MNP LLP

SUBMISSION TO THE DEPARTMENT OF FINANCE ON THE AUGUST 4TH, 2023 LEGISLATIVE PROPOSALS

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Submitted electronically at: Consultation-Legislation@fin.gc.ca

MNP LLP ("MNP") is pleased to make a submission in response to the Department of Finance, Tax Policy Branch (the "Department") request for comments on the August 4, 2023 draft legislative proposals (the "Proposals"). We appreciate the opportunity to provide our comments and recommendations.

MNP is a leading national accounting, tax and business consulting firm in Canada. MNP proudly serves and responds to the needs of our clients which include more than 280,000 private enterprise and small and medium-sized business clients throughout Canada.

EXECUTIVE SUMMARY

It is important to ensure that *certainty, predictability and fairness* to all taxpayers is considered when amending tax legislation. These principles are the foundation of tax law.

Our comments in this submission focus on the measures that, in our view, will significantly impact small and medium-sized businesses and entrepreneurs:

- **Intergenerational Business Transfers** – the Proposals contain language that creates uncertainty in some situations and appear to be overly restrictive in others.
- **General Anti-Avoidance Rule (GAAR)** – the subjectiveness of the economic substance measures and the somewhat redundant proposed penalty do not align with the principles of *certainty, predictability, and fairness.*
- **Alternative Minimum Tax (AMT)** – the proposed measures may have unintended consequences on certain vulnerable Canadians and may have a broad, negative impact on charitable giving in Canada.
- **Tax on Repurchases of Equity** – certain provisions require further clarity.

Our overall recommendation remains that the Department engage in a more comprehensive stakeholder consultation process regarding the GAAR, and to reconsider some of the proposed amendments to the AMT regime. Additional clarity is also requested in respect of various tax measures.

1. Intergenerational Business Transfers (IBT)

MNP Recommendations:

- Provide clarity in paragraph 84.1(2.3)(g) to specify whether or not all shares of the child in a purchaser corporation, subject corporation or relevant group entity are required to be sold in order for the relieving provision to apply.
- Consider the application of the deeming provision in paragraph 84.1(2.3)(i) to standalone businesses and extend such that the conditions in subparagraphs 84.1(2.31)(f)(ii) and 84.1(2.32)(g)(ii) would be met.
- Reconsider the wording of subparagraphs 84.1(2.31)(a)(ii) and 84.1(2.32)(a)(ii) to include situations involving the share sale of multiple corporations that derive value from the same active business, particularly sales that may take place at separate times.
- Extend the exceptions in paragraph 84.1(2.3)(h) to apply to additional scenarios such as the ones discussed later in this submission, and to contemplate other individuals in the purchasing child's household.
- Incorporate additional flexibility in the Employee Ownership Trust (EOT) rules to allow EOTs to acquire a minority interest in a qualifying business and provide clarity that a holding company can be used by an EOT to acquire a business. Also consider an exception to subsection 55(2) to allow for a business to reorganize prior to a sale such that the vendor can utilize their capital gains deduction on the sale to an EOT.

Rationale

The draft legislation released as part of the 2023 Federal Budget ("Budget 2023") introduced new conditions for intergenerational share transfers to be eligible for the exception in paragraph 84.1(2)(e) – specifically, the Immediate Business Transfer (three-year test) in proposed subsection 84.1(2.31) and the Gradual Business Transfer (five to ten-year test) in proposed subsection 84(2.32). We understand the Budget 2023 draft legislation and subsequent Proposals are intended to help safeguard against unintended tax avoidance "loopholes"; however, in our view, uncertainty remains with respect to certain provisions.

Technical Considerations

Paragraph 84.1(2.3)(g)

This paragraph is intended to provide relief where a parent and child (or children) undertake an IBT pursuant to the conditions in new subsections 84.1(2.31) or 84.1(2.32), and the child (or any of the children) subsequently disposes of, or causes the disposition of, the shares of a purchaser corporation, subject corporation or relevant group entity to another child or group of children of the taxpayer. In contrast to paragraph (f), which requires that **all** shares of the purchaser corporation, subject corporation, or **all** relevant group entities be disposed of (or caused to be disposed of), paragraph (g) simply refers to

"the shares". If the intent is for paragraph (g) to be available where some, but not all of the shares are disposed of, the use of "any of the shares" instead of "the shares" would provide greater clarity.

