MORTGAGE PROFESSIONALS CANADA
PROFESSIONNELS HYPOTHÉCAIRES DU CANADA

October 2, 2017

Minister Bill Morneau
Minister of Finance
Email: fin.consultation.fin@canada.ca

Re: Next Steps in Improving Fairness in the Tax System by Closing Loopholes and Addressing Tax Planning Strategies

Dear Minister Morneau,

Mortgage Professionals Canada is pleased to respond to the consultation on changes to the way small businesses utilize tax planning strategies. We would like to formally thank the Minister for conducting these public consultations and taking the views of Mortgage Professionals Canada into account before implementing the changes. Our members, however, have been frustrated by the adversarial tone and lack of clarity within the proposed tax code changes. We hope that the government listens to widespread concern within the business community and ensure that these changes do not inadvertently impact middleclass entrepreneurs.

Mortgage Professionals Canada is the national mortgage industry association representing 11,500 individuals and 1,000 companies, including mortgage brokerages, lenders, insurers and industry service providers. Our members make up the largest and most respected network of mortgage professionals in the country whose interests we represent to government, regulators, media and consumers. Together with our members, we are dedicated to maintaining a high standard of industry ethics, education and professionalism, consumer protection, and industry best practices.

Mortgage Professionals Canada's comments are provided for your review. Please do not hesitate to contact me should you have any questions.

Sincerely,

Paul Taylor
President and CEO

Since the announcement of the proposed changes and the beginning of the consultation period, our members tell us they have been frustrated by the seemingly confrontational tone and general lack of clarity within the consultation documents. While our members support tax fairness, they are disappointed with how the government appears to have characterized small businesses, who use these legal tax planning strategies, as not paying their fair share of taxes. To characterize these businesses as taking advantage of "loopholes" is unfair and divisive.

The Minister has also stated that these changes will not affect small businesses. In our discussions with the Minister's office, it was made clear to us that the implementation of these changes is expected to target only the highest income earners. Our own analysis of the technical brief leaves us with a different understanding, and we are concerned that a large number of unintended family businesses will find themselves with considerably larger tax liabilities than they face today.

Our members have told us that these changes do not properly take into account the risk or personal capital that is required for entrepreneurs to start a business, or the number of years with little or no income while the business grows. It is our assertion that the current rules understand that, with so much investment needed in early years, many small business owners have a shortened period of time to save for retirement. They have built their long-term plans around the current structures and feel betrayed by an immediate change that threatens their retirement savings and planning horizon.

Many tell us they would not have taken the risk to start their own business, instead opting to pursue a career as an employee in existing businesses. We are concerned we may see a reduction in entrepreneurship and innovation over the longer term if these policies are introduced as currently expressed.

<u>Results of Internal Member Survey</u>

We surveyed our members to gauge their understanding of how the three changes would impact them (Annex 1). Approximately 65% of respondents indicated that they were an incorporated business.

When asked how they would be impacted if income sprinkling was disallowed, 66% said that they would be negatively impacted. The majority of those impacted told us they would expect to see their tax bills rise by between $10,000 and $25,000 per year.

The proposed change to passive investments significantly disrupts the retirement and family planning strategies of thousands of our members. Almost 75% of those who responded indicated they would be negatively impacted with a large contingent estimating that this would reduce their net wealth at retirement by approximately 30%. These are entrepreneurs, who do not have a pension or benefits, and who use passive investment strategies to prepare for maternity leaves, other family planning matters and retirement.

Our members also tell us that they rely upon these strategies to plan for the ups and downs of business cycles. The timing of this is especially troublesome for many of our mortgage broker members, after recent changes made to mortgage rules are hurting their competitive position in the market.

Finally, when asked about the current capital gains conversion provision, 53% of our incorporated members, who responded to the survey, indicated they have used or were planning to use this mechanism in the future.

Our Recommended Approach

The finance ministry suggests that the implementation of these tax changes will increase revenue by roughly 250 million dollars. This revenue projection is, in a practical sense, negligible. However, the expectation of the increased tax liabilities within our membership is substantial. There is clearly a disconnect between the intention of the changes and the understanding of the outcomes among Canadian business owners and tax experts. The tone of the messaging and the lack of clarity in the tax consultation documents is, in our opinion, largely to blame for this.

