MNP LLP

SUBMISSION TO THE DEPARTMENT OF FINANCE ON THE AUGUST 12TH, 2024 LEGISLATIVE PROPOSALS RELATING TO BUDGET 2024 AND OTHER TECHNICAL AMENDMENTS

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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 12, 2024 draft legislative proposals with respect to Budget 2024 and other technical amendments (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 consist of more than 280,000 private enterprise and small and medium-sized business clients throughout Canada – including over 22,000 in the farm and agricultural sector.

Executive Summary

It is important to ensure that certainty, predictability and fairness are considered when introducing legislation, particularly when the legislation is intended to impact large groups of taxpayers. Legislation should address its intended objective but cannot do so if the language is ambiguous or subject to varying interpretations. The introduction of new or amended tax legislation should also consider the taxpayers’ perspectives; certainty and predictability of requirements on taxpayers must be present for legislation to be understood and for taxpayers to comply.

In our view, some of the language in the Proposals is ambiguous and would cause significant uncertainty for taxpayers and tax professionals alike. It remains unclear how certain proposed rules are to be interpreted by taxpayers and even more unclear as to how they will be applied by the Minister of National Revenue (the “Minister”). In addition, the language of the Proposals in some cases seems to contradict the objectives stated by the Department. Our submission highlights some of the challenges we anticipate our clients will face if the Proposals are enacted without further review and modification.

The volume and complexity of technical amendments included in the Proposals, as well as the short duration between when the Proposals were released and the consultation deadline, do not allow for adequate time to analyze the full impact of the proposed changes. Our concern is that these Proposals could have far-reaching implications – some of which could adversely impact Canadian taxpayers – if the changes are hastily enacted. **As such, it is our overall recommendation that additional time be taken to engage in a more comprehensive stakeholder consultation process.**

Our submission will specifically focus on the following measures outlined in the Proposals:

A. Trust reporting requirements
B. The Canadian Entrepreneur Incentive

Discussion

A. Trust reporting requirements

The enhanced trust reporting rules that came into effect for taxation years ending after December 30, 2023 have proven challenging for taxpayers, tax advisors, and possibly even for the Minister. In particular, the requirement for “bare trusts” to be subject to the enhanced reporting rules caused widespread uncertainty. As a bare trust arrangement is a legal concept and is not defined in the *Income Tax Act* (“the Act”), many taxpayers were simply unaware or unsure if they had a filing requirement for a variety of common legal arrangements. While the Minister ultimately announced on March 28, 2024, that bare trusts would generally be exempt from the filing requirement for the 2023 tax year, this announcement came just a few days before the March 30 filing deadline. Unfortunately, at this point, many taxpayers had already invested time and resources to meet their obligations in order to avoid the risk of the substantial penalties for failure to file.

As currently enacted, the interpretation and application of the enhanced trust reporting rules rely heavily on legal determinations. This is because the rules are based primarily on two legal concepts: (i) whether an arrangement is considered a bare trust and (ii) whether the particular “in trust” arrangement is an “express trust”. Based on our experience, many lawyers were either unfamiliar with the relevant legal principles or generally reluctant to opine on the appropriate characterization as anything other than a bare trust subject to T3 filing, due to the risk of severe penalties for non-compliance. This results in an unreasonable compliance burden for Canadians.

The Proposals include several substantial amendments to the currently enacted enhanced trust reporting rules. This highlights our ongoing concern that the Department’s objectives with respect to trust reporting remain unclear. The Department’s initial stated purpose of the enhanced trust reporting rules was "to determine taxpayers’ tax liabilities and to effectively counter aggressive tax avoidance as well as tax evasion, money laundering and other criminal activities."[1] Although the Proposals have clarified several arrangements which should not be subject to the enhanced trust reporting rules, the Proposals fall short of alleviating the compliance burden for many otherwise innocuous and immaterial business and personal arrangements.

The Proposals continue to create challenges in requiring taxpayers and their advisors to navigate legal concepts within these rules. Our view is that further time and consideration is required in order to ensure that further amendments to the enhanced trust reporting rules can be effectively incorporated into the existing framework of the Act as a whole.