Paragraph 84.1(2.3)(i)

This paragraph is intended to provide relief (in certain circumstances) from the conditions in subparagraphs 84.1(2.31)(f)(iii) and 84.1(2.32)(g)(iii), which require that each relevant business of the subject corporation and any relevant group entity be carried on as an active business. Paragraph 84.1(2.3)(i) refers to situations where a business has ceased to be carried on due to the disposition of all the assets that were used to carry on the business in order to satisfy debts to creditors. The provision appears to only apply in a situation where the business is failing and "under water" and it is liquidated as a result. Even where this relief applies, the requirements in subparagraphs 84.1(2.31)(f)(ii) and 84.1(2.32)(g)(ii) relating to the required ongoing active involvement of the purchasing child/children will likely not be met where we are dealing with a standalone corporation. In other words, if all the assets are disposed of, there will likely no longer be a business in which to be actively involved. As currently drafted, this provision is of little practical value in the case of a standalone corporation. To have the intended effect, the relief in subparagraph 84.1(2.3)(i) should also extend to subparagraphs 84.1(2.31)(f)(ii) and 84.1(2.32)(g)(ii).

Subparagraphs 84.1(2.31)(a)(ii) and 84.1(2.32)(a)(ii)

According to the Department's explanatory notes, the purpose of these provisions is to ensure that a business is effectively transferred only once from a taxpayer to their child pursuant to the exception in paragraph 84.1(2)(e). It precludes a taxpayer from undertaking successive transfers of shares of a subject corporation that derive their value from the same active business that was relevant to the determination of whether a prior disposition of subject shares satisfied paragraph 84.1(2)(e). To utilize this paragraph on the disposition of shares of a particular corporation, a vendor taxpayer may need to also dispose of shares of another corporation (a relevant group entity) to meet the condition in subparagraph 84.1(2.31)(c)(iii). If all the relevant conditions were met in each case, but one share disposition preceded the other, then this provision would nullify paragraph 84.1(2)(e) treatment on the second disposition. If both share dispositions meet all the relevant conditions, we see no reason from a policy perspective for precluding a vendor taxpayer from benefitting from paragraph 84.1(2)(e) on both share dispositions.

EXAMPLE: *A vendor taxpayer holds shares in Subject Corporation A and shares in Subject Corporation B. Both corporations rely on the same active business to meet the qualified small business corporation test referred to in subparagraph 84.1(2.31)(b)(iii). The taxpayer desires to sell Subject Corporation A to Child A's Corporation and to sell Subject Corporation B to Child B's Corporation.*

It appears on reading the new subparagraphs that the taxpayer would not meet the conditions required unless both sales occur simultaneously. We question the necessity of this requirement, as there are legitimate business, family dynamic or legal reasons why these two sales cannot take place

simultaneously. For example, the youngest adult child in a family could be in the midst of full-time university studies and therefore unable to acquire ownership of the family business at the same time as their elder siblings. As another example, one of the adult children could be facing an impending divorce and wants to defer acquiring ownership of the family business until a later time so the shares do not become marital property, which would be subject to division. Assuming that all other requirements are met for the sale of both corporations independently, there should not be different tax results as a consequence of the timing of sales transactions. This is imposing additional requirements beyond what would ordinarily be contemplated in an arm's-length sale of a business. If this is not the intent of subparagraphs 84.1(2.31)(a)(ii) and 84.1(2.32)(a)(ii), the legislation should be rewritten to clarify as such.

Other Considerations

While the rules allowing for IBTs remain a welcome change, the Proposals appear to be written with a view that such transitions can be planned to fall neatly within either the immediate or gradual transfer tests. We commend the Department's decision to include paragraph 84.1(2.3)(h) to consider relief for situations where the child, or children, after the disposition of the subject shares, dies or suffers one or more severe and prolonged impairments in physical or mental function. However, in our view, the exceptions in the Proposals are too narrow, and should be expanded to contemplate other situations where a small business owner would need to step back from business activities for personal or family reasons.

Example: *Parents plan to transition ownership of their automotive repair company to their adult son over 10 years. The first five years go according to plan, but in year six, the son is forced to permanently step away from day-to-day operations of the business due to a medical condition that, although not disabling, would threaten his longevity and well-being if his day-to-day involvement in the business continued.*

In this situation, the only option available to the family might be to have a non-family member employee run the business until it can be sold. As the son can no longer be actively engaged on a regular, continuous and substantial basis as required in proposed subparagraph 84.1(2.32)(g)(ii), the requirements of the gradual transfer test cannot be met. The parents would face a substantial and retroactive increase in the tax arising from their initial transfer in year one.

