The Canadian Private Corporation Tax Proposals – Part Deux

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The media frenzy and uproar over the July 18, 2017 tax proposals that had been routine throughout the summer and early fall has quieted down significantly ever since Minister Morneau's "Santa Claus" week of announcements in October (we have previously written about these announcements). Does this mean that the tax and business community are satisfied with the announcements and agreed with the government that it has "listened" to the concerns? Hardly. The simple fact is that we are patiently waiting for more information to be released. There is a limit to the number of times people like me can write biting arguments that the bulk of the private corporation tax proposals should be dropped without the audience being fatigued. Accordingly, the community is waiting for something substantive to comment on.

Having said the above, it's been interesting to read and listen to some of the comments from the current government since Santa Claus week. Some of the comments are paraphrased below:

1. *Letters from Liberal MPs* – I've read a number of letters from Liberal MPs to certain constituents that effectively state, "*we listened and we got it right*." Such statements by Liberal MPs show a complete lack of understanding of the complexity and pervasiveness of the private corporation tax proposals. It also shows that they do not understand the process that we are currently experiencing. We are currently awaiting "V2" of the "income sprinkling" draft legislation that was promised during Santa Claus week—more on that below. In addition, we await more details about the passive investment proposals that the government committed to and for which further details won't be released until the 2018 federal budget. Again, to say that "*we got it right*" displays a complete lack of empathy for the process and overall uncertainty that the tax and business community is currently experiencing. Uncertainty is never a good feature to have when trying to start and run businesses. Canada, overall, suffers.
2. *The 73% tax figure is apparently "phony"* – there have been a number of Liberal MPs that continue to state that the 73% tax rate that has been often discussed (slight variation depending on which province you are a resident of) is "phony." Such a tax rate is a flow-through result that will ultimately be payable by Canadian-controlled private corporations ("CCPCs") and their shareholders—combined—if they are subject to the new taxation regime for passive income realized by such CCPCs. Such a result is real, and, in my opinion, completely unfair. To suggest the tax result is phony again displays a complete lack of understanding of the private corporation tax proposals.
3. *The private corporation proposals will only affect 2.5% of CCPCs* – this statement has been trumpeted by various supporters of the passive investment proposals and discussed by the Parliamentary Budget Officer's analysis (we wrote about the PBO's analysis here). I have real difficulty with this statement. Would it be palatable to state: "*The disability tax credit is only available to 3% of the population who is disabled, therefore we're going to get rid of it*." Of course not. That would be a ludicrous statement assuming that having the disability tax credit in our tax system is good tax policy to begin with. Accordingly, to support a flawed tax policy—the passive investment tax proposals—by stating that only a small number of taxpayers will be affected is

ludicrous. The proper analysis should be: a) is this good tax policy?; b) who will be affected?; c) will there be behavioural responses from the affected parties? If so, what will the impact of the behavioural responses be?

4. *We reduced the tax rate for CCPCs!* – the bragging about the reduction of the tax rate is frustrating for a number of reasons. First, tax rates were never part of the discussion about the July 18, 2017 tax proposals. It is obvious that the tax rate reductions were used as a distractor and sweetener to try to quell the storm. Such reductions compound some of the issues that appear to have been the impetus behind the July 18, 2017 proposals. Further, because of Canada's integrated tax system, a tax reduction for CCPCs on the first $500K of active business income earned in Canada will be accompanied by an increase in the non-eligible dividend rate. This represents a very real tax increase to all of the retained earnings of a private corporation earned prior to the tax rate change—so tough luck for any CCPCs that have not paid out all historical earnings prior to the end of 2017. Such an increase was announced—via a footnote—but the Liberal MPs seem to conveniently forget that fact when they triumphantly announce tax rate reductions.

Finally, as I write this, the government has still not released V2 of the "income sprinkling" draft legislation that they intend to become effective January 1, 2018. When the government announced during Santa Claus week that they intended to release V2 "later this fall," I was cynical and told some of my colleagues that they would release it very close to December 21, 2017. I was not serious and was optimistic that V2 would be released with plenty of time to enable the tax and business community to absorb such changes so as to enable affected parties the limited ability to plan their affairs before January 1, 2018. It appears that my cynicism was not unfounded and that we are living in déjà vu land. As a reminder, the private corporation tax proposals were released under a flurry of rhetoric when a significant chunk of the business community was trying to slow down for summer. Now, V2 appears ready to be released during a similar period immediately before the Christmas holidays that will leave affected parties very little, if any, time to plan. Merry Christmas.

In 1993, the sequel to the 1991 movie of Hot Shots was released under the title of Hot Shots – Part Deux. Such a release contributed to the urban dictionary definition of "Part Deux" being "*a superficial, unnecessary, or overly bad sequel to a classic film.*" Well, the July 18, 2017 "income sprinkling" and other private corporation tax proposals were certainly classic *something*. Let's hope Part Deux is not a superficial, unnecessary or overly bad sequel to the classic. Canada deserves a much better process to introduce tax reform so as to reduce the uncertainty that we have lived with for far too long.