



Ontario Medical Association

**Submission to the
Department of Finance Canada**

Tax Planning Using Private Corporations

September 2017



Introduction

The Ontario Medical Association (“OMA”) represents Ontario’s 30,000 practicing physicians and advocates on behalf of the medical profession and the people of Ontario in the pursuit of good health and excellence in health care. The OMA appreciates the opportunity to respond to the proposals to amend the *Income Tax Act* (“Act”) regarding the taxation of private corporations.

Approximately two-thirds of Ontario’s physicians have incorporated their practices as Medicine Professional Corporations (MPCs). This has been done, primarily, for the ability to invest retained earnings for retirement and family tax planning opportunities a common practice afforded to small Canadian businesses operating as privately held corporations. These are legitimate tax planning opportunities that have been in place for decades, and have been accepted as legitimate by Canada Revenue Agency, the federal court, and both federal and provincial governments. In 2000, the Ontario government granted physicians and other professions the ability to earn professional income through a corporation. In 2005, the Ontario government further amended the Ontario *Business Corporations Act* to expand the list of eligible shareholders of MPCs to include family members of a physician in order to participate in widely accepted tax planning strategies.

The proposals contained in the Department of Finance’s “Tax Planning Using Private Corporations” consultation document (the “Consultation Document”) would have significant consequences for incorporated physicians, most notably for the vast majority of Ontario’s incorporated physicians who planned to use their MPC to draw income for their retirement. Furthermore, many physicians use the tax savings from the MPC to operate their practices. Removal of these tax planning strategies would not only impact physicians and their families, but also the care provided to patients.

Physicians are mobile and can relocate to the United States (or other jurisdictions) where the tax systems are more favourable. These jurisdictions have lower marginal tax rates, favourable tax brackets, and the ability to be taxed at the family level. North American jurisdictions compete to attract/retain physicians for their growing and aging populations. Removing tax incentives will discourage physicians from considering to practice in Canada, and ultimately jeopardize national physician human resources.

Holding Passive Investments Inside a Private Corporation

The Consultation Document states that “fairness and neutrality require that private corporations not be used as a personal savings vehicle for the purpose of gaining a tax advantage. Passive investments held within privately-controlled corporations should be taxed at an equivalent rate to those held outside such corporations.”

The OMA strongly disagrees with this position. Physicians and small businesses use the tax savings from passive investment for legitimate tax planning purposes that; (a) recognize the risks taken to own and operate a business; and (b) provide an opportunity to create benefits such as retirement planning in lieu of a pension and employment benefits such as extended health care. Tax savings on passive income also allows physicians to save income to eventually be invested in their practices in order to address major capital purchases or having funds available to address unforeseen expenses.

Planning for Retirement

Only 7% of Ontario physicians are employees. The vast majority are small business persons. Unlike many employed individuals, physicians do not have a pension. Current tax rules allow physicians, through their MPCs, the opportunity to invest passive income at a preferable tax rate. Such investments are typically used as a retirement fund for the physician. Tax is recognized on the income when the investment amounts are eventually received by the physician. Approximately 95% of surveyed physicians who have incorporated plan to use their MPC to draw on income when they retire, and 55% indicate tax deferral as the most important reason to be incorporated. Physicians have used MPCs for retirement planning since physicians in Ontario were permitted to earn professional income through their corporation in 2001.

If the “Elective Model” proposal set out in the Consultation Document is adopted, a retired physician who planned on only receiving income via investment income from her corporation would be taxed at approximately 73%. Taxing passive corporate income at this rate undermines the concept of tax integration as passive corporate investment income is taxed at a significantly higher rate than the individual rate. The results of such a drastic amendment to the taxation of passive corporate income is unnecessarily punitive and would

be extremely unfair to physicians who in good faith used legitimate tax planning strategies for their retirement.

