

Minister of Finance



Ministre des Finances

Ottawa, Canada K1A 0G5

2017FIN462552

2017FIN463045

2017FIN463625

DEC 22 2017

Mr. Steve McLellan
CEO
Saskatchewan Chamber of Commerce
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Dear Mr. McLellan:

Thank you for your correspondence of October 4, 2017 regarding our Government's proposed changes to address tax planning using private corporations. I am also in receipt of your correspondence of September 28, 2017, which was addressed to my Parliamentary Secretary, Mr. Joël Lightbound. Please excuse the delay in replying.

Since the launch of public consultations on July 18, 2017, Canadians have engaged in an important discussion on proposed measures to address tax planning using private corporations. We have listened to and appreciate the feedback of the many Canadians who are helping to get this right. Our Government is committed to addressing any unintended consequences of these measures and is focused on supporting Canada's hard-working, middle-class small business owners, while targeting unfair advantages that largely benefit the wealthiest Canadians.

Canadians work hard and should be rewarded for that work with greater opportunities for themselves and their families. Since coming to office, our Government has taken a number of actions that demonstrate our commitment to an economy that works for the middle class and those working hard to join it. As one of our first actions, we raised taxes on the wealthiest one percent in order to cut taxes for the middle class, benefitting nine million Canadians. In Budget 2016, our Government replaced the previous child benefit system with the Canada Child Benefit (CCB), which is simpler, more generous, and better targeted to those who need it most.

The *Fall Economic Statement*, tabled on October 24, 2017, builds on this progress by proposing to:

- Lower the small business tax rate to 10 percent, effective January 1, 2018, and to 9 percent, effective January 1, 2019. For the average small business, this will leave an additional \$1,600 per year for entrepreneurs and innovators to reinvest in their business.
- Enhance the Working Income Tax Benefit by \$500 million per year, starting in 2019, to improve the financial security of low-income working Canadians. This is in addition to the increase of \$250 million annually already set to come into effect in that year as part of the enhancement of the Canada Pension Plan.
- Strengthen the CCB by increasing the benefit annually, to keep pace with the rising cost of living, as of July 2018 – two years ahead of schedule.

Canada

As the economy grows, our Government will ensure that every Canadian pays their fair share, so that the benefits of that growth can be shared by more than just a wealthy few. Fairness in the tax system allows our Government to keep taxes low, while ensuring the ability to fund programs and services for all Canadians. Our Government will move forward to ensure that Canada's competitive corporate income tax rates are not being used by high-income individuals to gain a personal tax advantage through their private corporations, taking into account the feedback received from Canadians on each aspect of the consultation.

Income Sprinkling

Through income sprinkling, high-income individuals can divert corporate income to family members who are subject to lower personal tax rates or who may not be taxable at all. In some cases, someone earning \$300,000 with a spouse and two adult children can use a private corporation to get tax savings that amount to roughly what the average Canadian earns in a year.

Throughout the consultation period, our Government received feedback on the complexity of the proposed measures and potential unintended consequences. We also heard that the measures could create uncertainty in relation to how amounts received from a family business would be taxed.

Taking into account the submissions made through the consultation, we will move forward with simplified measures to limit income sprinkling using private corporations, while ensuring that the rules do not impact businesses to the extent that there are clear and meaningful contributions by spouses, children, and other family members. The simplified income sprinkling measures aim to provide greater certainty for family members who contribute to a family business. The revised measures are proposed to be effective for the 2018 and subsequent taxation years.

A number of stakeholders also identified potential unintended consequences associated with the proposed measures to address the multiplication of the lifetime capital gains exemption (LCGE). For example, concerns were raised about the potential impact on intergenerational transfers of family businesses. In light of these concerns, our Government will not be moving forward with measures to limit access to the LCGE.

Passive Investment

During the consultation period, our Government heard from business owners that the flexibility afforded from savings accumulated in the corporation is important to their success. Savings may be held within a corporation to finance an upcoming business expansion, to save for a downturn, or to provide greater flexibility to deal with personal circumstances, such as parental leave, sick days, or retirement.

