

<u>Myths / Comments</u>	<u>Facts</u>
1. <i>"...our Government is taking steps to....close loopholes.....that are only available to some....".¹</i>	1. There is no such thing as tax "loopholes". Such a phrase is used to influence people who do not have an appreciation of the complexity of tax law. ² Taxpayers have relied upon existing law dealing with private corporations and their shareholders for almost 50 years. ³
2. <i>"And it starts by making sure that we all pay our fair share of taxes – with no exceptions."⁴</i>	2. There is no "fair share". Each taxpayer needs to comply with existing tax laws. No more, no less.
3. <i>"To clear some things up: 1) #TaxFairness changes would only take effect going forward."⁵</i>	3. False. The proposed legislation for the "dividend to capital gains conversion rules" require consideration of transactions pre-July 18, 2017 that will cause, in many cases, the appearance of tax as a result of such historical transactions. That is, in effect retroactive / retrospective taxation. ⁶
4. <i>"If you are investing profits back in your business or investing to create jobs, these changes will not affect you."⁷</i>	4. False. While this statement may be directed towards the passive income / asset proposals, the "income sprinkling" and "dividends to capital gains" conversion rules still apply. At best, this statement is misleading.
5. <i>"Our proposals will not raise taxes. We have lowest #smallbiz tax in the #G7 and we're keeping it that way."⁸</i>	5. False. The passive asset / income proposals will result in a fully distributed taxation rate on passive income of greater than 70% which is >20% higher than it is today. The income sprinkling proposals will dramatically increase family taxation burdens for the middle class business owner. ⁹ The dividend to capital gain conversion proposals will cause sales of

¹ Source – July 18, 2017 Minister's Letter.

² See Karen Stillwell's blog about the language of "loopholes" at <http://connorsstillwell.com/viewpoint-meaningful-questions-must-answered-tax-reform-private-corporations-implemented/>

³ Source – July 18, 2017 Minister's Letter.

⁴ Source – July 18, 2017 Minister's Letter.

⁵ Source - @Bill_Morneau August 28, 2017 tweet.

⁶ See the change to sections 84.1 that require a look back to pre-July 18, 2017 non-arm's length transactions. If such transactions between non-arm's length persons took place, this can dramatically affect transactions between related parties today. See also proposed subsection 246.1(3) which can reduce the capital dividend account for historical transactions that relied on existing law. Lastly, the changes to the capital gains deduction rules require that any appreciation in value of the subject property be revalued for any time that the property was held by a trust or for any time that the property appreciation accrued when the individual was a minor which, in effect, is a "look-back" test to tax appreciations in value for periods of time prior to July 18, 2017.

⁷ Source - @Bill_Morneau August 28, 2017 tweet.

⁸ Source - @Bill_Morneau August 28, 2017 tweet.

⁹ See <http://moodysgartner.com/private-corporation-tax-proposals-unquestionably-harm-middle-class-business-owners/> for an example.

	businesses to family members to almost double their taxation burden. ¹⁰
6. <i>"We're consulting about closing unfair loopholes. We will NOT raise taxes on small business."</i> ¹¹	6. See #1 above. Existing laws are not "loopholes". Regarding raising taxes, the Minister is correct that corporate tax rates are not being raised but the overall statement is misleading...see #5 above.
7. <i>"Our proposals will protect #smallbiz ability to invest, grow & create good, middle-class jobs."</i> ¹²	7. False. As an example, the "income sprinkling" proposals cause havoc for start-up businesses to obtain financing from family, often the only source available. ¹³ In addition, compliance costs for small businesses will increase greatly.
8. <i>"If your family members make a meaningful contribution to your business, these changes will not affect you."</i>	8. False. Presumably the Minister is talking about the "income sprinkling" proposals in this tweet but ultimately there are 2 other sets of proposals that have application. The proposed rules that define "meaningful" (which is not the actual phrase in the legislation) are overly complex and do include the silent contributions of the stay-at-home spouse / common-law partner. The administration of these proposals will be very difficult. ¹⁴
9. <i>"Our proposals are targeted only at specific loopholes. Most #smallbiz won't be affected. Look for yourself: fin.gc.ca/activty/consul..."</i> ¹⁵	9. False. The income sprinkling proposals will affect ALL businesses – large or small – that currently pay dividends to inactive spouses / common-law partners or adult children. They will also apply to ALL businesses that wish to transfer their business down to the next generation. And, if the passive income / asset proposals are implemented as discussed in the consultation paper, will dramatically impact the ability for entrepreneurs to save funds for rainy days, retirement and future business expansion.

