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Business Tax Overhaul Series

Tax Fairness: Learning about apples and oranges from local farmers

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Next week, on October 2nd, the brief 75 day consultation window for the largest private corporate tax overhaul in decades will close. When the tax overhaul was first announced, numerous accountants and lawyers (including WV LLP) quickly raised the alarm. Soon thereafter, other professionals also raised concern. Most recently, farmers and their representatives have expressed dismay. Under the proposed changes, farmers (and other small and midsized business owners) may face a tax rate in excess of 70%. There are also serious concerns about the ability to pass the farm on to the next generation if these proposals go ahead. Indeed, it will likely be more economical to sell the farm to a stranger. So how did we get to a point where Prime Minister Trudeau is spending his weekend driving a tractor to win over farmers and trying to calm angry remarks at town hall meetings?

We have been told that the purpose of this overhaul is to address so-called loopholes and to create tax fairness. Indeed, since these changes were announced, Finance Minister Bill Morneau has tweeted #taxfairness and #équitéfiscale over two dozen times. According to Morneau, while the Act is designed to “help businesses grow”, it is being used to “shelter personal income from tax”, resulting in an inequality. Essentially, the government’s position is that it is unfair for business owners to have more tax strategies available than employees. As a result, the government is proposing eliminating or substantially limiting the following tax planning options: 1) Income Sprinkling (where dividends are paid to one or more of the business owner’s family members or to a trust); 2) Holding Passive Investments Inside a Private Corporation; and 3) Converting Income to Capital Gains. In regard to income sprinkling, on the go forward, any dividends paid to a family member would have to pass a “reasonability test”. If the test is not met, then the dividends will be subject to the Tax on Split Income (TOSI), and thus the amounts would be subject to the highest marginal rate of taxation. So isn’t that fair? Why should business owners get to reduce their income tax with “sprinkling”, when employees can’t reduce their income tax with splitting?

The problem with comparing business owners to employees is that it is akin to comparing apples to oranges. Unlike employees, business owners have to be ready to deal with the highs and lows of business. To be ready for the highs (that may require an expansion or new equipment) and to be ready for the lows (that may require money to keep the company afloat), smart business owners keep some earnings within the company, ready to be re-invested. If the hard times bring about the end of the business, then the business owner faces the loss of all that they have worked for. In addition, the

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business owner may be personally liable for the business' outstanding obligations, including any outstanding taxes and any unpaid employee wages. Further, consider some of the perks that employees get that are not available to business owners: paid sick days, paid vacation days, paid statutory holidays, termination/severance pay entitlements, and EI coverage for maternity leave, parental leave, sick leave, and unemployment.[1] One of the best perks that many Canadian employees receive is a pension. If we look at most public-sector pension plans, we see that the pension is safe in recessions and is, in effect, inflation proof. Indeed, a civil servant can retire after 30 years of service with a pension worth more than $1.1m. And this pension comes as further compensation, on top of a generally competitive salary. If the so-called income sprinkling is unfair, then why are employees able to qualify for sharing up to 50% of their pension income with their spouse or common-law partner? Further, why can the spouse of an employee receive a portion of the employee's pension upon their death?

A fair tax system is not one that treats business owners and employees as the same. They are apples and oranges. The country's farmers know. That does not mean that the Income Tax Act is without need for improvement. But if we are going to make substantial changes to the Income Tax Act, these changes should be made after a proper consultation with the experts and with a reasonable amount of time to review the tax consequences. If you have not done so already, please take the time to contact your local MP and express your concern. Or sign one of the numerous petitions imploring the government to extend the consultation period. Tax fairness is a noble goal, but let there be no confusion, these proposals do not create tax fairness.

[1] However, it should be noted that self-employed individuals may be eligible to enroll in the EI Special Benefits program. There is, though, no unemployed EI benefits under it and to receive benefits the individual must have been enrolled for at least a year (along with other restrictions).