

18 Lessons Learned from the Experience of the July 18, 2017 Private Corporation Tax Proposals

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Oh July 18...what a day!

It's the 199th day in the Gregorian calendar for non-leap years. Historically, July 18 is the [anniversary](#) to many events, including wars, disasters and birthdays/deaths of significant people. It's also the anniversary of many happy days including the celebration of [Nelson Mandela International Day](#).

But for Canadian small business owners and their tax advisors, July 18, 2017 was a day that most would like to forget. For the Canadian government, it was a day they chose to release a package of tax proposals aimed at a complete reform of how private corporations would be taxed. The proposals were released complete with a press conference and a Minister's letter that contained some of the most offensive rhetoric that Canadian small business owners and their advisors have ever seen.

What followed was a significant backlash by affected parties, a vigorous but non-sensical defense by the government and a retreat that encompassed a ("Santa Clause") week of staged press opportunities in mid-October 2017 and the 2018 Budget proposals that completed the retreat. Our firm has written a lot about these proposals over the past 12 months, including:

1. [July 18, 2017](#) – a quick summary of the proposals and our disappointment regarding the rhetoric;
2. [August 9, 2017](#) – "Income sprinkling" proposals and whether or not it was time to revisit family taxation instead;
3. [August 18, 2017](#) – the offensive rhetoric contained in the Minister's letter that accompanied the proposals;
4. [August 24, 2017](#) – the ongoing rhetoric and populist comments that Minister Morneau and other government members were making regarding the proposals;
5. [August 29, 2017](#) – proposals unquestionably harmed the so-called "middle class" Canadian;
6. [September 3, 2017](#) – our correspondence to Minister Morneau that discussed our concerns about the proposals;
7. [September 9, 2017](#) – regarding rhetoric by certain government supporters that attacked the taxation and foundational existence of family farms;
8. [September 13, 2017](#) – our firm's additional correspondence to the Minister;
9. [October 21, 2017](#) – summary of the "Santa Clause" week of announcements by the government that started the retreat from the proposals;
10. [December 14, 2017](#) – V2 of the "income sprinkling" proposals that had been released the day before;
11. [February 27, 2018](#) – the 2018 federal budget that contained the revised passive investment proposals;
12. [March 12, 2018](#) – reflections on the previous nine months and provided thoughts on go-forward strategies; and

13. [March 26, 2018](#) – V3 of the “income sprinkling” proposals

We also provided numerous presentations and other [information](#) to interested parties, all in an effort to educate people on the fact that these proposals – the revised versions of which are now law – would have a tremendous impact on them.

So, on the first anniversary of the release of the July 18, 2017 private corporation tax proposals, we provide to you our top 18 lessons learned and go-forward thoughts from this unfortunate debacle in Canadian tax history:

18. Major Tax Reform Should be Attempted with as Little Political Interference as Possible

This statement reflects my political inexperience since it is likely impossible to implement tax reform proposals without some form of political interference especially in today’s political environment around the world. Having acknowledged that, the Minister’s letter attached to the proposals contained some of the most offensive rhetoric that I have ever seen when introducing Canadian tax proposals. And the simple fact is that such rhetoric was not necessary. To be fair, the proposals contained some good policy tenets. However, the Minister’s letter was rightfully construed as an attack on small business owners and their advisors and such an attack clouded any good policy that the proposals contained. The letter was an obvious attempt to pander for votes to a select audience of left leaning voters. In my opinion, the letter was tasteless and it obviously contributed significantly to the backlash. The lesson: major tax reform attempts would be better introduced and implemented with sound policy arguments rather than political and ideological rhetoric.

17. Summer Time Releases of Major Tax Changes is a Bad Idea

The July 18, 2017 tax proposals represented an attempt at major tax reform. While there is nothing wrong with attempting to reform tax policy for the better, such reform should be an open and transparent process that attempts to engage all affected parties. Clearly, the selection of the July 18, 2017 date to release such proposals for “consultation” contributed to the significant backlash. Many business owners and their advisors were in holiday mode. Once educated about the proposals, such business owners and advisors were shocked at the fact that the government would attempt tax reform during the summer doldrums. This fact alone contributed to the mistrust and anger directed to the government during the backlash. The lesson: the government needs to be much more transparent in future attempts to introduce major tax reform.