We believe these proposals can be improved by clearly defining what the government refers to as passive investments and active investments, and to ensure that small business owners retain the ability to use investments to save for retirement, plan for taking time off to start a family, unexpected medical expenses, and to allow for contingencies such as economic downturns or marketplace shifts, and the perpetuation of their businesses during lean times when passive investment tax requirements change.

We believe a longer consultation period must be allowed, and more effort needs to be made to educate businesses about the government's expected implementation. It is vitally important that business owners are able to understand which employment and wage structures will continue to be permissible when prohibitions on income sprinkling are introduced. It is also important to adequately survey small businesses to better understand their current structures and ensure that any implemented tax reform, introduced under the guise of fairness, does not unfairly target the middle class.

We recommend that, instead of introducing a cumbersome and legally confusing reasonableness test for income sprinkling, that guidelines be created to demonstrate permissible structures to compensate family members who can prove they work in a business, or who are students enrolled in post-secondary education. We worry the only ones to benefit from this proposal are lawyers who will litigate what is reasonable and accountants hired to find ways around it.

Additionally, we ask that consideration be given to allow for some level of passive investment or a grandfathering of existing investment structures already in place. For those nearing retirement, changing the rules without some provision to protect their asset base may have significant consequences on their standard of living and therefore possible significant impact on the immediate operations of their businesses as changes are made to offset these possible losses.

Regarding capital gains, we feel the government's intention here it laudable but that the added complexity around this policy could create inefficiencies within the tax code, thereby increasing the administrative tax burden for our members. We are concerned that two classes of shareholders would be created with this policy and that this policy unfairly punishes family of business owners who would no longer be allowed to utilize the capital gains exemption that is currently available to non-family members.

Finally, we suggest the government strongly consider changing the tone used to communicate the motivations for these changes. The turbulence could have been largely avoided if the government used to a more conciliatory voice resulting in a debate about public policy rather than politics.

Summery of Recommendations

1. We recommend that the government change the tone regarding the way it has characterized small business owners who use the legal tax planning strategies available to them.

2. We recommend that the government delay the implementation of these proposals until a more fulsome and comprehensive study be undertaken about the impacts that these changes will have on business owners and the revenue that will be generated by them.

Income sprinkling

3. We recommend that the government reconsider this policy altogether. But, if they are to move forward, that instead of introducing a cumbersome and legally confusing reasonableness test for income sprinkling, that guidelines be created to demonstrate permissible structures to compensate family members who can prove they work in a business, or who are students enrolled in post-secondary education.

Passive investments

4. We recommend that existing investment structures already in place be grandfathered in and that the new rules would not apply to any investment made prior to when the new rules take effect.

5. We recommend that the government clearly explain what is defined as active investments in the business versus passive investments and that consideration be given for the following accounts to be classified as active investments (if the government is concerned that this will be misused, we recommend that a 10-year time limit be established whereby after 10 years the funds, if unused, become passive investments):

a. Emergency account
b. Family planning account
c. Building or Real Estate accounts (for business premises)
d. Expansion account

6. We recommend that if the government is concerned that too much capital is being shielded in passive investments, that an indexed amount of no less than $1,000,000 be allowed under the existing rules to ensure that middle class business owners are not impacted.

Capital Gains Exemption

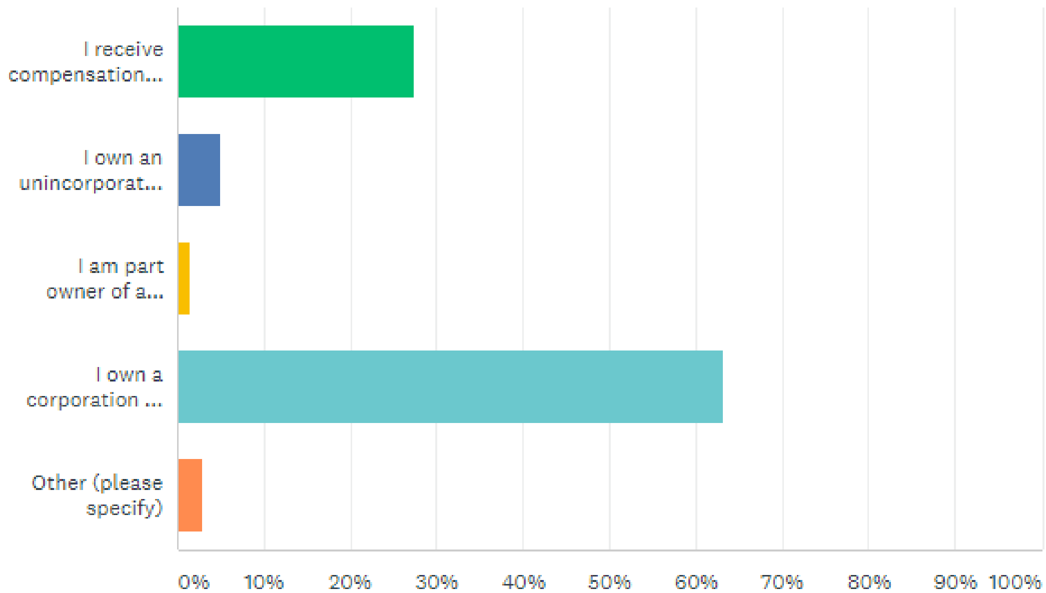
7. We recommend that the government hold off on this technical and complex proposal to ensure that family members who were once active members in the business , are not penalized unfairly by an inability to utilize the same capital gains exemption that is available to other shareholders.