Planning for Leaves

Similarly, many physicians use the deferred tax savings in their MPC to plan for health-related leaves from practice. Physicians do not have employer funded benefit plans for leaves such as pregnancy or illness. Tax savings from passive investment allows for physicians to plan such leaves. The current maternity/parental leave program offered to physicians by the Ontario government only covers a short period of time and is often not sufficient cover overhead expenses during the leave. Many female physicians use investment income from their MPCs to fund their pregnancy and parental leaves. Taxing a physician who has prudently planned to address the financial impact of a leave is misguided and indirectly discriminates against young female physicians.

Contingency Planning

The proposal to tax all passive income in a private corporation will harm the corporation's ability to contingency plan or plan for future large scale purchases. Physicians use the income earned through their MPC on passive investment to address future large scale purchases such as costly equipment for radiology or ophthalmology, or the installation and operations of an electronic medical records system. Corporations often require several years of savings to make these purchases. The taxation of passive corporate income would penalize this type of planning as unspent corporate income would now be taxed at a higher rate.

Implementation

The OMA offers caution regarding the implementation of any such changes. The complexity of the rules makes implementation complicated. In fact, the Department of Finance recognizes this in the Consultation Document, which noted the repeal of the 1972 plan to impose a refundable tax in respect of ineligible investments as it was "complex and difficult." This remains equally complex today.

Income Sprinkling

The Consultation Document proposes amendments to the Act that would expand the tax on split income to include adult individuals (Canadian resident) who receive income from the related business, subject to a “reasonableness test.” The Consultation Document uses the example of Jonah and Susan to compare the income tax paid by an individual who is employed and someone who earns income through a private corporation to demonstrate the difference in taxes paid. This comparison is flawed as an employee should not be compared to someone who operates their own business.

Equating the tax treatment of a self-employed incorporated business owner with a salaried employee ignores the fundamental non-tax differences between the two individuals. This comparison provides no recognition of the risks associated with starting and operating a business. For physicians, these risks include, incurring and personally guaranteeing debt for start-up, staff recruitment, provision of staff benefits, rent, equipment and overhead costs. Employed individuals face none of these risks and have added financial protection under the employment law and the *Employment Insurance Act*. A self-employed incorporated business owner has no paid holidays, sick days, or pregnancy/parental leave, extended health or insurance benefits, or other perks and benefits enjoyed by most employees. Hence, equating employees and individuals who operate a business through a corporation is misguided.

Approximately 80% of surveyed incorporated physicians use their MPC for income splitting, and nearly one-third of surveyed physicians use their tax savings today. These savings allow physicians to open new medical practices and build their business to provide care for more patients. The proposed amendments would change this, especially for new physicians who enter practice with tuition debt that on average exceeds \$150,000. Current tax rules reduce the impact of these financial liabilities thus allowing physicians through their MPCs to focus on improving the type of services and care offered to patients. This would undoubtedly suffer if current tax planning strategies were removed.

Conclusion

These proposed changes are the most significant changes to the taxation of private corporations since 1972, when the government acted on the recommendations of the 1966 Report of the Royal Commission on Taxation by the Carter Commission. It took several years for the report to be created and the Act to be amended. Making decisions of this

magnitude requires careful consideration. Such consideration must include consultation with all impacted stakeholders. The brief 75-day consultation period offered to these amendments does not suffice.

In addition to the more than 20,000 incorporated Ontario physicians, the proposed changes will negatively impact hundreds of thousands of Canadians who operate small businesses. Businesses of farmers, restaurateurs, convenience store owners, and other professionals will be damaged if these proposals are implemented. Accordingly, we request that the Department of Finance reconsider these proposals as they will cause considerable harm to Canadian small business, including the medical practices of physicians.

We appreciate the opportunity to provide feedback on the Consultation Document and trust you will consider our views in your deliberation. We again hope that you consider our request to extend your consultation period in order expand the scope of your consultation to ensure any amendments to the Act are prudent. We are available to the Department of Finance to answer any questions and to elaborate on points raised in this submission.