16. Major Tax Reform Should Be Given Sufficient Time

The “consultation period” for the July 18, 2017 proposals was 76 days for affected/interested parties to respond. The last major tax reform was implemented in 1972 after the Royal Commission on Taxation – the so-called “Carter Commission” spent approximately four years studying before releasing its landmark report in 1966. After approximately six years of further study and debate, the recommendations formed the basis for 1972 tax reform. With that comparison, hopefully you can see the ridiculousness of a 76 day “consultation period”. The lesson: attempts to implement major tax reform should be done very carefully, involve ALL affected stakeholders (not just academics and government bureaucrats/politicians) and take the necessary time to “get it right”.

15. Facts Matter

The defense of the proposals by the government during the so-called consultation period was shocking.

Accompanied by propaganda released on the Department of Finance's social media channels and non-stop speaking points by the Liberal caucus, a lot of the defense contained factual errors. Our firm – and others – started tracking some of the errors. A review of this [list](#) still makes me cringe. Frankly, it's embarrassing. The government should have respected the integrity of the so-called "consultation period" by simply accepting comments rather than defending. The lesson: the government should respect the integrity of the "consultation period" for future releases of proposed tax changes by simply accepting comments rather than engaging in misguided defenses.

14. Engage Affected Stakeholders in Advance

Similar to the themes of the above, any attempts at major tax reform would be better received if affected stakeholders were engaged in advance of the release of any proposals. While it was clear that some academics and government bureaucrats had spent a lot of time on the July 18, 2017 proposals prior to its release, it was also quite clear that the government had not spent any significant time engaging with the business community and their advisors in advance. Instead, private business owners were subjected to a full-frontal attack with the rhetoric and proposals that would have turned their world in a mire of complexity (in addition to possibilities for double and triple taxation). No one likes to be negatively surprised or to put it more succinctly go from a world of order one day to world of chaos the next day. The lesson: to preserve order for affected stakeholders, the government should engage stakeholders transparently, honestly and well in advance of the release of any major tax proposals.

13. Complexity is the New Norm

The private corporation tax proposals contained some of the most complex and wide-sweeping proposals I have ever experienced in my tax career. While complexity certainly has its place at times, this was not one of them. Unfortunately, the amount of tax complexity introduced into Canadian tax law that affects private corporations and their shareholders has been tremendous over the last three years and it's my opinion that we have reached a tipping point. I recently wrote about tax complexity in a LinkedIn [article](#) that I published where I wrote the following:

While tax constantly changes – which requires qualified tax practitioners to constantly keep pace – the last three years has seen a flurry of changes that are both complex and cut a wide swath. Some of the recent examples in Canada are:

- 1. Subsection 55(2) amendments – such amendments (first proposed in 2015 and now law) require any inter-corporate cash movements be very carefully reviewed to ensure appropriate tax results. Such amendments are mind bogglingly complex and apply to all corporations – public or private, large or small – to comply;*
- 2. Small business deduction amendments – these amendments were first proposed in the 2016 federal budget and are now law. Such amendments apply to all Canadian-controlled private corporations where there is an intent to utilize the small business deduction. Such amendments are [extremely complex](#) and we are just now seeing – as our firm predicted – how general practitioners are struggling to comply with the rules; and*
- 3. The new "income sprinkling" proposals – the "Tax on Split Income" or "TOSI" rules which were first proposed in the July 18, 2017 materials released by the government. Such proposals have gone through three rounds of revisions and will likely be passed into law soon. Such rules are, again, mind bogglingly [complex](#). In my opinion, the average general practitioner accountant or lawyer will not be able to comply with these rules easily.*

