

CMA submission:

**A MEDICAL INDUSTRY  
PERSPECTIVE – SUPPORTING  
SMALL BUSINESS, THE  
ECONOMIC ENGINE OF CANADA**

Submission to the Department of  
Finance consultation on tax planning  
using private corporations

October 2, 2017

The Canadian Medical Association (CMA) is the national voice of Canadian physicians. Founded in 1867, the CMA's mission is empowering and caring for patients.

On behalf of its more than 85,000 members and the Canadian public, the CMA performs a wide variety of functions. Key functions include advocating for health promotion and disease/injury prevention policies and strategies, advocating for access to quality health care, facilitating change within the medical profession, and providing leadership and guidance to physicians to help them influence, manage and adapt to changes in health care delivery.

The CMA is a voluntary professional organization representing the majority of Canada's physicians and comprising 12 provincial and territorial divisions and over 60 national medical organizations.

## Introduction

The changes announced on July 18, 2017, are the most significant change to the private corporation tax structure in 45 years and will have a negative impact on doctors and also convenience store operators, electrical contractors and family farmers. In short, these proposals will negatively affect all small business owners, most of whom are squarely in the middle class and are the engine of the Canadian economy.

We believe a 75-day consultation is inadequate to assess the scope of these changes and the ramifications for not only our members but also the 1.1 million other small business operators as well as the impacts of the proposals on Canada's prospects for future economic growth.

The Canadian Medical Association (CMA) strongly urges the federal government to:

- 1) suspend the current proposals;
- 2) conduct a comprehensive review of these proposals to ensure that legislation can meet policy objectives without significant unintended consequences; and
- 3) engage all Canadians in a comprehensive review of the tax system considering unique aspects of all sectors, including safety net provisions.

## Economic considerations of the tax proposals:

### Small business in Canada

Most Canadian businesses are small. As of December 2015, there were 1.17 million employer businesses in the Canadian economy. Of these, 1.14 million (97.9%) were small-sized businesses, 21,415 (1.8%) were medium-sized businesses and 2,933 (0.3%) were large-sized businesses.

Small- and medium-sized enterprises (SMEs) are critical contributors to the Canadian economy. They generate the majority of Canadian jobs. Across the country, an estimated 10.6 million people (66.8% of the labour force) work in small-sized businesses and another 3.3 million (20.4%) are employed in medium-sized businesses. Only 2.0 million (12.8%) work in large-sized businesses.

In addition to generating jobs, SMEs make a significant contribution to gross domestic product (GDP). Notably, small businesses with fewer than 50 employees will contribute on average 30% to national GDP. SMEs also make sizable contributions to research and development. Between 2011 and 2013, SMEs accounted for 27% of the research and development expenditures in this country.

### Medical industry

Physicians' offices are an important component of the Canadian economy, employing people and supporting suppliers in their communities. The majority of physicians (66% or 54,000) own and operate a private corporation.

The direct GDP contribution produced by physicians' offices in Canada in 2016 was \$22.3 billion. They paid \$6.2 billion in wages and salaries, employed 137,000 people and contributed \$643 million in tax revenues to governments. Including the supply chain and induced effects of this economic activity, the total GDP supported by the economic footprint of physicians' offices was \$33.4 billion and the total number of jobs supported was 250,000.

Physicians' medical practices, in addition to providing essential health care services to Canadians, also provide a noticeable contribution to Canada's economy. The total economic footprint of physicians' practices in 2016 — directly, through their supply chain and through induced effects — accounted for 1.6% of Canada's total GDP in 2016.

### Making Canada an attractive place to practise medicine

Physicians and small business owners across the country believe that the proposals are complex and will ultimately lead to unintended consequences that will affect all Canadians. With so many underserved regions of Canada and 5.3 million orphan patients, it behooves government to establish conditions that facilitate recruitment and retention of highly skilled professionals, such as physicians.

Physicians are more mobile than many other small business owners. Between 2014 and 2015, for instance, approximately 740 physicians (about 1% of all physicians) moved from one province or territory to another. In the CMA's recent member survey, 22% of practising physicians stated they would consider relocating their practice to another country as a result of the proposed federal tax changes. Of the medical residents who participated in the survey, 39% would consider moving their practice to another country if the proposed federal tax changes are implemented.

The experience of the 1990s provides evidence that this is a real possibility. In 1992, health ministers agreed to reduce medical school enrolment, and shortly afterward provincial governments began to put restrictions in place, such as a two-year moratorium on new billing numbers in Ontario for physicians who had not completed their undergraduate or postgraduate training there. These measures sent a clear message that doctors were not welcome in Canada and it was no surprise that they left in large numbers. From 1995 to 1997 Canada experienced an annual average net loss of 454 physicians to migration, the equivalent of four medical school classes. The United States continues to face a shortage of physicians, and it may be an attractive alternative for Canadian physicians to practise. Projections released earlier this year for the American Association of Medical Colleges indicate that the United States will have a shortage of between 40,800 and 104,900 physicians by 2030.

The path to becoming a physician is a long one, which includes 10 or more years of postsecondary education. As a result, physicians start their careers later than other workers. Average student debt ranges from \$160,000 to \$180,000. This represents a large personal investment of time and money. We want to ensure that Canada establishes the public policy conditions necessary to retain and attract the next generation of physicians.

### **Thriving medical practices are the best medicine for patients**

Public policy should strive to promote economic growth, innovation and quality of life for all Canadians. Thriving medical practices are a key ingredient in ensuring that Canadians have access to medical care when and where they need it. Any changes to the existing tax regimen can have the unintended consequences of forcing owners of medical practices to curtail their operations, reduce availability of care and stifle expansions of much-needed medical services.