The Proposals do not contemplate the impact of mental or physical illnesses suffered by business owners where such illnesses do not rise to the level of being a "severe and prolonged impairment". For example, a business owner may be diagnosed with a medical condition that is not debilitating in the near term but threatens to become more serious in the future, necessitating his or her withdrawal from the business before complications arise. Furthermore, the Proposals do not consider the impact of ailing family members. Both situations could require significant absences by the business owner from the business to care for themselves or others. In situations where a business owner acquired the business from an arm's

length party (the "original vendors"), a subsequent sale of the business would generally not result in an additional retroactive tax cost to the original vendors. The risk of additional taxes on a retroactive basis for what was intended to be a genuine intergenerational business transfer will likely disincentivize business owners from considering transferring businesses to a family member.

Employee Ownership Trusts (EOTs)

While we note there were some welcome changes in the Proposals, we have some suggestions to facilitate the use of EOTs as well as to enhance the effectiveness of the proposed rules.

Flexibility of Ownership by EOTs

The definition of "qualifying business transfer" in subsection 248(1), paragraph (b)(ii), states that at the time of disposition, the trust acquires control of the subject corporation. This in effect means that EOTs can only be used when a business owner (or group of owners) sells control of their corporation, which will limit the usefulness of the new rules. Consider allowing for a flexible EOT structure, where employees can be minority shareholders that do not control the Opco. This will make EOTs more appealing in situations where business owners undertake succession planning by gradually selling the business over time. This has the added benefit of allowing employees time to learn to operate the business prior to taking control.

Clarity on Use of Holding Corporations to Acquire a Business

It is unclear if the Proposals allow EOTs to utilize a holding corporation to acquire a qualifying business. It is common for a purchaser to set up a holding company ("Buyco") to acquire the shares. This allows for post-acquisition planning to utilize deductions for interest on financing for tax purposes and also allows the purchaser to pay off any amounts owing to the vendor in a more efficient manner, using after-tax earnings at the corporate level versus fully distributed earnings, which will have been also subject to personal tax. The Proposals provide an exception for a trust borrowing funds to buy shares via the changes in subsection 15(2.51). However, paragraph (j) of the definition of "employee ownership trust" states that "all or substantially all of the fair market value [FMV] of the property of the trust is attributable to shares of the capital stock of one or more qualifying businesses that the trust controls". It is unclear if this provision restricts the EOT from incorporating a Buyco to purchase the target corporation. Adding clarity to allow for this type of acquisition structuring ensures EOTs are not disadvantaged in such situations.

Subsection 55(2) Exception for Purification Purposes

Consider providing an exception to subsection 55(2) in situations where a corporation must be purified in order for its shares to be considered qualified small business corporation shares prior to the sale to an EOT. This would allow the vendor to utilize the capital gains exemption as part of the sale. The current rules contain an exception in paragraph 55(3)(a) which is often relied on when undertaking a related party purification butterfly, but this exception cannot be relied on when there is a sale to a third party being contemplated. Facilitating the purification of a target corporation will also better enable the target corporation to meet paragraph (a) of the "qualifying business transfer" definition, which requires all or substantially all of the FMV of the assets of the subject corporation to be attributable to assets used principally in an active business.

2. General Anti-Avoidance Rule (GAAR)

MNP Recommendations:

The Proposals are in direct conflict with creating certainty for taxpayers. Consideration should be given to abandoning the current proposals and instead engaging in meaningful consultation to address Finance's concerns without compromising taxpayer certainty. In the absence of such further consultation, we provide the recommendations below.

1. Provide timely guidance as to how the Minister's representatives and taxpayers are to navigate the interpretive challenges that will arise with the economic substance test.
2. Remove the GAAR penalty proposed in subsection 245(5.1), or at a minimum, expand the application of the penalty exception in proposed subsection 245(5.2). Further clarity can be provided through a list of "mischief" transactions that will be precluded from relying on the penalty exception.

