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SHOULD CANADIAN INVESTORS BE ABLE TO ENJOY THE SAME BENEFICIAL TAX TREATMENT AS PUBLIC AND FOREIGN CORPORATIONS?[1]

Apparently the Canada Revenue Agency ("CRA") does not think so.

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Did you know that every public and foreign controlled Canadian corporation (collectively referred to as "Public & Foreign Corporations") that is taxable in Ontario pays 26.5% tax on all of its income, including investment income, and that capital gains earned by Public & Foreign Corporations are taxed at half that rate — 13.25% (collectively these tax rates are referred to as "Public & Foreign Tax Rates")?

Presumably, Public & Foreign Tax Rates represent competitive international tax rates and are required to encourage these sectors. However, Public & Foreign Tax Rates are approximately 50% of the tax rates paid on investment income and capital gains income by the most common other category of corporation in Canada, the Canadian-controlled private corporation ("CCPC"). Furthermore, recently the CRA has embarked on a project to review, reassess, and deny access to Public & Foreign Tax Rates on the investment income and capital gains of another category of Canadian corporation, the non-Canadian-controlled private corporation ("non-CCPC").

If this project is successful, Public & Foreign Corporations will enjoy significant tax advantages in respect of investment income and capital gains relative to how Canadian investors are taxed (the "Public & Foreign Investment Tax Advantage")[2]. It is unclear why disadvantaging Canadian investors in this manner would be a desirable government policy option and, in this article, no attempt will be made to discern the policy reasons for doing so.

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[1] Because this article has been written in a non-technical manner, I acknowledge that many complex technical details, such as the workings of integration in the context of the capital dividend account (which applies to all Canadian corporations, including foreign-controlled Canadian corporations but not public corporations) and the working of refundable tax accounts for CCPCs with non-resident shareholders, have not been reviewed in the article.

Such technical details deserve to be discussed, perhaps in another forum, which could involve broader tax reform. Nonetheless, in my opinion, these technical details have no impact on the conclusions reached in this article.

[2] It is important to be clear that the Public & Foreign Investment Tax Advantage is generally considered to be a tax "deferral" advantage, not a tax savings advantage.

In layman's term, this means that the Public & Foreign Investment Tax Advantage tends to be lost when profits are distributed to individual shareholders of entities that enjoy a deferral benefit. This is because the individuals will then pay additional taxes at rates that, when combined with the corporate tax already paid, should approximate the tax payable in the absence of the deferral (foreign shareholders would be subject to withholding taxes in Canada and possibly additional local taxes). However, due to the operation of the "time value of money", if the deferral is long enough, the value of deferral can, in some situations, approximate tax having been saved.

Examples of sanctioned Canadian deferral examples abound. For example, consider your RRSP, where funds are invested and grow tax free until retirement when the return of funds will be taxable to the recipient, or not, if the recipient's income is low enough (RRSPs also entitle the contributor to a current deduction from income which makes them even more valuable).

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Investment income earned by CCPCs is subject to tax rates that are intended to tax CCPCs on investment and capital gains income at rates that are approximately the same as what a top-rate Canadian individual taxpayer would pay. For example, an Ontario-resident CCPC will pay 50.17% tax on its investment income and its realized capital gains will be taxed at 25.09%. These much higher CCPC tax rates create a clear investment disadvantage for CCPCs when compared to Public & Foreign Corporations, which are able to enjoy the Public & Foreign Investment Tax Advantage. If the CRA's project to deny non-CCPCs access to the Public & Foreign Investment Tax Advantage is successful, then it may become very difficult or even impossible for Canadian investors to be taxed in the same way as Public & Foreign Corporations.

To illustrate the Public & Foreign Investment Tax Advantage, let's assume that a non-resident of Canada wants to incorporate a corporation in Canada ("Foreignco") to make passive investments. That corporation will pay much lower taxes on its investment income and capital gains income than CCPCs. As a result, subject to any foreign taxes that Foreignco will need to pay, if any, Foreignco will enjoy significant advantages over CCPCs and, if the CRA's project is successful, over non-CCPCs as well.

CCPC tax treatment is not all bad. There are many advantages that CCPCs have over entities that are not CCPCs. For example, CCPCs carrying on active businesses can access: low tax rates on active business income (in Ontario 12.2% on the first $500,000 of profit), advantageous tax credits, and, among other benefits, a reduced period of time that the CRA can take to review and reassess tax filings. Also, shareholders of these corporations can sometimes sell nearly $1 million of qualifying CCPC shares tax-free during their lifetimes.

Investors often want their corporations to be CCPCs to enjoy these CCPC advantages. In fact, a great deal of case law has been fought all the way up to the Supreme Court of Canada because the CRA sought to limit CCPC advantages to entities that it believed did not qualify as CCPCs.

