CANADIAN DENTAL ASSOCIATION
ASSOCIATION DENTAIRE CANADIENNE

Submission to the Consultation on Tax Planning Using Private Corporations

Submitted by the Canadian Dental Association

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1. EXECUTIVE SUMMARY

The tax measures addressed in the government's consultation on tax planning using private corporations are not "loopholes," as the consultation paper suggests. They are legitimate tax planning strategies which were established more than 45 years ago to recognize the risk small business owners assume, and the broader societal rewards of helping small businesses grow and prosper.

As such, the changes proposed aren't mere tweaks, but fundamental changes to the rules on which dental offices and their business models were established.

Dental offices are small businesses, providing middle-class jobs for tens of thousands of Canadians. They purchase supplies and equipment from Canadian suppliers, and they are strong contributors to the economy, both locally and nationally.

We believe the tax changes suggested in the discussion paper will result in:

1. **Leaner practices**
   a. Reduced operating hours and reduced staff
   b. Less investment in new treatment technology and upgrades– both of which improve the care dentists provide to patients
   c. Lower economic output– which will result in less tax revenue for all levels of government

2. **Disproportionate negative impact on female providers of care**

The consultation paper's comparison of a salaried employee and the owner of a Canadian-Controlled Private Corporation (CCPC) creates a false equivalency between two individuals, and focuses too narrowly on the individual tax burden. The comparison does not account for added benefits enjoyed by salaried employees and subsidized by employers, including paid vacation and leave, retirement benefits, and Employment Insurance. It also does not account for the stability of predictable remuneration for employees versus the economic fluctuations faced by business owners.

Moreover, the focus on the individual tax burden does not account for the added costs in establishing a small business, nor the risk assumed by small businesses. It also does not recognize the economic activity generated by small businesses, which creates added tax revenues. For dentists, this includes capital expenditures to maintain a dental clinic—in essence a "mini-hospital."

The proposed solution in the draft legislation on "income sprinkling" and a "reasonableness test," is vague and will create uncertainty and added administrative burden to dental offices. The lack of clarity on what is "reasonable" will also result in years of ongoing litigation between the Canada Revenue Agency (CRA) and small business owners, at significant expense to both parties.

Moreover, the Supreme Court has already established that contributions to a business, and the dividends received from it, are independent factors.

The proposals addressing passive investment in a corporation would result in double taxation of savings. These funds are already taxed at the appropriate marginal tax rate when they are drawn out of the corporation, and serve a vital role in ensuring that small businesses have reserve funds to help them access capital to expand and grow, or to withstand economic fluctuations or downturns.

The ability to access these funds as needed rather than having them locked into retirement vehicles (such as RRSPs or TFSAs) is vital, especially in the early phases of establishing a business.

Diminished reserve funds invested passively within small businesses to deploy as capital, or to hold to show potential lenders, will have unintended consequences. This will include small businesses being forced into taking a more deliberate approach to growth, less capital investment and slower job growth.

A growing cohort of female dentists will be hardest hit by new taxes on funds invested within the corporation. With less access to these funds, female dentists in the early stage of their career may be faced with untenable choices between starting a family and building their career and business.

Moreover, the vast majority of jobs created in dental offices are staffed by female employees.

The concerns over the rate of growth of CCPCs are overstated, with annualized growth of 2.74%, and obvious contextual factors for this growth over the past decade.

The government's goal of "fairness" is laudable, but achieving this by isolating aspects of the Income Tax Act is unlikely to achieve this goal. Without a fulsome examination of the tax code that puts these legitimate tax planning strategies into an appropriate context, the actions taken in this area will harm a vital segment of Canada's economy while not addressing other issues, such as the offshoring of money out of the Canadian economy.

In seeking to create fairness, the government should not target changes that affect small businesses, such as dental offices, and negatively portray their legal, long-standing and well-established business practices as outside the norm.

These proposals must be set aside, and a new process established to review tax policy with a full view of the potential negative consequences, and the deeper economic and social impact that such changes could have, especially on the middle class.