Annex

Q1

Please tell us how you structure your compensation for mortgage brokering activities.

Answered: 771   Skipped: 1

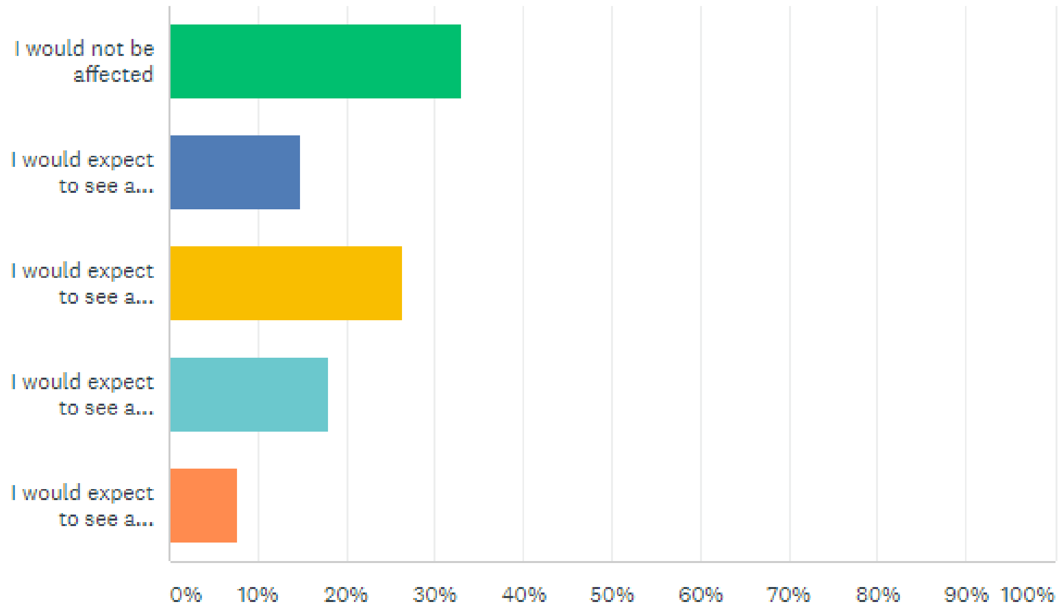


ANSWER CHOICES		RESPONSES	
I receive compensation payable directly to me as an individual		27.50%	212
I own an unincorporated business and draw my personal income from it		4.93%	38
I am part owner of a registered partnership and draw my personal income from it		1.56%	12
I own a corporation and draw my personal income from it		63.16%	487
Other (please specify)	Responses	2.85%	22
TOTAL			771

Q2

How would you be affected if income sprinkling was disallowed:

Answered: 505   Skipped: 267



ANSWER CHOICES	RESPONSES	
I would not be affected	33.07%	167
I would expect to see a household tax increase of \$0-\$9,999 per year	14.85%	75
I would expect to see a household tax increase of \$10,000-\$24,999 per year	26.34%	133
I would expect to see a household tax increase of \$25,000-\$49,999 per year	18.02%	91
I would expect to see a household tax increase of over \$50,000 per year	7.72%	39
TOTAL		505

