Kingston Advocacy for Small Business ("KASB")

Executive Summary

of Submission to the Department of Finance Regarding July 18th, 2017 Tax Reforms

Kingston Advocacy for Small Business (KASB), which is made up of 59 professionals and business academics in Kingston, Ontario, has prepared the attached detailed submission to the Department of Finance, in response to the request for comments on the proposed amendments to the *Income Tax Act* (Canada) (ITA) published by the Department Finance on July 18, 2017 (Proposals).

This Executive Summary is qualified in its entirety by the detailed submission attached. Readers are urged to review KASB's entire submission.

KASB's purpose is to educate and inform our community and small business owners about the possible impact of the proposed tax reforms. The following summarizes our common view:

"We think the government should slow down this process and we encourage a comprehensive review of our tax system. We think some of the policy objectives have merit but that the proposed tax reforms will have many unintended consequences that will negatively impact small businesses and therefore, our communities. This does not mean we are saying there will be harm in all situations, but in enough situations, such that the proposed tax reforms should not be passed until there is significant consultation with Canadians."

KASB has the following summary comments and concerns about the Proposals:

KASB believes the proposed tax reforms will:

- Result in increased complexity
- Result in increased uncertainty
- Be retroactive 'in impact'
- Result in increased compliance fees and tax

Specifically,

More Time Required: Recognizing their scope, complexity and potential harm to small businesses, a responsible review of the Proposals demands more time for consideration and consultation. We submit that none of the Proposals should become effective until at least January 1, 2019, and that appropriate transitional provisions be included in the ITA to mitigate the harm to small businesses in the transition from the current, long-standing provisions to the new provisions.

Target Wealth, not Income: If the intended policy objectives are to target the "richest Canadians" only, we propose the government consider changes that target 'wealth' rather than the proposed reforms that target 'income'. Using an 'income' tool while targeting 'wealth', means that the tool cannot help but miss some of the time.

Increased Complexity and Costs: The ITA should be reformed and simplified. Despite this, the Proposals create more complexity and uncertainty. The inclusion in the Proposals of more than 20 new "reasonableness" tests will increase compliance costs and professional fees for small businesses, and result in costly tax litigation to clarify what is and what is not reasonable in any given circumstance. In many cases small businesses will not be able to determine with any certainty whether their payment of dividends or other annual distributions will comply with the ITA.

Unfair Treatment of Estates that own Private Companies: The current provisions allow for capital gains treatment for the disposition of shares by the estate of deceased private company shareholder, a tax result comparable to that achieved by the shareholder selling the same shares to an unrelated third party. Under the Proposals, the lowest rate that could be achieved is the dividend rate, which is about 18% higher than the capital gains rate, but only if the required steps are completed by the shareholders' estate within one year of death. If, as is often the case, the required steps cannot be completed within one year of the shareholders' death, the Proposals would impose a 72% rate of tax, in many cases assuring the closure of the business. Even a 45% dividend rate creates significant cashflow strain on a family business such that many businesses will be forced to sell to a third party; However, if no such buyer is available, a business will simply close.

Disincentive to Keep the Business in the Family: The proposed tax reforms make it disadvantageous to sell your company to your family and encourage a sale to a third party. If the changes to Section 84.1 of the ITA contained in the Proposals are implemented, families will have a strong tax incentive to sell their businesses to unrelated to third parties instead of keeping small businesses or farms in the family on retirement. Under the Proposals, the lowest rate that could be achieved is the dividend rate, which is about 18% higher than the capital gains tax rate, Again, this creates significant cash flow strain on family businesses and this will be destructive to the Kingston economy and the Canadian economy at large.

Retroactive in Impact: KASB believes it is unfair to change laws in a manner that unwinds years of tax planning and to do so, in the family business context, will cause irreparable harm to business successions. At a minimum, any proposed reform should be drafted without a 'retroactive impact'.

Differing Retirement Treatment: If the Proposals are implemented, income splitting will continue to be available to holders of pensions when they turn age 65, but not to some shareholders of small business corporations. Further, this change announced on July 18th, 2017 would have the effect of unwinding years of retirement planning and therefore, is retroactive 'in-impact'. Further, it is important to recognize that small business owners need to keep cash flow in the business and cannot simply save through a RRSP. Business owners also need to save for their maximum life expectancy, with their retirement funds subjected to the continued risks of their businesses. Small business owners will be further disadvantaged relative to the advantages of pooled investment, employer contributions, and where some people have the ability to save through a pension for only their average life expectancy of the pension holder.

Middle Class Small Business Owners will be impacted: KASB has demonstrated in its submission that the proposed tax reforms do impact some small businesses that earn $73,000 annually. It is important for the Department of Finance to communicate this to small businesses so that they are aware if the proposed laws are enacted.

Negative Impact on Capital Dividend Account: KASB strongly recommends that life insurance policies not be impacted by these proposed reforms given for some businesses the planning has been in place for decades (e.g., to use CDA to help in buy-sell arrangements). KASB also strongly recommends that these proposals first, be limited to transactions occurring after July 18, 2017 and, second, that it be made clear that the CDA will remain for gains created by arm's length sales.

Passive Income Consultation-Disadvantaging CCPC's vs Public Companies: The elimination of RDTOH would result in a 50% corporate tax rate on passive income for a CCPC vs only a 26.5% tax rate for public companies. Why would our tax system tax CCPCs and ultimately their shareholders at a higher tax rate than public companies and their shareholders? Further, eliminating the capital dividend account for corporate level capital gains would create significant double-tax in certain scenarios.