2. INTRODUCTION

The Canadian Dental Association (CDA), on behalf of its members and dentists across the country, is compelled to make this submission to the government's consultation process on Tax Planning Using Private Corporations.

Given that the majority of dentists across the country are incorporated, the draft legislation put forward in the government's consultation paper would have an undeniable and profound effect on individual dental practices, their employees, their suppliers, their patients, and communities in which they operate.

Dentists, by virtue of their training, knowledge and expertise, are healthcare providers, first and foremost. The care they provide to their patients is done primarily through private dental clinics, owned by a dentist.

While the business structure of individual dental offices can vary, they are all legitimate small businesses that employ Canadians in communities throughout the country. In many cases, they are family businesses, supported both directly and indirectly by the individual family members through their labour and their assumption of shared risk. Small businesses are the backbone of the Canadian economy. They employ more than 10 million Canadians, accounting for 66.8% of Canadian jobs.[1] Any government action that impacts such a significant proportion of the Canadian economy should only be taken after deliberate study, meaningful consultation, and with clarity of purpose.

The CDA firmly believes that the measures addressed in this tax consultation are not "tax loopholes," as stated in the discussion paper and in other venues by officials, but rather are long-standing, deliberate and legitimate ways for small businesses – including dental practices – to structure to ensure the stability and viability of their enterprises.

[1] MNP, Implications of Federal Tax Changes for Dentists, pg.10

3. DENTAL OFFICES AS SMALL BUSINESSES

Although the acts and regulations that govern health professionals restrict how dental practices can be established and owned, dental offices are small businesses, sharing many of the same concerns as small operators and entrepreneurs across different sectors of the economy.

Dental practices make significant contributions to the local, provincial and national economy. Operating a modern, efficient dental practice requires significant investments and ongoing expenses.[2]

Major expenses for dental practices include office space (either purchased or through a lease), current dental equipment and technology and supplies. Licensing fees, regulatory costs, professional services and insurance are also significant expenses.

Labour is the most significant expense incurred by dental offices, accounting for approximately 40% of the average dental office's expenses.

4. COMPARISON OF EMPLOYEES, SALARIED WORKERS AND BUSINESS OWNERS

In both the discussion paper released by the government in July 2017, and in subsequent discussion and communication, the focus and intent of these changes are to create tax fairness and equity between employees and those who are incorporated business owners.

The examples put forward in the discussion paper to contrast the amount of taxes paid by salaried employees versus owners of CCPCs do not account for many common scenarios for dental practices, including:

- Incurring personal debt for dental education to enter the profession, with student debt loads exceeding $200,000, and increasing substantially.
- Use of personal savings or incurring debt to capitalize the business, with start-up costs for dental practices ranging from $750,000 to more than $1,000,000 including new equipment.
- Opportunity cost of a spouse supporting the business, or forgoing career opportunities.
- The significant amount of post secondary training required to become a dentist, meaning a much later start to a working career.

Furthermore, a dentist's ability to be active in their practice is not only vital to their own earning ability, but the entire dental office is reliant on the dentist's ability to perform his/her duties to ensure the ongoing viability of the practice.

[2] MNP, pg.11

If a dentist is unable to perform his/her duties for reasons of illness, disability or any other leave that is required, they must either absorb the significant cost of paying a salaried replacement for themselves, or be forced to sell, or even close, the practice.

The comparison also focuses narrowly on the amount of direct taxes paid by an individual on a yearly basis. The CDA strongly suggests that this comparison is unfair, as it does not account for rights and benefits which are provided to employees, often mandated as a result of employment standards legislation or collectively bargained agreements.

These benefits include, but are not limited to:

- Vacation pay
- Severance pay
- Employment Insurance benefits
- Sick leave
- Statutory holidays
- Disability or Long-Term Disability
- Personal leave
- Maternal/Parental leave benefits
- Retirement Benefits, including pensions or RRSP-matching

Moreover, employees ultimately benefit from the risks taken by small business owners, in the stability of ongoing and annual remuneration. Employees also do not bear responsibility for changes in the structural operating costs of running a business, including regulatory fees and professional fees.

