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BY EMAIL: Diane.Lebouthillier@parl.gc.ca

The Honourable Diane Lebouthillier
Minister of National Revenue
House of Commons
Ottawa, ON, K1A 0A6

Madame Minister:

Re: July 18th, 2017 proposed tax changes

I write to you as a tax practitioner with almost 40 years of experience. I have seen many changes in legislation over the years, and many changes in the manner in which the Canada Revenue Agency and its predecessors (the Canada Customs and Revenue Agency, and the Department of National Revenue) have administered the *Income Tax Act*.

I will not take your time to discuss my concerns with the actual proposals, and will keep that for my submissions to your colleague, the Minister of Finance.

However, I have some significant concerns about how the proposals, assuming that they will be implemented in their present form, will be administered by the CRA.

In the proposals dealing with income splitting and, by extension, the provisions that will limit the entitlement of taxpayers to the Lifetime Capital Gains Exemption (LCGE), it is proposed that there will be a reasonableness test to determine whether any particular dividend will be subject to the Tax on Split Income (TOSI).

The reasonableness test is proposed to apply differently based on the age of the adult specified individual (i.e., whether the individual is between 18 and 24 or is 25 or older).

An amount would not be considered reasonable in the context of the business to the extent that it exceeds what an arm's-length party would have agreed to pay to the adult specified individual, considering the following factors:

- labour contributions the extent to which:
  - for an adult specified individual age 18-24, the individual is actively engaged on a regular, continuous and substantial basis in the activities of the business; and

- for an adult specified individual age 25 or older, the individual is involved in the activities of the business (e.g., contributed labour that could have otherwise been remunerated by way of salary or wages). and

- capital contributions based upon assets are contributed to the business or risks are assumed in respect of the business

From an audit point of view, I see problems with this. For example, are you auditors trained to determine what is reasonable? If a taxpayer is actively involved in the business in one year, but not in a previous or subsequent year, what is the impact. Presumably, if the determination of reasonableness is upheld, dividends could be treated differently from year to year, i.e. subject to TOSI or not, based upon the recipient's level of contribution in any year.

However, how is it intended to assess the availability of the LCGE? If a taxpayer has been active but in the year of sale is not active, does that disqualify them from claiming the LCGE?

A huge concern with this was set out by Kim Moody and Kenneth Keung, directors of Moody's Gartner Tax Law LLP, in a special posting to the Financial Post on August 16th, 2017, as follows:

> *A typical private business is often started and capitalized with family assets. In many cases, the operations of the business are run by family members. Often, but not always, one of the spouses/common-law partners stays home to raise the children while the other focuses on the operations of the business. In many cases, both spouses/common-law partners (and sometimes the children either directly or indirectly) are shareholders of the business. Such an arrangement allows the eventual rewards of the business — often after many, many years of struggles to make the business successful against the odds — to be split among the family. Any dividends or capital gains realized are taxed according to each family member's individual tax brackets (with the exception of minors who are generally always taxed at the top marginal tax rate under the current "kiddie tax" regime).*
>
> *….*
>
> *However, is a reasonableness test appropriate in a spouse or common-law partner scenario when the provinces' various matrimonial property regimes grant property rights to such persons regardless of who contributes to the business? Is basing taxation on an individual-by-individual basis, rather than on a family-unit basis, the right or fair approach? Do the proposals contradict our current government's emphasis on gender equality when many entrepreneurial families have a stay-at-home parent?*
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> *It turns out that the Royal Commission on Taxation already thought about many of these questions over 50 years ago. The commission noted the substantial*

> *contribution each family member usually makes to the family's finances, and strongly recommended the family unit be the appropriate taxing unit: "we believe firmly that the family is today, as it has been for many centuries, the basic economic unit in society."*
>
> *While many things have changed over the last 50 years, we submit that this assertion remains just as true today, particularly with respect to families that run businesses. A spouse/common-law partner who stays home to raise children and manage the household is as much a key ingredient to the family's success as the other spouse's day-to-day hustle for the business. When you combine that with the further fact that non-active spouses/common-law partners have property rights with respect to family assets that have been used — directly or indirectly — to grow the business, is it really offensive from a tax-policy perspective for the non-active spouse/common-law partner or other family member to receive dividends or realize capital gains notwithstanding they may not have expended the same level of direct effort in the business as other family members?*

The policy behind these proposals and whether they actually add to or detract from fairness in the system is a discussion for the Minister of Finance.

But I want to address the administrative issue. As we know, the government has, in recent years, invested considerable sums for compliance with the Income Tax Act. Unfortunately, there has been no corresponding investment in the appeals side of the CRA.

Even with additional resources devoted to compliance, an auditor will be required to review every dividend paid to every shareholder in every taxation year that is the subject to an audit. The level of contribution in one year may not be the same as the level in another taxation year. If six family members receive dividends, consider the additional time required in every audit for every small and medium business for every year.

I do not believe that CRA auditors are either trained or qualified to make a determination of whether a particular dividend is reasonable. And we know from experience that it may be years before the courts have an opportunity to opine on the issue. Given the significance, we can safely assume that the initial appeals will, no matter who wins at the Tax Court of Canada, be appealed at least to the Federal Court of Appeal, and, perhaps, the Supreme Court of Canada.

Given this extreme level of uncertainty being introduced, it will be my recommendation to all of my clients to file a Notice of Objection to any assessment under the new rules, since we don't know how the courts will deal with these rules. From my discussions with other tax practitioners, this recommendation will be made universally.

At present, a taxpayer filing a Notice of Objection will wait approximately 8 to 10 months before there is an appeals officer available to discuss the file. If we are now faced with multiple notices of objection for every company that is assessed, what will this do to the backlog?

I may be cynical, but after 40 years I have reason to be. I assume that the Appeals section will invariably confirm any assessments under the new rules.

This is, of course, unfair, since it will require the affected taxpayers to go to the trouble and expense of filing Notices of Appeal to the Tax Court. We know that the Court is already displeased at the backlogs in the appeals system. How will the number of pending appeals increase under the new proposals?

It has been my practice that in virtually every objection file I file an application under the Privacy Act or Access to Information Act to obtain a copy of the CRA file. This will be especially important to see the considerations by the auditor in making any "reasonableness" determination.

The CRA has a statutory obligation to provide the file within 30 days, but can request an extension of that deadline. Under the Privacy Act, for individuals, the time requirements for compliance by the CRA are not unreasonable. However, under the Access to Information Act, for corporations, I have recently received extension letters stating that in addition to the statutory 30 days, an additional 240 days will be required.

Again, from an administrative point of view, I fail to see how the CRA can possibly cope with the additional workload that will be generated by the new proposals.

I thank you for taking the time to consider my comments.

Yours very truly,

Charles M. Rotenberg