There are other examples of introduced tax complexity over the last three years but the above is, in my mind, a tipping point in Canadian tax law. The three examples cover broad areas that general practitioner advisors for private clients (which is by far the largest audience which needs basic tax advice and assistance with tax compliance) could historically give good advice with minimal but adequate training. Now, the above subject matters and even the most basic areas – like shareholder remuneration planning – will likely need tax specialist advice on an ongoing basis in order to ensure compliance with complex tax law. In its March 8, 2018 submission to the Department of Finance regarding the TOSI proposals, the Joint Committee on Taxation of the Canadian Bar Association and CPA Canada had the following to say about complexity:

There is a time and place for complexity. Rules likely to apply primarily to multinational corporations, who can be expected to have access to sophisticated advisors can reasonably be complex and involved where necessary for their purpose. The TOSI rules apply in a context that could not be more different. Every single individual resident in Canada who receives or realizes an amount derived from a private corporation, partnership or trust will need to understand these rules in order to comply with the law.

Yep. Totally agree. In Canada's self-assessing tax system, the system has a high risk of breaking down if you need sophisticated tax advice for a large number of people in order to comply.

The lesson: The government needs to engage in a genuine attempt to simplify our taxation system. In the meantime, practitioners and taxpayers need to spend the time to learn complex new rules, develop strategies to minimize the consequences and align themselves with parties who can assist them.

12. There is a Significant Mistrust of Tax Advisors in Some Camps

During the private corporation tax battle, there was no shortage of politicians and academics (and some bureaucrats) who attacked tax advisors for “inappropriately” criticizing the proposals. Some even went as far to state that tax advisors were fear mongering. The easy thing for tax advisors would have been to dismiss such foolish commentary and move on. Upon reflection, my view is that such criticism reflects a significant mistrust of tax advisors. I understand that. However, most of the tax advisor peers that I know have a genuine concern for our country and to ensure that our tax system works for all. Of course, there are always bad apples amongst any group of people but by and large I can attest that Canada's tax practitioners are a proud, dedicated and hard-working group who simply want the best for our country and clients. The lesson: healthy debate is positive. Baseless attacks are not. It would bode Canada well to try to heal the divisiveness that occurred between tax practitioners and the “other camps”. Working together to get positive results for all is better.

11. Politics is an Ugly Game

Never before in my life have I been exposed to the underbelly of politics like that of the past 12 months. While I have always admired those in public office for their contributions to society – often at great financial and personal sacrifice – I certainly don't admire the purely partisan politics that was very evident during the private corporation tax “battle”. Whatever happened to politicians trying to understand legislative proposals and applying their own smell tests of whether or not such proposals are good for the country as a whole and to their constituents that they serve? While some of the Liberal caucus did apply such good standards, and had the courage to stand up and speak out, there were many who appeared to simply follow their “leader” and stick to non-sensical “speaking points”. The lesson: politics is an ugly game. While I'm certainly no political expert, “getting it right” appears to often be at the expense of “getting the vote”. Disappointing.

10. The Amount of Wasted Effort

When you compare the original July 18, 2017 proposals to what was ultimately implemented into law, you will quickly realize that what was implemented into law – with the exception of the “income sprinkling” proposals – is a mere shadow of what was originally proposed. Across the country, the amount of effort that was put into understanding, educating and battling the government on these proposals was unprecedented in my experience. Now think about the thousands of hours that practitioners and others spent on these proposals; there is no doubt that the efforts contributed to the watered-down law. But think about how such engagement could have been instead transformed into a positive effort rather than the negative experience that was. The hundreds of people across Canada who became engaged would likely be very interested in being involved in comprehensive tax reform...more on that below. The lesson: the amount of “wasted energy” spent on the July 18, 2017 proposals should be transformed into a positive comprehensive reform experience. Let’s not waste the efforts.

