation. She is also a member of the MNP Tax Executive Committee and is a Director on the MNP Board.



Thank you for the opportunity to submit our report.