Rationale

The explanatory notes to the Proposals indicate that the GAAR is intended to prevent abusive tax avoidance transactions or arrangements, but at the same time is not intended to interfere with legitimate commercial and family transactions. The GAAR changes include amendments to the definition of "avoidance transaction", an inclusion of a penalty, and a new concept of economic substance. The inherent concern remaining after the various public consultations on the GAAR is how the legitimacy of the economic substance of these transactions should be determined, and who is best able to make that determination. Jurisprudence[1] has indicated that it is not the role of the Minister to dictate or second guess the reasoning behind taxpayers' business decisions, but the language of the GAAR in the Proposals appears to be expanding the powers of the Minister and supplanting bona fide business decisions with the rationale of a surrogate or official, with the benefit of hindsight.

Economic Substance Test

In our view, the proposed presumption of a misuse or abuse where a transaction is lacking in economic substance expressly allows for the Minister to dictate or second guess taxpayer decisions. In the first draft of proposed legislation released as part of Budget 2023, the test was "tends to indicate", which would allow the Courts to hear evidence by the parties and come to a determination of the economic substance. The Proposals have been updated to include much stronger language where the specified factors presume that a transaction or series of transactions is/are significantly lacking in economic substance. **The explanatory notes explain that taxpayers can rebut the presumption in "appropriate circumstances" where there is a specific policy objective of the legislation that they are using. This policy objective is the hallmark of the GAAR and historically has been the responsibility of the Minister to prove the abuse or misuse. This amendment, if passed, would burden Canadians with a requirement to prove the legislative intent, which they may not always have the means to do. Additionally, this could diminish the reasoning of the jurisprudence in various tests such as income versus capital nature, as taxpayers**

[1] For example, *Stewart v The Queen,* 2022 SCC 46.

will be looking for a specific provision to allow a transaction, versus relying on the economic and reasoning of concepts that are integral to the understanding of legislation.

It is also our view that the preamble in proposed subsection 245(0.1), which states that the GAAR is not to prevent taxpayers from obtaining tax benefits contemplated by Parliament, is in conflict with the economic substance test. How is a taxpayer intended to know what was contemplated by Parliament? Are transactions lacking in economic substance automatically viewed as abusive unless there is a pre-existing and explicitly stated tax policy to specifically allow the outcome? This narrow reasoning could impact Canada's ability to be competitive when facing new and emerging business trends, as tax policy often lags economic reality. Further, long standing jurisprudence tests such as income versus capital are not legislated by Parliament. The Proposals create uncertainty as to whether such tests can be relied upon for future interpretation.

According to proposed subsection 245(4.2), the factors used to establish where there is a significant lack of economic substance will depend "on the particular circumstances". This language and the notion of an economic substance test have no agreed-upon meaning in law, business, or common everyday parlance; therefore, there is no objective means of independent analysis of this by any party, be it a taxpayer or the Minister. This provision grants the Minister's agents the ability to apply the test in any manner they wish, subjectively based on their individual assessment of what they "feel" is acceptable or not. For example, if a taxpayer chooses to incorporate their business to utilize the small business deduction, those circumstances would be considered to fail the economic substance test as they are clearly caught in paragraphs (a) to (c) in subsection 245(4.2). The Minister may take the position that the *Income Tax Act* is designed to allow for claiming the small business deduction so the section does not apply; however, on a plain reading, the transaction would be considered to be significantly lacking in economic substance and any exclusion would be wholly dependent on the phrase "depending on the particular circumstances".

The updated proposals have expanded the GAAR in a manner that the Minister would have incredible powers to allege a lack of economic substance in all non-arm's length situations, resulting in a much higher bar for non-arm's length transactions in comparison to arm's length transactions. Two substantially similar transactions could have significantly different tax consequences, simply because one is at arm's length and another is non-arm's length.

It will be a matter of a subjective "smell test" as to whether a transaction lacks economic substance. The explanatory notes indicate that the importance of the factors will require a "holistic assessment of the facts and circumstances".

The highly subjective nature of subsection 245(4.2) will most certainly create interpretive challenges. Consideration must be given to issue timely guidance and examples on how the GAAR will be interpreted, or there will be a lengthy delay as all parties wait and watch for guidance from the Courts on this new legislation. Uncertainty caused by lengthy delays is contrary to the intent in proposed subsection 245(0.1): there is no fairness nor certainty in having to wait years to learn how to interpret a particular statute. If the changes proceed as proposed, the Minister will have to provide timely guidelines as to how its representatives and taxpayers are to navigate these interpretive challenges prior to the coming into force of the legislation.

