

Kingston Advocacy for Small Business

August 29, 2017

Mr. Mark Gerretsen
Constituency office
841 Princess Street
Kingston, Ontario
Canada
K7L 1G7

Dear Mr. Gerretsen,

Re: July 18th, 2017 Proposed Tax Reforms

We write in response to the July 18th, 2017 tax reforms that have been proposed by The Rt. Honourable William Morneau. As a group of Kingston business advisors, we are deeply concerned that these tax reforms will negatively affect a significant number of family business owners in Kingston and the surrounding area. Accordingly, we would like to schedule a meeting with you in September to discuss the proposals. We regret the short notice; however, The Honourable Minister has given Canadians only 75 days to respond to the proposed tax reforms.

We are concerned that our elected representatives in parliament may not have a complete picture of the impact these reforms will have on family businesses. Our concerns have been magnified by recent correspondence we have seen from other MPs to their constituents.

Collectively, we agree with the government that some tax reforms are required. We request, however, that the government not rush into law these proposals that have been hastily assembled without an adequate consultation period or public debate. These proposals have significant impacts, far beyond their stated objectives. It is our view that the legislation will cause considerable uncertainty in the administration of the Income Tax Act, expose families to significant levels of double (or even triple) taxation, retroactively destroy years of family business retirement planning, and encourage our family businesses to be sold to public corporations rather than be passed on to the next generation of entrepreneurs.

As our elected representative for Kingston and the Area we are asking that you slow down this process and let us rethink such comprehensive tax reform as a collaborative group across Canada.

It is worth repeating that if our elected officials do not pause at this critical juncture, we believe that these proposed new rules will cause significant and irreparable harm to family businesses across Canada.

In advance of our meeting, we would like provide you with some additional feedback.

Lack of Awareness and Transparency

We have found that the public and business owners are largely unaware of the proposed changes and their likely impact on small businesses. The Minister issued the discussion paper at a time when many Canadians were focused on summer vacations. Moreover, the Minister has severely hindered any chance of the public understanding the proposed legislation by restricting discussion to a 75-day summer-time consultation period. We question whether even the MPs who will vote on this proposed legislation have had an adequate period of time to read and understand the effects of the changes.

The last major tax reform, which occurred in 1972, was preceded by a 6-volume report that was issued in 1966. The tax changes proposed today constitute some equally significant tax policy reforms; the public deserves significantly more than 75 days for meaningful consultation. We believe it is reckless to implement tax reforms without studying all the related consequences and by not consulting with taxpayers and the tax community. *For all of these reasons, we are asking you to slow this process down.*

We also believe that the message being conveyed by the Department of Finance is inconsistent with the likely impact of the reforms. The proposed changes, if implemented, would provide significant disincentives to start and grow family businesses in Canada and reduce employment opportunities for Canadians.

Finally, we believe the tax reforms are misguided as to who they are targeting. The Department of Finance has communicated to Canadians that they are targeting the 'one-percenters'; however, this legislation will affect all family businesses. You can tell when you walk down Princess Street that the majority of businesses in Kingston that will be caught by these rules are not among the 'one-percenters'.

Are the Owners of Our Family Run Businesses Tax Cheaters?

Business owners who work hard, are honest, and are valuable contributors to our community are *not tax cheaters*. The Department of Finance has unjustly alleged that small business owners are 'not paying their fair share of tax' and are taking advantage of 'loopholes' in the tax system. However, business owners did not create the income tax system. Small business owners who split income with their

spouses from the income of their family businesses do so through **legitimate** means of tax management. Specifically, 'income splitting' is an example of this as ruled by the Supreme Court of Canada in the case of Neuman (1998). The Supreme Court of Canada stated:

"Since the distribution of the dividend is not determined by the quantum of a shareholder's contribution to the corporation, it would be illogical to use contribution as the criterion that determines when dividend income will be subject to S. 56(2)".

The Imminent Decline of Family Business

If the proposals are implemented in their current state, various experts have shown that family business owners could pay 73% or more of their firms' value in tax upon death. Would you be motivated to start a business if you knew the government would leave your loved ones with only 27% of your assets after you pass away? Can a family business survive after the death of its owner if it must somehow raise 73% of its value in cash to send to the Canada Revenue Agency in taxes?