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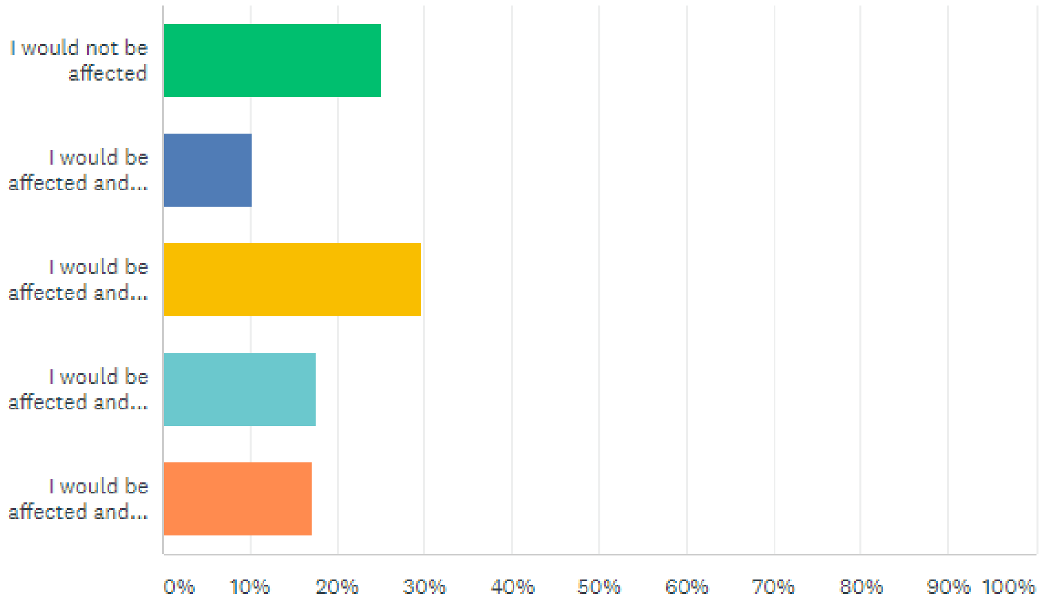
Q3

Would the changes to disallow or reduce eligibility for passive investments within a corporation affect your retirement planning and how much do you believe these changes would affect your retirement?

Answered: 477 Skipped: 295

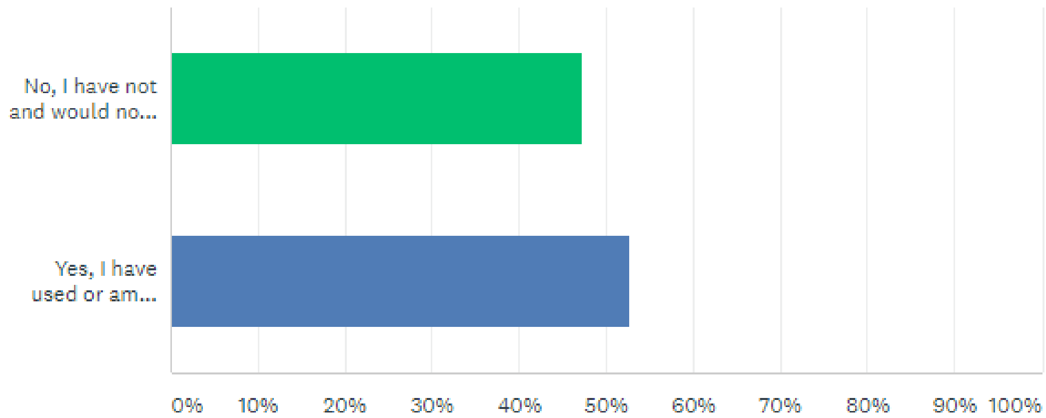


ANSWER CHOICES	RESPONSES	
I would not be affected	25.16%	120
I would be affected and expect a reduction in my net wealth at retirement of up to 10%	10.27%	49
I would be affected and expect a reduction in my net wealth at retirement of up to 25%	29.77%	142
I would be affected and expect a reduction in my net wealth at retirement of up to 40%	17.61%	84
I would be affected and expect a reduction in my net wealth at retirement of more than 40%	17.19%	82
TOTAL		477

Q4

Have you used, or were you planning to use, the currently legally-allowed capital gains conversion to minimize exposure for yourself and your corporation?

Answered: 469 Skipped: 303



ANSWER CHOICES	RESPONSES	
No, I have not and would not have used this mechanism	47.33%	222
Yes, I have used or am planning to use this mechanism in future	52.67%	247
TOTAL		469