Importantly, employers are responsible for the maintenance of reserve funds to ensure that the business can continue to operate or support its employees and suppliers in the case of dramatic events, such as natural disasters, or sudden economic downturns.

5. INCOME SPRINKLING

Small businesses in Canada have a long-standing history of sharing income within the family unit, referred to as "income sprinkling". In fact, this practice has been supported by previous judgments from the Supreme Court of Canada.[3]

The draft legislation includes the introduction of a reasonableness test to determine if certain income should be subject to the higher Tax on Split Income (TOSI) rules. The Government has put forward

[3] *Neuman v. M.N.R.*, [1998] 1 S.C.R. 770

several factors which may be used to determine if an income amount is reasonable, the so-called "Reasonableness Test."

The CDA is concerned that the proposed rules will result in inconsistent application of the "Reasonableness Test", as this requires a subjective self-assessment of labour and capital contributions which would be assessed against as yet undefined standard valuations.

The Supreme Court has already established that there is no correlation between the quantum of one's contribution to a company and the dividends that one receives from that company.

In regard to labour contributions, the draft legislation, as it is currently presented, does not properly define what factors would be considered, what reporting mechanisms would be required of businesses, and what range of comparable labour would be considered by the CRA. The vagueness in this area would likely result in years of litigation between the CRA and small business owners of all types to define these factors, at great expense to both the Crown and individual small business owners.

Labour Contributions: On contributions of labour, spouses and family members may be involved on an ongoing basis, but may see their contributions vary depending on a variety of factors.

Such an approach would certainly create a requirement for added internal administration and tracking of hours and tasks undertaken by individuals, which is not in keeping with the government's stated goals of simplifying the tax code.

Capital Contributions: The Reasonableness Test would also seek to assess the level of risk assumed by an individual receiving dividends from a business. This is an impractical measure, as determining and assessing risk would be highly subjective with a multitude of economic, demographic and geographic factors contributing.

Importantly, family law regimes across Canada treat marriage as an equal economic partnership.[4]

Because of the complexity that the new constraints would cause, the TOSI income rules should not apply to a small business owner's spouse or common law partner.

6. PASSIVE INVESTMENTS IN A PRIVATE CORPORATION

Investing passively in a private corporation has been a legitimate long-standing practice for many generations of Canadian business owners.

[4] https://www.attorneygeneral.jus.gov.on.ca/english/family/familyla.html

Allowing owners and entrepreneurs to utilize and reinvest the capital within their businesses creates vital economic activity, incenting owners to take measured risks to expand and grow their businesses.

In the specific case of dental practices, they require vital capital equipment investments to keep up with government and non-government mandated imposed regulations. They also spur employment as the practice grows, and create good, middle-class jobs for skilled healthcare workers. Investing passively within a corporation:

- accommodates businesses who assume risk and responsibility not otherwise assumed by employees.
- provides a business owner with efficient access to capital so that opportunities can be seized creating growth and employment for our economy.
- encourages business owners to accept risk and make investments if they have access to more capital.
- allows a business owner to manage risks assumed when one goes into business for themselves. These risks are not otherwise assumed by employees.
- allows a business owner to diversify risk by investing in assets that are very different than private corporation shares.
- allows a business owner to provide for retirement and other unforeseen circumstances that may need to be self funded. As stated previously, self employed individuals do not have pension plans, paid holiday, benefits or sick days like an employee.

In establishing their small businesses, many dentists have chosen to legitimately organize themselves through passive investment in their corporation, as opposed to other individual savings tools such as RRSPs or TFSAs. In large part, this can be attributed to the fact that passive income saved within the corporation can be deployed as capital on an ongoing basis as needed, whereas savings in these other savings tools cannot be reinvested in businesses. Small business owners take on personal risk with their corporations, and need to access personal capital to maintain stability.

Moreover, passive income saved within a corporation is already taxed fully when it is drawn out of the corporation as income. The proposals of the discussion paper would result in “double taxation” of passive income funds, resulting in a combined income tax rate of as much as 73%, depending on the province.