Even worse, these proposed tax reforms make it much simpler and more tax efficient to sell a family business to a third party than to one's own family. If a family business owner wants to retire, they can sell their business to a third party (think large public company) at a top Ontario marginal tax rate of 27%. Comparatively, if that same owner were to sell that family business to descendants, the effective tax cost to the family would be at least 39% - 45% on that same sale. Thus, the proposals create a significant tax disincentive to continue any family business.

We believe that discouraging family businesses from transitioning within the family is bad for communities across Canada. Moreover, the timing of this policy change could not be worse as we enter the largest period of intergenerational transfer of family businesses in Canada's history. As advisors to our local businesses, we can tell you that these tax reforms during this period of intergenerational transfer of family businesses will have a detrimental impact on our community.

The Retroactive Destruction of Family and Business Financial Plans

Imagine that you have operated your business for 30 years within the income tax framework created by the government. Tax laws have evolved and you have employed legitimate tax planning techniques that have been available for decades to properly structure your family finances in preparation for retirement. You've never considered yourself a tax cheat because the tax laws specifically permitted your planning. Indeed, the Canada Revenue Agency and the courts confirmed its legitimacy. Now imagine that when you are just about to retire, the rules are suddenly changed in a manner that unwinds everything.

Decades of retirement and succession planning are left in shambles and suddenly a substantial hole is created in your family finances. This is the situation that would befall many family business owners if the proposed reforms were enacted. Does this sound like 'tax fairness'? Will Canadians feel confident in their tax system if they see that the government is willing to change the rules of the game, just before the game is about to end? Is it fair that employees who have company pension plans or saved for their retirement through registered pension plans can 'split' their income with their spouses under legislated pension income splitting rules, yet business owners who saved for retirement through their companies cannot? Does this sound like a double standard or 'tax fairness'?

The lack of transitional rules for the proposed legislation is particularly punitive to family business owners. Finance had previously announced that it was 'looking into' possible tax changes and would issue a 'discussion paper' for consultation. No one was expecting the immediate and retroactive nature of the proposed legislation.

Other proposed tax reforms are retrospective in effect, including impacts to the capital dividend account, which we can describe further to you when we meet.

The Decline of Taxation Certainty

The proposed reforms are complex and layered with "reasonableness" tests. A dividend would be subject to the highest rate of tax unless it were 'reasonable' in the circumstances. A tax-free capital dividend would be denied and converted to a taxable dividend if it were 'reasonable' that one of the reasons for triggering a capital gain was to remove money from the company. From whose values and perspective would we determine what is reasonable in such situations?

This vague legislative approach will increase the cost of families conducting business and increase uncertainty for all business owners.

We also think that the proposed tax reforms will be nearly impossible to enforce for the Canada Revenue Agency without years of court cases defining what parliament intended when it implemented a 'reasonableness' test.

It is generally agreed that it is bad for the economy when government policy creates uncertainty. These laws would do this.

In summary, we are advocating for *simpler* tax laws even though we earn a living from helping clients navigate *complexity* in tax legislation.

We look forward to engaging in constructive dialogue with you on these critically important matters for family businesses in Eastern Ontario and across Canada. In the meantime, we ask you to take our message to Ottawa: **Slow down and let's make sure the tax reforms only impact the specific areas of concern identified by Finance. We can rethink the tax reforms together**, to ensure Canada remains a model for tax fairness and prosperity in the global economy.

We will coordinate with your office manager to set up a meeting time to discuss these points.

Yours faithfully,

Dan Coderre
Colleen Lawrie
Peter Tobias
John Crouchman
Lisa Asbreuk

Karen Sands
Daniel Thornton
Eric Bennett
David Doyle
Jason Skilnick

Jonathan Warren
Patrick Legresley
Angela Brown
Len Anderson
Jeff Hanley

Sean Tait
Peter Gibson
Jennifer Sims
Scott Kehoe