9. Class Warfare Has No Positive Place in Tax Reform

As mentioned earlier, the rhetoric contained in the Minister’s letter attached to the proposals was offensive. This government has engaged in numerous examples of “identity politics” since it has taken office. On tax matters, it has loudly and proudly trumpeted the “tax the rich” message. While certainly that message has been an effective vote getting tool, the private corporation tax proposals of July 18, 2017 took that message one step further by stating that small business owners were employing strategies at the expense of or at the detriment of “others”. Classic class warfare messaging. Again, I understand that politics will inevitably creep into tax policy and legislation but the blatant attack on such a prominent and important group of people – the job creators of this great country – was a disgusting, unnecessary and regretful tactic deployed by our government. The lesson: tax policy and reform should involve all Canadians and not deploy divisive class warfare tactics that do nothing but pull at the seams of the fabric of this great country.

8. Certain Government Bureaucrats are Worth Their Weight in Gold

I certainly don’t hold this view of all civil servants. But the people at the Department of Finance Tax Policy and Legislative Branch – for the most part – are some of the hardest working and dedicated people that I have ever experienced in government. Most appear genuinely interested in working with the tax community to “get it right”. While such bureaucrats have their political masters that they must answer to, there is no doubt that they have some ability to influence tax policy/legislative decisions to get it right. There are always certain exceptions, but Canada is very fortunate to have such dedicated people that care. During the private corporation tax battle, such bureaucrats were always willing to receive commentary or answer questions in a non-political environment. The lesson: a strong, dedicated group of tax policy/legislative bureaucrats makes our country stronger.

7. Academic Policy Should Not be the Sole Influencer of Tax Policy

The original passive investment proposals were a mess. Had they been fully implemented; such proposals would have resulted in a punitive tax regime that could have resulted in tax rates on passive income exceeding 70% on a flow-through basis for private corporations and their shareholders. Government tried to prove its case – with many academics jumping in to support the government – with spreadsheet analysis that “proved” the proposals. In my view, this is a classic example of someone who might know how to fix a car (because he/she studied it for years and has become an “expert”) vs. someone who has also studied mechanics but more importantly has hands-on experience fixing cars for years. In other words, experience matters.

If implemented, the original passive investment proposals would have had a devastating impact on the entrepreneurial spirit and contributed significantly to destroying the very foundation of Canada's historical success. Entrepreneurs take significant risks that are very different than those of employees that can only readily be described with experience. As an analogy, I often chat with first time expecting parents and express my happiness for them. I'll often say to them: *"I know that many people have told you this already, but your life is going to change but no matter how many times people tell you this, you won't know what that means until you hold your new baby for the first time"*. Parents, can you relate to this? If so, then that is what being an entrepreneur is like. You can't exactly relay the experience, risks and rewards to a non-entrepreneur. They have to experience it to truly understand it. The lesson: the spreadsheet analysis of the passive investment proposals used to support the proposals displayed a complete lack of understanding of being an entrepreneur. Like a long-time parent chatting with parents-to-be, trust me, such proposals would have been devastating.

6. Tax Awareness

Tax is one of those topics where many people have opinions but many such opinions often lack technical substance. As an example, I first experienced this years ago when some of my friends used to say: *"I don't like working overtime because the tax I pay is more than the money I make"*. I quickly realized that this was hogwash but over time realized that such a myth was pervasive. Over time, I would be the fellow that hung out at cocktail parties contributing to tax discussions where the discussion was lively but the opinions often lacked technical correctness. The private corporation tax proposals were like that to a certain extent. For a period of time from about August to October 2017, there wasn't a day that went by where the media was reporting on the proposals. While some of the articles were simply wrong or contained opinions that I didn't share, it was a great time for the profession where tax policy discussion was more than just at a cocktail party level. In other words, awareness was high. It continues to be high notwithstanding the substance of the battle is now over. Awareness is always a positive and for tax policy it is great that the public was engaged like it was. However, as the old saying goes, the battle may be over but the war for good and fair tax policy is not done. The lesson: engaged and broad awareness on important tax policy matters affecting our country is positive.