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[1] 2018 Federal Budget Plan, Department of Finance, February 27, 2018.
https://www.budget.canada.ca/2018/docs/plan/budget-2018-en.pdf

The amendments presented in the Proposals expand the list of trusts exempted from the application of subsection 150(1.2), attempt to provide clearer exclusions of certain arrangements from the meaning of "express trusts" for the purpose of subsection 150(1.2), and narrow the meaning of "settlor" – these are positive changes. However, we are of the view that the Proposals continue to create confusion on trust reporting obligations instead of providing the clarity sought by many.

Deemed Trusts [Express Trusts]

Accountants, lawyers and taxpayers alike have invested significant time and resources over the past six years since the enhanced trust reporting rules were first announced. In addition, these stakeholders have identified unintended implications of these rules throughout this period. The Proposals now appear to alter the meaning of an "express trust" to deem all implied, statutory, or contractual beneficial ownership arrangements to be express trusts. An express trust is inherently uncertain at law, while the Proposals appear to contain an inclusionary definition for the term. Canadians must once again engage advisors to reconcile prior interpretations and filing positions to the Proposals.

Looking at proposed subsection 150(1.3), does this provision mean, for example, that a typical Quebec *prête-nom* agreement could be subject to the filing requirements if it does not otherwise meet an exclusion or one of the listed trust conditions? This would appear to be contrary to the Canada Revenue Agency's view released in technical interpretation 2024-1006681E5.[2]

Again, the Proposals seem to put the new meaning of express trusts in direct conflict with the ordinary meaning,[3] such that it captures those trusts previously understood to be excluded (i.e. resulting trusts or certain trusts deemed to arise under the provision of a statute). Further, the Proposals now include two exemptions in paragraphs 150(1.2)(c) and (q) for trusts required under the laws of Canada, or established for the purpose of complying with a statute, respectively, to access the relief from filing a tax return available under subsection 150(1.1). In interpreting the existing legislation, many were already confused by the inclusion of the paragraph (c) exemption on the basis that a trust that arises under the laws of Canada (i.e. a statute, and by extension – as we understand – a statutory trust) should not be an express trust, and as such, the arrangement was not otherwise caught by the limitation in subsection 150(1.2) and there is no need to look further for an exemption from the reporting requirements. Further clarification is required from the Department on whether trusts deemed to arise under statute[4] would be deemed to be express trusts under the Proposals, but that the combination of paragraphs (c) and (q) would then exempt all such trusts from the enhanced trust reporting rules, even where there are client-specific accounts with balances in excess of the $250,000 threshold contained in subparagraph 150(1.2)(b.1)(iii) of the Proposals.

Another example of confusion and uncertainty caused by the Proposals relates to the Department's comment in the explanatory notes that adding the new listed trust exemption in paragraph (q) aims to relieve bankruptcy trustees from filing obligations. In particular, paragraphs 128(1)(b) and 128(2)(b) deem the estate of a bankrupt not to be a trust for the purposes of the Act, and so we question why an additional exemption under the Proposals is needed. We understand the intent is to provide relief to these types of

[2] 2024-1006681E5, *Arrangements subject to trust reporting*, Canada Revenue Agency, February 28, 2024.

[3] See, for example, *New reporting requirements for trusts and bare trusts: T3 returns filed for tax years ending after December 30, 2023, Question 2.4 What is an express trust?* Canada Revenue Agency, 2024. https://www.canada.ca/en/revenue-agency/services/tax/trust-administrators/t3-return/new-trust-reporting-requirements-t3-filed-tax-years-ending-december-2023.html

[4] For example, holdbacks in the construction industry, and which we understand to be governed by a provincial Builder's Lien Act, possibly requiring a specific client account to govern each holdback arrangement depending on the jurisdiction.

arrangements; however, our ability to follow the Department's comments on intent and purpose in the explanatory notes plays an important role in applying the Proposals in other contexts. Clarification is needed on whether it is the Department's view that beneficial ownership arrangements involving trustees in bankruptcy fall within the meaning of a deemed trust in proposed subsection 150(1.3). If so, this would also suggest the Department's view is that, in the legal determination of whether an agent-principal relationship exists, a bankruptcy trustee is acting as an agent (presumably for the bankrupt).

Finally, with the amendments to subsection 104(1) and the repeal of subsection 150(1.3), it is unclear how deemed trusts would have a filing obligation under subsection 150(1) and obtain relief under subsection 150(1.1), as deemed trusts are only relevant under subsection 150(1.2), which in itself does not create any filing requirements.