Further, the proposed approach in many instances may encourage small business owners to take income out of the company as salary in order to maximize their RRSP room, as opposed to leaving it within the corporation to maintain business flexibility.

While there is no draft legislation in the discussion paper dealing with passive investment, the suggested changes – both an apportionment and an elective method – would represent a radical change to legitimate tax structures. Both suggested methods would add further complexity to the already complex and daunting tax system.

A fair tax system accommodates taxpayers who assume different levels of risk and is flexible enough to allow taxpayers to manage various circumstances.

From a policy perspective, there are many examples of accommodation or incentive such as the Long-term Capital Gains Exemption (LCGE) and the Small Business Deduction (SBD) that accommodate a self-employed individual's realities when compared to an employee.

In our view, passive income is already taxed at rates of almost 50% to discourage investing passively in a corporation and when passive income is distributed to individual shareholders, investment income is taxed appropriately.

7. POTENTIAL OUTCOMES OF THE PROPOSED CHANGES

The approach of this consultation has been to compare and assess the owners of CCPCs from a perspective of individual taxpayers, in comparison and contrast to individual salaried workers who are taxpayers.

What this approach negates is the complex involvement of the owner with the business. Any new tax measure which impacts on the owner will inevitably have an impact on the business, and vice versa.

Leaner Practices: In the specific case of dental practices, tax measures that create a significant additional tax burden could result in broad and fundamental changes in the way that dental offices are established and organized.

The average annual expenses in a dental practice according to Statistics Canada figures is approximately $604,100, the most significant portion of which is labour costs.[5] Approximately 40% of the costs within dental practices are for labour.

An additional significant cost is professional and business fees, which account for 11% of expenses. These include regulatory fees and levies which are compulsory for professionals to operate. It also includes the external professional counsel, including legal and accounting advice required by dental offices to navigate the existing complexity of the tax code.

Rent accounts for a further 8% of business expenses.

[5] MNP, pg 22

Where regulatory fees and rent are fixed costs and often increasing, labour is the largest area of expenses where business owners have discretionary ability to contain the overall costs of business.

It is estimated that a $2.14 reduction in expenses will be required to maintain each dollar of after-tax cash under the proposed rules.[6] To account for the loss in net revenues to the practice, dentists may decide to operate their practices in a more streamlined manner to offset the loss in net income. To reduce spending, dentists may choose to reduce hours or reduce staffing costs, or choose not to hire new employees to grow the business.

Dental practice spending creates significant economic activity across the country. A reduction in expenses results in additional taxable income at the corporate level, after which the amount distributed to the individual is then taxed personally.

Reductions in spending and economic activity by dental practices to recover portions of net income will ultimately result in lower economic output, less employment within dental practices and less tax revenue for all levels of government.

Reductions in spending would result in losses of between 1,400 and 7,000 total Full Time Equivalent ("FTE") Jobs (direct, indirect and induced) across Canada.[7]

Innovation and Investment: Dental clinics are "mini-hospitals," requiring significant investment in technology to serve the needs of patients. The average cost of new equipment in a standard dental office can range from $750,000 to $1,000,000.

Decreasing operating profits from dental offices will reduce the ability of those offices to reinvest in this technology, or delay capital cost investment in the practice.

Gender Equity Considerations: The number of female dentists is growing in Canada, with women representing the majority of dental graduates from Canadian dental schools. In 2008, the percentage of female graduates was 54.7%.

Dentists in the early part of their career face significant start-up costs. Young female dentists who intend to start a family must account for these costs, while also ensuring that there is sufficient capital to continue to keep the practice running.

This includes all the costs involved in ensuring that their patients can continue to be served through hiring a locum (replacement dentist) at a significant cost to ensure that the practice remains active, and that employees of the dental practice continue to be paid.

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[6] MNP, pg 22

The capital saved within the corporation allows dentists who wish to take parental leave with adequate resources to take leave. Moreover, the funds drawn from the corporation are taxed when they are used for this purpose.

If passive investments are taxed at higher rates on an ongoing basis, the real cost of taking parental leave – or any other necessary leave – will grow increasingly prohibitive.