Penalties

Given the extensive penalties that can apply for failure to comply with the reportable transaction and notifiable transactions reporting requirements in sections 237.3 and 237.4, respectively, it is our view that the GAAR penalty in proposed subsection 245(5.1) is excessive. If the Department is concerned that sections 237.3 and 237.4 do not adequately address the tax planning the GAAR is intended to discourage, the Department can work with the Minister to expand the list of transactions that fall into the notifiable transactions regime. With the extended reassessment period for GAAR, if no disclosure is made, there is more than adequate time to find transactions that are otherwise difficult to identify and audit within the normal reassessment period. The combination of the proposed changes to the meaning of "avoidance transaction", the economic substance test, and the extended reassessment period is a substantial and sufficient deterrent to most taxpayers without the application of an additional penalty.

While the addition of the penalty exception in proposed subsection 245(5.2) is welcome, its application – as currently drafted – is expected to be very limited, since little administrative guidance on situations where the GAAR would not apply currently exists. It is also unclear what will occur in situations where the Minister has stated the GAAR applies in their view, but where there is prior case law that is contrary to that view. Furthermore, as the concept of tax avoidance has changed significantly over time, prior GAAR decisions and CRA guidance may not be relevant today and therefore would have little value. In order for this exception to be meaningful, consideration should be given to expanding the exception to cover transactions beyond those that are "identical or almost identical" to those addressed in existing guidance. One suggestion to add clarity to the exception would be for the Minister to produce a list of certain targeted transactions considered to be a misuse or abuse of the *Income Tax Act* that are precluded from relying on the subsection 245(5.2) exception.

3. Alternative Minimum Tax (AMT)

MNP Recommendations:

- Allow for the use of losses of other years for AMT purposes to be equal to those for regular income tax purposes.
- Extend the AMT exemption in proposed paragraph (a) of the description of C in section 127.51 to inter-vivos trusts to mitigate double taxation where income or gains giving rise to AMT are incurred at the trust level and allocated to beneficiaries.
- Consider removing the limitation on the deductions and expenses noted below, as most are intended to apply to lower-income individuals.
- Exceptions should be considered for those non-refundable tax credits relating to vulnerable individuals, specifically, the medical expense tax credit and disability tax credit.
- Preserve current treatment of charitable donations for AMT purposes to continue to encourage charitable giving, particularly to those supporting public institutions such as hospitals and schools.

Rationale

While the Proposals are generally consistent to the measures announced in Budget 2023, they contain some unanticipated adjustments that do not appear to be aligned with other government initiatives or stated priorities.

Our comments on the Proposals focus on the calculation of the adjusted taxable income (ATI) for AMT purposes in subsection 127.52(1), as well as the potential impact of the Proposals on charitable giving in Canada.

Inclusions

Subparagraph 127.52(1)(d)(i) is amended to increase the inclusion rate for taxable capital gains, allowable capital losses and gains from listed personal property from 80% to 100%, or 1/1. The removal of the current exception for capital gains on gifts to qualified donees was not outlined in the Budget 2023 documents and is a surprising addition to the Proposals. Not only will capital gains on gifts to qualified donees be fully included in ATI for AMT calculation purposes, but any available donation credit will be limited to 50%. The sole exception for gifts is for donated publicly listed securities, which will have an inclusion rate of 30% per new paragraph 127.52(1)(d.1). In our view, this will seriously curtail many large donations to a charitable sector already struggling from reduced donation proceeds due to the current economic environment.

Deductions and Expenses

Subparagraph 127.52(1)(i)(i) is amended to limit the use of non-capital losses deducted under paragraph 111(1)(a) and limited partnership losses of other years deducted under paragraph 111(1)(e) for the purposes of determining an individual's minimum tax. The deductions for these amounts will be limited to one-half of the amounts that the individual otherwise deducted for the year. A further amendment to clause 127.52(1)(i)(ii)(A) limits the amount of capital losses of other years that may be deducted under paragraph 111(1)(b) to the amount that the individual actually deducted for the year. This effectively reduces the inclusion rate for capital loss carryforwards from 80% to 50%.

