And Now For the Rest of the Story: Tax Reform 2017

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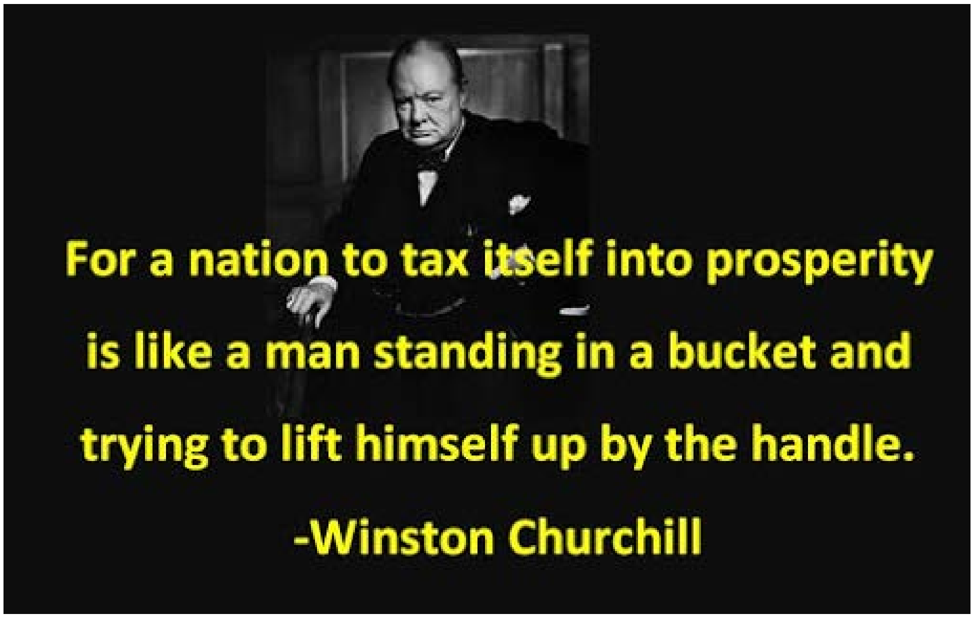

You could always count on Winston Churchill to come up with the right few words to make his point.

A few weeks ago, we published a newsletter about tax reform legislation proposed in a white paper released by the Liberal government on July 18th, 2017. At the time, we wrote that income splitting would be prevented and tax rates on passive income inside private corporations would rise for income earned after January 1st, 2018.

Since then, we have learned "the rest of the story" as Paul Harvey would have said. We now know that a more literal interpretation of the proposed legislation would make matters considerably worse than we expected. Specifically:

- Retroactive changes to corporate tax credits such as the Capital Dividend Account (CDA) and Refundable Dividend Taxes on Hand (RDTOH) could result in combined corporate and personal taxes on corporate investment income of up to 71%, which is an increase of approximately 45% (from an average rate of 49% in B.C.).
- The new rules could be in effect as of July 18, 2017 or, as suggested above, earlier if made retroactive. This means that business owners would have no time to prepare

for the pending tax changes, nor be "grandfathered" from rules which they had relied on from tax code enacted decades ago.

In addition to all of this, we have done some research on taxes and benefits for self-employed owner-managers / professionals, as well as employees who are entitled to significant tax benefits from defined benefit pension plans and extensive health benefit programs that, in some cases, last well beyond retirement.

Start with the Facts: Who are the 1%?

First, some facts worth noting (for the record, the sources of the information below include both the CBC and Statistics Canada and so are not funded by libertarian think tanks who believe all taxes are a form of robbery):

- There are more than 1,200,000 private businesses in Canada and more than 98% of them are considered small (less than 100 employees).
- Last year 115,000 new businesses were created, but more than 100,000 failed, which shows just how risky starting and maintaining a private enterprise is. The chance of surviving five years is less than 20%.
- 2,700,000 Canadians are self-employed, including many professionals. That is 16% of all working Canadians, so obviously they cannot be all in the '1%.'
- Small businesses employ more than 5,000,000 Canadians, or 41% of the private workforce, and generate 42% pf private GDP.
- In the 2015 federal election, more than 130 members of parliament either lost their seat or retired. The Canadian Taxpayers Federation estimates that the value of their lifetime pensions is over $200,000,000, of which the MPs contributed about 8% (the other 92% was funded by tax payers). At the top of the list is one MP whose pension will be $130,000 per year indexed for life. The value of that pension based on today's annuity rates is about $2,600,000. This easily puts this legislator in the 1%. Let's compare this pension benefit to what an owner /manager of a private corporation can do.

    1. The funds in their pension accumulate completely free of tax. In the case of the private corporation, income is taxed at between 13% and 26% before it can be saved.

2. There are no taxes to be paid on the passive income earned inside the pension. The current tax rate on passive income in private corporations is almost 50% and the new proposed rules would increase that tax rate to about 71% when distributed to the private company shareholders.