Ongoing compliance burden for innocuous arrangements

We note the Proposals provide some relief through the broadened list of exceptions in subsection 150(1.2), along with the clarification of certain arrangements to be excluded from the enhanced trust reporting rules. However, we encourage the Department to reconsider some of the conditions and thresholds introduced to further extend this relief to more innocuous, but common business and family arrangements that should not otherwise constitute aggressive tax planning nor lead to loss of tax revenues.

For example, in our experience, the rules as currently enacted have adversely impacted farming families, as there can often be a separation of legal and beneficial ownership of farmland. It appears the Proposals will provide no additional relief to these arrangements, since the property in issue will generally not qualify as a principal residence, there is not always a partnership involved, and/or there can often be a related farming corporation that is either the legal owner or beneficiary under such arrangements. Additionally, agricultural joint venture arrangements are commonly formed between traditional farming families and Hutterite communities. The Proposals, however, do not seem to offer any relief for such arrangements either.

Further, we question why the exclusion under subsection 150(1.31) for certain Canadian resource property otherwise considered to be held under a deemed trust arrangement applies only if a public corporation is involved. We expect there will be many private corporations engaged in similar Canadian resource activities that will be unfairly excluded from this relief.

As for the new exemption in paragraph 150(1.2)(b) for trust arrangements involving only related individuals with liquid assets less than $250,000, we note that this relief will not be available where a corporate trust company is acting as trustee. It is unclear why trust arrangements where a trust company (as opposed to a related individual) acts as a trustee should cause concern for the Department.

Regarding the new exemption for client-specific accounts that do not exceed $250,000 contained in the Proposals, we believe this threshold is insufficient to provide any meaningful relief and again query what pertinent information the Department intends to gain from the required beneficial ownership reporting or, more importantly, why specific client trust accounts that arise in the course of business activities governed by a provincial statute, or rules of professional conduct, should attract more scrutiny than the general accounts. In either case, these accounts are generally already subject to oversight and reporting.

Lastly, the necessity to track daily fluctuations in value over the course of a year in order to assess one's filing obligations (i.e. whether one of the relevant subsection 150(1.2) exemption thresholds is met) is cumbersome and, in our view, unnecessary. It would be challenging to effect genuine legal transfers of funds or other property to manipulate values for a year-end threshold. A year-end determination will somewhat ease the burden of the complete annual review for the majority of compliant Canadians that likely have, all things considered, immaterial assets held in trust.

Penalties

As noted in our previous submissions to the Department,[5] the penalties in subsection 163(6) for a false statement, omission, or failure to file a return due to gross negligence appear to be excessively punitive, given the level of complexity and uncertainty of the trust reporting requirements. We encourage the Department to revisit these proposals to better align the penalties to those of other information reporting measures in the Act, such as for foreign reporting.[6]

MNP RECOMMENDATIONS

To address the uncertainty of the Proposals on the trust reporting requirements:

- Provide clarification on the **specific** areas of concern that these reporting requirements are intended to address and to allow for more meaningful public consultation to develop a targeted and practical approach to collect this information, including alternative reporting methods such as a one-time disclosure. For example, if the Minister seeks information on real property holdings or transactions, this information can be provided with assistance or directly from sources that have already collected this information, such as provincial land and personal property registries.
- Clarify whether the intent of the Proposals is to deem *any* arrangement that has separated beneficial ownership from legal ownership to be a trust for the purpose of the trust reporting rules, unless the arrangement specifically meets one of the exceptions to the new deemed trust definition, provided in proposed subsection 150(1.31).
- Due to the amendments proposed to subsection 104(1) and the repeal of current subsection 150(1.3), the Department should clarify whether the reference to a "trust" in paragraph 150(1)(c) would include a reference to an "express trust" and whether an express trust would be considered an individual for the purposes of the filing exceptions in subsection 150(1.1). The explanatory notes indicate that a "trust is deemed to include any arrangement…" whereas that is not clear in the draft legislation itself.

[5] MNP submission to the Department of Finance on the February 4, 2022 Draft Legislative Proposals (dated April 4, 2022) and on the August 9, 2022 Draft Legislative Proposals (dated September 30, 2022).