The Proposals discriminate against the use of non-capital and capital losses of other years. It has been the intention of Parliament that non-capital losses can be carried back up to three years and forward up to 20 years, and that net capital losses can be carried back up to three years and forward indefinitely. These losses represent real, economic losses to individuals and should not be considered as simple preferential deductions. Allowing only 50% of these to be deducted for AMT purposes unfairly penalizes individuals whose income varies greatly from year to year, particularly in the case of capital losses which are already restricted in use to only offset capital gains. An example is as follows:

Assume a capital gain of $300,000
Assume a capital loss is $100,000

Capital gain and capital loss both incurred in 2024:

Federal tax purposes:		AMT purposes	
Capital gain	300,000	Taxable income	100,000
Capital loss	100,000	Addition - 50% gain	100,000
Net capital gain	200,000		
Net taxable income	**100,000**	Net Adjusted Taxable Income	**200,000**

Capital gain incurred in 2024, capital loss carryforward from prior year:

Federal tax purposes:		AMT purposes:	
Capital gain	300,000	Taxable income	100,000
		Addition - 50% gain	150,000
Net taxable capital gain	150,000	Addition - 50% loss	25,000
Less: net capital loss deducted	50,000		
Net taxable income	**100,000**	Net Adjusted Taxable Income	**275,000**

If an individual incurs both the gain and the loss in the same year, there will be a vastly different result for ATI than if the gain and loss are incurred in separate years. This is not a fair result for individuals who have incurred a real economic loss.

We also draw attention to the potential for double taxation in situations where there are beneficiaries of inter-vivos trusts that have income and expenses that are subject to the amendments. For example, consider the scenario of an inter-vivos trust that has investment income, and deducts carrying charges against that income. The net income of the trust is allocated to the beneficiaries, resulting in no taxable income and no federal tax in the trust. Under the Proposals, only one-half of the carrying charges will be allowed for AMT purposes, which will result in AMT payable in the trust. Additionally, if the beneficiaries allocated income from the trust are also subject to the AMT, it is possible that AMT will be payable by both the trust and the beneficiary on the same income. Extending the AMT exemption in proposed paragraph (a) of the description of C in section 127.51 to apply to inter-vivos trusts can help to mitigate the potential double taxation.

As noted, these amendments were stated to target high-income individuals, however, some of the proposed deductions which are to be reduced to one-half for AMT purposes are typically claimed by lower-income individuals:

- The old age pension supplement, social assistance, workers compensation and the deduction for Canadian Forces and police for designated international missions - new clauses 127.52(h)(iii)(A) and (B). The old age pension supplement and social assistance amounts are both, by definition, only available to low-income individuals. The Guaranteed Income Supplement (GIS) is available to those

65 or older and who have income below a maximum annual (low) threshold. Social assistance payments are based on a means, needs or income test and include payments for food, clothing and shelter. Canadian Armed Forces and police on international missions, as well as those individuals receiving worker's compensation benefits are not typically among the nation's highest tax bracket.

- The disability supports deduction applies to already vulnerable individuals who have paid for certain medical expenses related to an impairment in physical or mental functions. The expenses must have been paid in the year to allow the individual to work, go to school or do research for which a grant was received.
- Child care expenses are also included in paragraph 127.52(1)(k) as a preferential deduction that will be reduced. For the past several years, the government has prioritized the lack of affordable child-care and has enacted various measures to address this issue. These expenses can only be claimed against earned income, which does not attract preferential tax rates, and must generally be claimed by the lowest income spouse in the household.

Overall, it is unclear why these amounts should be considered as preferential deductions for high-income earners. Consideration should be given to removing the limitations on these deductions.

Non-refundable Medical & Disability Tax Credits

Various individuals with disabilities, seniors in care homes with health issues and parents with special needs children can easily incur over $150,000 of medical and attendant care expenses in a single year. For tax purposes, such medical expenses qualify for a non-refundable tax credit at a 15% rate. There are many occasions where individuals must actually choose to realize higher income in order to pay for these expenses, such as by extracting greater dividends from an incorporated business, selling stocks in their portfolio, and even taking on a second job. Targeting medical expenses and the associated tax credit, as well as the disability credit, unfairly disadvantages individuals who are already in vulnerable and stressful positions. Additionally, there is already an impact with the AMT tax rate increasing to 20.5% while the non-refundable tax credit rate remains at 15%, which is then is further reduced by one-half.

Impact on Charitable Giving in Canada

Many publicly funded registered charities (i.e., hospitals, universities, and museums) rely on significant donations of both cash and marketable securities being made by high income individuals to fund both ongoing expenses and capital campaigns. The Proposals to reduce, for AMT purposes, the non-refundable credits for charitable donations and implement a 30% inclusion rate for capital gains arising from the donation of publicly traded marketable securities is very concerning to the already struggling charitable sector and will absolutely impact the overall quantum of donations.