At the same time, holding a passive investment portfolio inside a private corporation allows the owners to take advantage of low corporate income tax rates to gain a personal wealth advantage. The low small business rate, for example, can provide an initial advantage of roughly 35 cents on each dollar of corporate income saved, compared to the same investment made outside a corporation. A significant advantage persists after the investment income is paid out of the corporation to its owners.

We will move forward with measures to limit tax deferral opportunities related to passive investments, with a focus on high-income individuals who benefit under the current rules from unlimited savings opportunities far beyond the pension, Registered Retirement Savings Plan, and Tax-Free Savings Plan limits available to other Canadians. In further developing these measures, our Government will ensure that:

- All past investments and the income earned from those investments will be protected. In other words, the measures will apply only on a go-forward basis.
- Businesses can continue to save for contingencies or future investments in growth.
- A \$50,000 threshold on passive income in a year (equivalent to \$1 million in savings, based on a nominal 5-percent rate of return) – an amount that is exceeded by only 3 percent of corporations – is available. These changes will provide business owners with more flexibility to build a cushion of savings for business purposes and to deal with personal circumstances. There will be no tax increase on passive income below this threshold.
- Incentives are maintained so that Canada's venture capital and angel investors can continue to invest in the next generation of Canadian innovation.

Our Government will propose specific measures to limit tax deferral opportunities related to passive investments and will release draft legislation as part of Budget 2018.

Conversion of Income into Capital Gains

In the consultation paper of July 18, 2017, we sought to strengthen the income tax rules to curb tax planning strategies involving the conversion of income into lower-taxed capital gains.

The consultation raised issues concerning unintended consequences and potential challenges for intergenerational transfers of businesses, including farms. Given these issues, our Government will not move forward with the proposed changes regarding the conversion of income into capital gains, and the draft legislative proposals released with the consultation, including the proposed effective date of July 18, 2017, will not proceed.

We will continue our outreach to farmers, fishers, and other business owners to develop proposals to better accommodate intergenerational transfers of businesses, while protecting the fairness of the tax system.

Support for Small Businesses and Entrepreneurs

Our Government is committed to providing comprehensive and effective support to help businesses grow, invest, and create additional good, well-paying jobs. Canada's low corporate taxes and other supports through the tax system encourage new capital investment that make businesses more productive and competitive. Reducing the federal small business tax rate to 9 percent will allow small businesses to retain even more of their earnings to reinvest, supporting the growth of their business and job creation.

Small and medium-sized businesses in Canada also benefit from direct federal program support for scaling up, including access to financing and foreign markets, support for innovation, and

services to build entrepreneurial and management capacity. This support is delivered through a number of key federal organizations including:

- Innovation, Science and Economic Development Canada;
- The National Research Council of Canada's Industrial Research Assistance Program;
- Global Affairs Canada's Trade Commissioner Service;
- Export Development Canada (EDC);
- Regional Development Agencies; and
- The Business Development Bank of Canada (BDC), which serves 49,000 Canadian small and medium-sized enterprises and has made more than \$29 billion in commitments.

Most recently, our Government is advancing a number of key initiatives that are increasing the availability of financing for businesses. Budget 2017 announced we are making available \$400 million through the BDC to increase the availability of late-stage venture capital, through a new initiative called the Venture Capital Catalyst Initiative. Budget 2017 also announced that nearly \$1.4 billion in new financing would be made available through the BDC and EDC to help Canada's clean technology businesses grow and expand. As well, Budget 2017 is making available up to \$950 million for a small number of business-led innovation "superclusters," making it easier for innovators and potential customers to work closely together on research, development, and demonstration activities to boost productivity, create jobs, and drive economic growth.

Going forward, we will ensure that corporations that contribute to job creation and economic growth continue to benefit from a supportive tax environment and other measures aimed at helping them succeed.

Thank you for writing.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Bill Morneau".

The Honourable Bill Morneau, P.C., M.P.