[6] Existing failure to file penalties for foreign reporting in the Act are generally capped at a maximum dollar amount pursuant to subsection 162(7). Additional failure to file penalties for foreign reporting only come into effect after 24 months pursuant to subsection 162(10.1). The gross negligence penalty for false statements and omissions in foreign reporting determined according to subsection 163(2.4) depends on what the false statement or omission is related to and generally relies on cost amounts. A due diligence exception is also available in some cases under section 233.5 for taxpayers who make diligent efforts to obtain the required information and disclose the information that is unavailable.

To relieve the trust reporting compliance burden for taxpayers involved in otherwise innocuous business or family arrangements:

- Extend the deemed trust exclusion for property under an arrangement that is Canadian resource property to private corporations and clarify whether this exclusion is generally intended to apply to joint venture activities common to the oil and gas industry.
- Remove the condition that there must not be a corporate trustee under the proposed exemption for trusts with certain liquid assets with total fair market value that does not exceed $250,000 so that corporate trust companies may benefit from this exemption.
- Remove the exclusion of client-specific trust accounts from the listed trusts altogether, or at minimum increase the threshold to a reasonable amount that would sufficiently alleviate the compliance burden for routine business transactions. Any exemption for this purpose should also allow for investment in certain near-cash, interest bearing investments such as guaranteed investment certificates (GICs).
- Consider the impact of the enhanced trust reporting rules on farming families and consider opportunities to extend exemptions to beneficial ownership arrangements commonly arising for farmland and farming activities. For example, the Department might consider extending the deemed trust exclusions described in paragraphs 150(1.31)(b) and (c) to qualified farm or fishing property. As well, an exclusion might be provided where property deemed to be held in trust is qualified farm or fishing property used in an agricultural joint venture.
- Revise the timing for the determination of any applicable exemption thresholds (i.e. $50,000 and $250,000 under the Proposals) to the end of the year to ease the compliance burden of having to track daily fluctuations and values.

B. Canadian Entrepreneur Incentive (CEI)

The announcement of the CEI in the 2024 federal budget ("Budget 2024") was welcome news. We note that the Proposals appear to have increased access to the incentive in some ways over the original Budget 2024 announcement by reducing requirements on ownership, holding period and level of engagement, accelerating the phase-in period of the incentive, and extending the CEI to dispositions of qualified farm and fishing property.

However, apart from the clear benefit to be realized by farmers, it remains unclear which other small business owners this incentive is intended to target. More specifically, the nature of the excluded businesses described in the Proposals appears overly restrictive, generally limiting access to this incentive in a manner that contradicts the Department's claim that the CEI would "ensure innovators and small business owners, including farmers, are rewarded for their hard work."[7]

The "excluded business" definition will prevent access to this incentive for many hardworking small business owners and entrepreneurs, and appears to be more restrictive than as initially described in the Budget 2024 documents. For eligible non-farming businesses, the CEI is limited to the capital gains on a

[7] *Government announces details on new Canadian Entrepreneurs' Incentive*, Department of Finance, August 12, 2024. https://www.canada.ca/en/department-finance/news/2024/08/government-announces-details-on-new-canadian-entrepreneurs-incentive.html

share sale. This prevents entrepreneurs and innovators who have used alternate business structures, who must sell their business and property through an asset sale, or those who came to own their shares through a stock option plan, from accessing this incentive. In so doing, it is our view that the CEI proposals will be limited in their effectiveness in encouraging entrepreneurship.

We discuss our specific concerns below.

Principal asset is reputation or skill of employees ("excluded business" definition)

This exclusion is problematic in a few ways. First, practically speaking, how are business owners expected to determine whether they meet this threshold? In a standard business valuation, one would expect a portion of the value be attributable to goodwill, but in our view, it is not reasonable to further dissect the goodwill value to determine in what proportion it is attributable to the reputation and skill of the employees versus other intangible assets without guidance.

It remains unclear exactly which businesses the Department is targeting with this exclusion. It is strongly recommended the Department provide further guidance on exactly which businesses or industries this provision seeks to exclude from the CEI, as this is not apparent in the Proposals nor in the accompanying explanatory notes. To ensure certainty and fairness, it is imperative to provide business owners with established criteria against which their ownership can be measured to determine if they are caught by this exclusion.