Furthermore, such measures may result in women choosing not to pursue dentistry as a profession from the outset.

Practice consolidation, downsizing or deferral of hiring to grow practices that could occur as a result of such significant changes to the tax regime would have a further impact on female professionals and staff within dental practices. The overwhelming majority of staff within a dental office are women:

- Dental Assistants: 98% female
- Dental Hygienists: 97% female
- Administrative support: 80% female

8. CONTEXT FOR GROWTH OF CCPCs

A key factor stated in the consultation paper for pursuing these changes was a sharp increase in the utilization of CCPCs. However, this sharp growth is expressed as a single figure over a longer period of time. In fact, the annualized growth rate of CCPCs is 2.74% between 2002 and 2014.

Context is vital to understand why there was growth during this period, and why the growth curve is unlikely to rise in perpetuity.

The rise in the use of CCPC between 2002-14 came as regulated professions across the country first gained access to the ability to incorporate themselves. For instance, medical doctors in Ontario first received the right to incorporate in 2000.

This also arose at a time when concerns of liability or the potential of litigation is of greater concern for small business operators. One of the primary benefits for the establishment of a CCPC is the ability to insure against personal liability.

Within the context of dentistry, it should be noted that the acts which govern health professions at the provincial and territorial level place restrictions on dental corporations, most specifically on who can own them. Unlike other businesses, there is a limited market for who can purchase a dental corporation, which ultimately limits their market value.

9. CONCLUSION

The changes to tax policy which would arise from this process are profound. For dental practices, like many other small businesses, these changes could have a fundamental impact on how dental offices are established, how they are managed, how they are staffed, and how they are sold.

The changes will result in behavioural changes by all small businesses, which are not addressed or considered in the government's consultation paper. These changes in business activity will dampen economic growth and prosperity in the engine of Canada's economic growth and job creation.

The goal of a more prosperous and inclusive middle class is laudable. But the tax measures proposed will have a chilling effect on the ability and motivation for small business to invest and grow. For dental offices, like most any business, the largest driver of costs is staff salaries and benefits, and a new regime of added taxation cost to businesses will make it more challenging to add employees, raise wages, expand hours, or retain staff.

The discussion paper released on July 18, 2017, is a highly technical document. Moreover, it is multifaceted, with multiple proposals. Some of the proposals include draft legislation while others do not, creating uncertainty regarding the potential impact of a full suite of tax legislation changes versus individual legislative changes.

To appropriately study the impacts of such changes and share in a meaningful discussion of the negative consequences is simply not feasible within the parameters of this consultation.

The government has indicated that it is interested in potential alternatives or changes to the suggested legislation. However, conceptualizing potential alternatives and understanding their impacts is simply not possible within such a short time frame. Such discussions require significant consideration within organizations to weigh options and make informed proposals that are supported within their own memberships.

Moreover, the discussion paper takes a narrow view of the impacts, without examining the deeper social or economic impact of such changes on small businesses and their employees.

A 75-day consultation period is simply not sufficient to engage meaningfully on these changes. The Canadian Dental Association would strongly recommend that the government sets aside the current proposals, and establishes a process which allows for a broader, more fulsome, discussion of the modernization and improvement of the tax code.

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10. ABOUT THE CANADIAN DENTAL ASSOCIATION

The Canadian Dental Association (CDA) is the national voice for dentistry dedicated to the promotion of optimal oral health, an essential component of general health, and to the advancement and leadership of a unified profession.

The CDA is a federation of the provincial and territorial dental associations, and represents the interests of dentists through our members. The associations which are members of the CDA are as follows:

- Alberta Dental College and Association
- British Columbia Dental Association
- Manitoba Dental Association
- New Brunswick Dental Society
- Newfoundland and Labrador Dental Association
- Nova Scotia Dental Association
- Northwest Territories and Nunavut Dental Association
- Ontario Dental Association
- Dental Association of Prince Edward Island
- College of Dental Surgeons of Saskatchewan
- Yukon Dental Association

In addition, the CDA has more than 500 individual dentists as affiliate members in the province of Quebec.