3. The MP or civil servant can income split all of the pension benefits with a spouse. The proposed rules are designed to prevent all forms of income splitting for private corporations.

It is true that owners of private corporations can pay salaries to themselves and then buy RRSPs or, later in life, Individual Pension Plans (IPPs), to save funds in a tax-free environment for retirement. However, one has to consider all of the following:

- Often, owner-managers or professionals are in their late twenties or early thirties before they start to generate reasonable incomes, yet have major obligations to fund such as student loans, debts created to fund a business, etc.

- They are often responsible for generating sufficient revenue to cover basic expenses before they can pay themselves anything in the way of a salary, let alone accumulate funds for retirement. A civil servant starting their career at 25 years old will have fully funded their maximum pension by age 55 or 60 (usually based on their best five years' income and indexed for life), meanwhile a business owner may require many more years to accumulate the equivalent retirement funds.

  An RRSP/IPP combination cannot reasonably accumulate anything like the value of an indexed defined benefit plan over the time frame that professionals and business owners have to work with.

- Self-employed individuals fund 100% of their retirement savings, CPP contributions, and any health care / dental benefit plans. They are also not entitled to receive Employment Insurance (including maternity / parental leave benefits) and are usually not eligible for Worker's Compensation. Meanwhile, employees and civil servants receive these benefits partially or completely paid for by their employer.

In doing our research on this, we found another group that has not been targeted by the new Liberal proposals, but arguably has the best tax deferral benefits of anyone in Canada: CEO pension benefits from publicly traded companies in Canada. I believe the slide below says it all.

NAME	ORGANIZATION NAME	Total Pension obligation for CEO
Bradley Shaw	Shaw Communications Inc.	$105,870,010
Jeffrey Orr	Power Financial Corp.	$31,247,000
Brian Ferguson	Cenovus Energy Inc.	$27,638,957
Paul Desmarais, Jr. (3)	Power Corp. of Canada	$26,624,000
André Desmarais (3)	Power Corp. of Canada	$26,058,000
Paul Mahon	Great-West Lifeco Inc.	$24,468,655
William Downe	Bank of Montreal	$22,227,391
Nancy Southern	Canadian Utilities Ltd.	$21,330,030
Steven Williams	Suncor Energy Inc.	$20,810,979
Yvon Charest	Industrial Alliance Insurance and Financial Services Inc.	$20,200,575
Rich Kruger (2)	Imperial Oil Ltd.	$18,529,390
Al Monaco	Enbridge Inc.	$18,144,000
James Smith	Thomson Reuters Corp.	$17,818,540
Donald Guloien	Manulife Financial Corp.	$17,201,400
Russell Girling	TransCanada Corp.	$16,944,000
Louis Vachon	National Bank of Canada	$16,186,000
Darren Entwistle	Telus Corp.	$15,665,000
Christopher Huskilson	Emera Inc.	$15,376,000
Bharat Masrani	Toronto-Dominion Bank	$15,177,300
Sean Boyd	Agnico Eagle Mines Ltd.	$14,821,325
David McKay	Royal Bank of Canada	$12,762,000
Brian Porter	Bank of Nova Scotia	$11,854,000
Brian Hannasch	Alimentation Couche-Tard Inc.	$11,090,403

There are thousands of senior management and high ranking civil servants who are in the "1%" and eligible for pension and health benefits worth millions of dollars. In most cases, they are funding a fraction of the costs involved in providing these benefits.

One other benefit employees of public companies receive is stock options. These are effectively deferred compensation that, when realized, will be taxed at half the rate of regular income. A private business owner or incorporated professional cannot provide stock options to themselves in any practical way.

One last note, public companies have a general tax rate of 26% and that rate applies to passive income. That is about half the rate that private corporations pay in tax on the same income.

So what to do about all of this?

First let me say I am not particularly upset about the level of benefits provided to civil servants, legislators or senior management of public companies. What bothers me the most about these new proposals is the following:

- They suggest a level of unfairness that is simply not there.

- They purport to be taxing "the rich," when in fact they are attacking much of the working backbone of this country who are a major source of good paying jobs in Canada.

- The new rules were introduced in the middle of the summer with a completely inadequate 75-day period of consultation. Two generations ago, The Carter Committee was given four years to develop a new tax framework for Canada and the then-Liberal government took another five years to finalize reasonable legislation.

If tax reform is appropriate, then it needs proper analysis, input from all sectors of our economy, and above all it must be and be seen to be fair and evenhanded.

Below is a link to a template letter you should share with your MP that summarizes the key talking points discussed on this memo. Please make the effort to have an effective dialogue with your federal representative and voice your displeasure with both the proposed rules and the process by which they have been delivered. The Liberal Caucus meets in Ottawa on September 5th and Parliament resumes on September 18th. Ideally you would speak to your MP before the 5th.

I am generally not a political person, but this is something worth the effort of speaking out about. Let me leave you with this thought from an anonymous source:

"A fine is a tax for doing something wrong. A tax is a fine for doing something right."