4. Tax on Repurchases of Equity

MNP Recommendations:

- Clarity is required with respect to the treatment of warrants for purposes of variable B in the Part II.2 netting formula.
- Consider an exception in the netting formula for shares issued in lieu of payment to service providers, particularly for startup businesses.

The definition of variable B in the netting formula in proposed subsection 183.3(2) does not include any reference to warrants. Many public companies issue units of the corporation, which include both a warrant and an equity component. It is unclear in the Proposals if such units would be viewed as a single component, and therefore excluded from variable B, or if the warrant component can be carved out for purposes of the computation.

It is also common for some public entities (particularly startups) to issue shares in lieu of payment to service providers. As issuances, acquisitions, redemptions or cancellations of these shares are not contemplated in the proposed exceptions from the netting formula, future redemptions or cancellations of such shares may trigger Part II.2 tax. The additional tax cost incurred in these situations could be detrimental to businesses that are in the growth stage. Coupled with current income tax rates, this could be yet another hurdle for Canada to attract foreign investment.

CONCLUSION

Major changes to our tax system should consider how they may disincentivize entrepreneurial risk taking and undermine investor confidence, which could stifle our economic growth as a nation. A certain degree of taxpayer certainty and fairness is required in order to encourage growth and investment. It is paramount that the Minister is not granted the ability to second guess taxpayer business decisions.

The changes to the AMT regime, although intended to apply to high-income taxpayers, contain provisions that impact the most vulnerable Canadians and will have far-reaching impacts on the charity sector.

The looming departure from our current and broadly understood GAAR regime will impact all taxpayers. This casts a negative light on many common, legitimate transactions that taxpayers undertake to manage their personal and business affairs and will discourage entrepreneurship and investment in Canadian business.

Summary of Recommendations

Our primary recommendation continues to be for the Department to engage in a more comprehensive consultation process to properly identify specific weaknesses that need to be addressed in our tax system and reasonable methods to address such weaknesses. Roundtable discussions should be held across the

country to allow for open dialogue with stakeholders to discuss the concerns and recommendations that are undoubtedly being brought forth in consultation submissions such as this one.

In respect of the Proposals, we offer the following specific recommendations:

1. **Provide** clarity on the technical application of the proposed section 84.1 measures to address the practical concerns identified earlier.
2. **Extend** the exceptions in paragraph 84.1(2.3)(h) to apply to additional scenarios that can impact a child purchaser's ability to actively work in and manage the acquired business.
3. **Facilitate** the use of EOTs by:
    - **Allowing** for EOTs to be a minority shareholder of a business for a period of time to allow for a gradual transition of control of the business;
    - **Clarifying** the legislation to allow EOTs to utilize a holding corporation to acquire a qualifying business; and
    - **Including** an exception in subsection 55(2) to allow for a corporation to be purified in a tax-efficient manner prior to a sale to an EOT.
4. In the absence of further meaningful consultation on the proposed changes to the GAAR:
    - **Provide** timely guidance as to how the Minister's representatives and taxpayers are to navigate the interpretive challenges that will arise with the economic substance test; and
    - **Remove** the GAAR penalty proposed in subsection 245(5.1), or at a minimum, expand the application of the penalty exception in proposed subsection 245(5.2). Further clarity can be provided through a list of "mischief" transactions that will be precluded from relying on the penalty exception.
5. With respect to determination of ATI for AMT purposes:
    - **Allow** for the use of losses of other years for AMT purposes to be equal to those for regular income tax purposes;
    - **Extend** the AMT exemption in proposed paragraph (a) of the description of C in section 127.51 to inter-vivos trusts to mitigate double taxation where income or gains giving rise to AMT are incurred at the trust level and allocated to beneficiaries;
    - **Consider** removing the limitation on the deductions and expenses noted above, as most are intended to apply to lower-income individuals; and
    - **Consider** exceptions for those non-refundable tax credits relating to vulnerable individuals, specifically, the medical expense tax credit and disability tax credit.
6. **Preserve** the current treatment of charitable donations for AMT purposes to continue to encourage charitable giving, particularly to those supporting public institutions such as hospitals and schools.

MNP is pleased to continue to work with the Government, Parliamentarians and policy makers across Canada to further discuss our observations, comments and recommendations in this submission.