5. Canada Needs Comprehensive Tax Reform

What became apparently obvious during the last 12 months is that many parties are seeking comprehensive tax reform. For over 10 years, Canada's tax practitioner community has been calling on government to engage in another comprehensive tax review – like the 1962-1966 Royal Commission on Taxation – instead of limited form reviews which have been undertaken over the years. However, it now appears that many other parties – such as many of Canada's tax and economic academics, government bureaucrats, politicians, business owners and the non-profit and charitable sectors are all interested in engaging in comprehensive tax reform as well. The lesson: the government of Canada should put politics aside and use this opportunity to engage all stakeholders and implement another "Royal Commission on Taxation" for the betterment of our country. It's time.

4. "Surplus Stripping" has the Government Annoyed

For Canadian tax practitioners, this is not a surprise. For years, any attempt by a private corporation shareholder to convert an otherwise dividend receipt from a corporation into a capital gain is often attacked by the government. In many cases, rightfully so. The private corporation proposals attempted to stop all forms of "surplus stripping". While one can sympathize with some of the policy intent, the proposed "fix" was an unbelievable mess that would have effectively resulted in retroactive taxation. In addition, such proposals would have very negatively applied to many vanilla commercial transactions.

During the October 2017 “Santa Clause” week, the government rightly abandoned the surplus stripping proposals. Does this mean that the government has “given up” on its dislike for surplus stripping and the open season for business owners and their advisors to deploy surplus stripping strategies? Hardly. There is a lot to do to curb abusive surplus stripping while also ensuring that existing law does not negatively affect inter-generational transfers comparatively. The lesson: more work needs to be done in this area. Ideally, tax practitioners and others would work closely with government bureaucrats and the politicians to “get it right”.

3. The Rules for Passive Investment Income Realized by a Canadian-controlled Private Corporation Have Changed Significantly

While the new laws surrounding this area are certainly not as devastating as they could have been had the original proposals been adopted, the landscape has still changed dramatically. Affected parties will see reductions to the small business deduction which could result in effective tax rates on their passive income exceeding 100%. In addition, as a result of changes to the refundable dividend tax on hand regime, old rules of thumb about how surplus pools should be accessed have changed. A good friend of our firm – Jay Goodis of Tax Templates Inc. – has documented his thoughts by way of a short [video](#) presentation on how such surplus pools should be accessed in light of the new passive investment rules. I’d encourage practitioners and business owners to take the short time to watch Jay’s presentation. The lesson: old rules of thumb when dealing with passive income earned by a Canadian-controlled private corporation have changed dramatically; take the time to understand them carefully and adjust course as necessary.

2. The TOSI Rules are Complex

Continuing with the complexity theme of above, the TOSI rules are horrendously complex. Our firm developed a “simplified” [flowchart](#) which attempts to distill down the legislation to something understandable but even this simplified version is complex. While the new law is certainly an improvement over the original July 18, 2017 proposals, the simple fact is that most general practitioner advisors to private business owners will not be able to give good advice in this area unless they seek specialized tax advice. Even tax specialists such as me struggle with this legislation. Every fact pattern must be very carefully considered. Not good. The lesson: while complexity is the new norm as stated above, business owners and their advisors are left with no choice but to accept such complexity and deal with it as best as they can.

1. Working Together Works!

While this is not a new proposition, it was very satisfying to get to meet like-minded tax professionals, economists, academics, business owners, politicians, industry advocates and others who very quickly recognized that the July 18, 2017 private corporation tax proposals were a mess with potentially devastating consequences. Loud voices quickly formed with education to affected parties being the primary objective. It’s amazing how many smart and dedicated people there are in Canada who care and are not afraid to speak up for the betterment of Canada. The lesson: never be afraid to speak up and work together for the betterment of all.

Well, there you have it. My top 18...not necessarily yours. A tip for the government for the next time it wants to try and release proposals that would result in major tax reform: you might want to pick a day other than the anniversary of the start of the [Great Fire of Rome](#) of 64 AD that destroyed much of Rome.

Just saying ?.