Provision of services relating to property/allowing for use of tangible/intangible property ("excluded business" definition)

In our view, subparagraph 110.63(1)(f)(ii) significantly restricts which businesses can access the CEI. As this exclusion does not refer to any specific industry or a particular asset type, its impact will be broad.

This exclusion appears to conflate the meaning of a supply of property (whether tangible or intangible) and a supply of a service. In our view, the renting, leasing, or otherwise allowing the use of tangible or intangible property would generally be considered a supply of property rather than a service. The Proposals suggest these supplies of property will be included in the provision of *services* related to property. If this is not the Department's intent, it will be necessary to amend the legislation or otherwise clarify what is meant by services relating to "allowing the use of tangible or intangible property".

If it is the Department's intent to exclude otherwise active businesses that earn a portion of their revenues through leasing or licensing activities, we expect there will be many small businesses and entrepreneurs that could easily be excluded under this provision. For example, a technology business could be excluded because it supplies internally developed intangible property under a license agreement. Similarly, a business in real estate or construction supplying heavy equipment under a lease could also be excluded under this provision. Consider a comparison between a hair salon and a software development company: both are entrepreneurial businesses that create jobs for Canadians. However, based on this provision, the hair salon appears to qualify for the CEI, but the software development company might not. Based on the apparent contradictions between the Department's previous communications and the actual Proposals, it is unclear whether this result is intended.

Nature of qualifying property

It appears, likely for ease, that the CEI has leveraged the existing framework established under section 110.6. Specifically, except in the case of qualified farm or fishing property, a qualifying individual must

dispose of shares of a corporation in order to access this incentive. We encourage the Department to consider extending this incentive, at minimum, to partnership interests in addition to those in farming or fishing.

Employee stock options

Due to cash flow shortages inherent in most start-up businesses, such as the technology sector, many entrepreneurs and innovators attract others to join in their business endeavours through stock option incentives. However, the Proposals do not reward those same innovators and entrepreneurs who earned their shares through a stock option plan for their hard work. More specifically, the Proposals only provide an enhanced deduction from taxable capital gains realized on the disposition of qualified CEI property, whereas one might expect the substantial portion of accrued gains on qualifying CEI shares acquired under an employee stock option plan would be included in employment income pursuant to subsection 7(1.1) in the year the shares are disposed.

MNP RECOMMENDATIONS

- Remove the exclusion for businesses that have as their principal asset the reputation and knowledge of one or more employees. Alternatively, reconsider the purpose of the exemption to help establish a condition that provides more certainty to taxpayers with clear and measurable criteria. For example, consider if a limit based on the total number of employees would meet the Department's objectives. Only with a clear understanding of the Department's policy intent of the exclusion can we provide meaningful recommendations.
- Remove the exclusion for the provision of services relating to property including renting, leasing, or otherwise allowing for the use of tangible or intangible property.
- Expand the definition of "qualifying Canadian entrepreneur incentive property" in proposed paragraph 110.63(1)(a) to include interests in partnerships that carry on businesses otherwise eligible for the CEI on a share sale.
- Extend the CEI to qualifying individuals who earned their shares through an employee stock option plan by increasing the stock option deduction available on dispositions of qualifying CEI property in a manner consistent with the increase in the deduction available to capital gains on qualifying CEI property.

Conclusion

Based on the issues noted above, the measures introduced in the Proposals and discussed above will, in our view, create further confusion and uncertainty as to how they are to apply. We request that consideration be given to each of the recommendations discussed above.

Over the past few years, Canadians have seen a succession of tax legislative changes, adding layers of complexity, uncertainty, as well as taxpayer compliance burden on an already-complicated tax system. To create a more stable tax environment to not only maintain existing investment, but also attract new investment in Canada, we strongly urge the Department to engage in collaborative consultation ahead of legislation being tabled. The government should commit to increased consultation with industry groups and experts before legislation is introduced to Parliament. The government must constructively react to the feedback being provided; otherwise, such consultations will be perceived to have no meaning.

Furthermore, greater alignment is needed between the objective of policy changes and the process by which they are administered. Consultation between government departments and external stakeholders should be utilized to ensure policy objectives are met without causing undue administrative burden on all taxpayers. Thorough planning should be undertaken before changes are implemented to prevent last-minute changes to compliance requirements as we have seen in the past.

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

MNP LLP