However, to be competitive in the investment world, there are good arguments that Canadian investors that have no use for CCPC advantages should be able to opt into the same tax treatment that Public & Foreign Corporations enjoy (i.e., Public & Foreign Tax Rates) so that they can also benefit from the Public & Foreign Investment Tax Advantage.

There is no prescribed system in the *Income Tax Act* for CCPCs to relinquish their CCPC advantages and to opt into being taxed at Public & Foreign Tax Rates. Fortunately, there are many ways for a corporation that is neither a public nor a foreign corporation to benefit from the Public & Foreign Investment Tax Advantage. Typically, to do so such a corporation will need to be a non-CCPC or it will need to become a non-CCPC.

A corporation may be or become a non-CCPC because the provisions of the *Income Tax Act* deem it to be a non-CCPC, or as a consequence of planning implemented by a Canadian investor that is fully in accordance with the provisions of the *Income Tax Act*. Regardless of how a corporation becomes a non-CCPC, it should be kept in mind that, in an unrelated context, the Supreme Court of Canada recently reaffirmed the fundamental principle that taxpayers are entitled to arrange their affairs to minimize the amount of tax payable by them.

Still, the non-CCPC structure has been the subject of a number of recent news articles, which have described the planning as a tax "loophole" for rich Canadians without acknowledging that Public & Foreign Corporations have always enjoyed the Public & Foreign Investment Tax Advantage. For example, see Allan Lanthier's "The latest Canadian tax scam has a Caribbean flavour" in the *Financial Post*, January 18, 2022, and Sheila Wang's "Inside a little-known tax 'loophole' experts say is helping rich Canadians avoid millions in taxes" in the *Toronto Star*, March 5, 2022.

The CRA has been aware of non-CCPC planning for over a decade. However, they appear to have recently concluded that it is now abusive for Canadian investors to use non-CCPCs to access the Public & Foreign Investment Tax Advantage.

As a result, at significant cost to the Federal Government and taxpayers, the CRA has undertaken a project to review and reassess non-CCPC structures. Court cases are expected to follow in the very near future. In addition, non-CCPC structures were among a number of structures targeted by a package of mandatory reporting requirements set out in draft legislation released by the Federal Minister of Finance ("MoF") on February 4, 2022.

For the most part, the reassessments tend to be issued on a technical basis by utilizing the general anti-avoidance rule (the "GAAR") in the *Income Tax Act*. The GAAR is a provision that will deny benefits of a tax plan that complies with the provisions of the *Income Tax Act* but is considered to violate a policy in the *Income Tax Act*. The CRA appears to take particular exception with tax planning that can be implemented in advance of a capital gains realization transaction to allow CCPCs (many of which would have never enjoyed any material CCPC benefits) to convert into non-CCPCs to enjoy Public & Foreign Investment Tax Advantages.

This article is not intended to review technical tax issues related to the GAAR. Nevertheless, based on the current state of Canadian tax law, it is far from clear that the CRA is correct in its view that the use of non-CCPC planning structures to access the Public & Foreign Investment Tax Advantage should be subject to the GAAR. Unfortunately, it will take considerable time before the Canadian courts provide definitive comments on completed and ongoing non-CCPC strategies.

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Based on the actions of the CRA, it is clear that its intention is to deny the Public & Foreign Investment Tax Advantage to Canadian investors operating through non-CCPCs. Doing so will put Canadian investors at a significant disadvantage relative to Public & Foreign Corporations.

The Public & Foreign Investment Tax Advantage is not a "loophole" and it should not be limited to Public & Foreign Corporations only. If the CRA would recognize this to be the case then, in a perfect world, it would terminate its costly non-CCPC review and audit project as well as the pending non-CCPC litigation. In addition, working together, the CRA and MoF would enable Canadian investors to merely opt into non-CCPC tax treatment.

Alternatively, if the CRA is committed to implementing a policy that punishes Canadian investors and favours Public & Foreign Corporations, then, rather than doing so through the courts, the Federal Government, through the MoF, should enact legislation that applies on a go-forward basis and that is clear to all Canadians.

— Michael Goldberg, BComm, LLB, TEP, FEA, Partner, Tax Lawyer, Minden Gross LLP, MERITAS© Law Firms Worldwide. Michael is also founder of "Tax Talk with Michael Goldberg", a quarterly conference call about current, relevant, and real life situations for professional advisors who serve high-net-worth clients.

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Email: cservice@wolterskluwer.com *Phone: 1-800-268-4522 or (416) 224-2248 (Toronto)*

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Wolters Kluwer Canada Limited
300-90 Sheppard Avenue East
Toronto ON M2N 6X1
1 800 268 4522 tel
1 800 461 4131 fax
www.wolterskluwer.ca

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