¹⁰ This is because of the change to section 84.1 which will cause an otherwise capital gain on a disposition a business to a family member to be re-characterized as a taxable dividend.

¹¹ Source - @Bill_Morneau August 28, 2017 tweet.

¹² Source - @Bill_Morneau August 28, 2017 tweet.

¹³ This is because related party who is not active in the business and receives income receives from a corporation will be considered "split income" and thus will be taxed at the highest marginal tax rate. See <http://moodysgartner.com/private-corporation-tax-proposals-unquestionably-harm-middle-class-business-owners/> for a simple example that illustrates this.

¹⁴ The reasonableness tests are contained in amended section 120.4 and are very broad.

¹⁵ Source - @Bill_Morneau August 28, 2017 tweet.

<p>10. <i>“When the rules meant to help businesses grow, are being used for personal gain - we all lose. See our proposals: fin.gc.ca/activity/consul...”¹⁶</i></p>	<p>10. Save personal tax? How? Because you can build up assets using corporate tax rates and because business income is now integrated as a result of the eligible dividend regime introduced in 2006? And because personal tax rates dramatically increased and corporate tax rates decreased? Or because self-employed professionals are able to legally incorporate?¹⁷ At worst, the build-up of passive assets is a tax deferral because income tax will be paid upon withdrawal from the corporation, the death of the shareholder or the shareholder becoming a non-resident. This statement is misleading.</p>
<p>11. <i>“Morneau contends the proposed change to passive investment income will have negligible impact on anyone making less than \$150,000 per year. “Under this amount there is very little benefit from the loophole because you could simply max out your RRSP and TFSA (tax free savings account),” said Lauzon.”¹⁸</i></p>	<p>11. False. To maximize RRSP contributions, you need “earned income”.¹⁹ To pay salaries out of your corporation, you will pay income tax at graduated tax rates.²⁰ And the RRSP contribution room does not increase until the following year. TFSA contribution limits are only \$5K. How you could avoid the passive asset / income rules with an approximate \$25K RRSP contribution and \$5K TFSA contribution escapes logic.</p>
<p>12. <i>“Trudeau characterized the changes as being in step with his oft-repeated promise to help the middle class, even if it requires Canada’s wealthiest to “pay a little more.”²¹</i></p>	<p>See #9 above.</p>

¹⁶ Source - @Bill_Morneau August 23, 2017 tweet.

¹⁷ If the professional who incorporates would otherwise be an employee, the “personal services business” rules under section 125 of the Income Tax Act would apply to severely punish such a person from incorporating.

¹⁸ Source – August 23, 2017 Canadian Press article [https://globalnews-ca.cdn.ampproject.org/c/globalnews.ca/news/3711319/bill-morneau-small-business-tax-plan/amp/](https://globalnews.ca.cdn.ampproject.org/c/globalnews.ca/news/3711319/bill-morneau-small-business-tax-plan/amp/)

¹⁹ “Earned income” is defined under subsection 146(1) of the Income Tax Act that, overly simplified, is salary type income.

²⁰ And the salaries need to be “reasonable” in the circumstances pursuant to existing law – section 67 of the Income Tax Act. If such salaries are not reasonable in the circumstances then no deduction would be available to the payor corporation and thus double taxation risk exists.