The CMA asked physicians whether they would consider reducing the number of hours they worked if the government eliminated any or all of the benefits of incorporation. Over half of the practising physicians who responded to the survey (54%) indicated they would consider reducing their number of hours worked, and 24% indicated they would consider retirement. In addition, 31% of the respondents stated they would consider closing their practice and moving to another practice setting (such as a hospital-based or salaried position). Of particular note, 64% of the medical residents who responded to the survey indicated that they would avoid independent practice.

If fewer physicians opt to stay in or enter into independent practice there could be important implications for physician supply and patient accessibility. This may be particularly important in rural and remote regions, where independent practice is the most common means for delivery of physician services.

In some rural and remote communities across Canada, there is already a shortage of physicians. According to Statistics Canada, about 19% of the Canadian population lives in rural and remote communities, but only about 14% of family physicians and 2% of specialists practise in such communities. The ratio of physicians to patients is also much lower in rural than in urban Canada (0.8 versus 2.1 per 1,000 in 2013).

Some of the challenges in recruiting and retaining physicians to rural and especially to remote communities include the reality that physicians in these regions often have to work long hours, have a high level of on-call responsibilities and need additional competencies to meet their community's needs. Unlike most physicians working in urban environments, they may also experience insufficient backup or a total absence of backup from other physicians, nurses and complementary services. There are typically fewer professional education opportunities in rural and remote communities. Finally, physicians

sometimes find it difficult to travel long distances to visit their families in urban regions or to convince their spouses and children to relocate from urban to rural and remote communities because of limited job prospects and educational opportunities for their families.

## **Promoting gender equality in small- and medium-sized businesses and in medical practices**

The current federal government has advanced a feminist agenda with a view to ensuring that all public policy aligns with and supports gender equality. It is therefore perplexing to see the tax proposals being considered, as these may further deter women from entering the medical profession.

It is worth noting that female physicians now account for 40% of all Canadian physicians and they represent 60% of physicians under the age of 35. This statistic represents a significant achievement in promoting gender equality in the profession. While the potential indirect effects of the federal tax proposals apply to all physicians regardless of gender, female physicians will likely see an incrementally larger decrease in income at all career stages and particularly as they start a family. This is coupled with the fact that there are already fewer female physicians over the age of 50. Many female physicians may choose to stay at home if the current financial and entrepreneurial incentives are no longer available.

In addition to the direct impact of the proposed tax measures on female physicians, any practice consolidations or closures resulting from these measures will also impact women currently employed in physician practices, including nurses and administrative support staff. This is significant for occupations such as medical administrative assistants and other health services support staff; 98% and 80% of total employees in these occupations are women, respectively.

## **Inspiring innovation as the cornerstone of Canada's future**

A significant portion of medical research in Canada is funded by physician donations of cash and unpaid physician labour. This is especially true for physicians working in academic health science centres (AHSCs). AHSCs are vital to ensuring that leading-edge medical research continues in Canada. Since most AHSCs are structured as partnerships of incorporated physicians, they will also be affected by the federal tax proposals, and donations to fund medical research will be compromised as physicians make financial decisions to reduce their spending to make up for their increased tax burden. This is significant, as the CMA estimates that physicians provide \$340 million from their gross earnings to fund medical research and teaching in AHSCs.

Furthermore, if physicians are facing a reduction in after-tax income from their practices, they will likely favour paid labour over unpaid labour to offset the reduction, which would result in fewer physician hours spent on medical research. There would be little financial incentive for physicians to continue with medical research, which would significantly impede medical innovation in Canada.

## **Technical considerations of the proposals:**

In reviewing the specifics of the proposals, the CMA wishes to provide its perspective on several of the elements being considered, including fairness, complexity, passive income of a small business corporation, anti-avoidance rules and income splitting.

### **Fairness**

The tax rules for private corporations are available to everyone should they wish to start and run their own business. They have been supported and even promoted by various governments to encourage entrepreneurship and those who are willing to take the risk of starting up a small business, entering independent practice or taking over the family business.

Seeking to compare a salaried employee to someone who works through a private corporation where the corporation earns an equivalent amount of income fails to take into account all the factors necessary to operate a successful business through a corporate structure. For example, private corporations reinvest in the business and save funds to weather adverse economic events and to offset the lack of employment

provisions and benefits. Physicians start their medical practice with significant debt and enter their career in their 30s. Private corporations in different sectors face their own unique set of challenges and the existing policies provide certainty that enables them to make plans.

The CMA is aware that in 2011 an Employment Insurance (EI) program was established for self-employed individuals whereby they could register and pay for benefits including maternity and parental leave. We understand that there has been low uptake; we suspect that is because many self-employed people cannot take a full year off for maternity/parental leave and therefore do not receive the full value of what they put into the program. Other considerations include the fact that the program is not topped up by an employer, the program does not factor in expenses related to replacement costs, and there is loss of flexibility to cover lifestyle costs.

Although well-intentioned, it seems that the enhancements to the EI program may not address the realities of running a business (regardless of incorporation) and that is why we need a more comprehensive review of the tax system that considers unique sector conditions and safety net provisions.

Corporations are legitimate business vehicles that facilitate compliance and administration, and they have been sanctioned and encouraged by successive governments for decades. Changing the rules now will be highly destabilizing for small business owners who have chosen to organize their affairs in this way, many of whom also do not have the resources to adjust to these changes.

In some cases, provisions for physician incorporation have been part of a negotiated settlement with provincial governments. The proposed changes will drive up medical costs, increase pressure on provincial and territorial governments and worsen fee-schedule negotiations between physicians and their provincial and territorial governments, causing yet more unnecessary disruption.

The use of corporations has to a certain extent kept the underground economy at bay because of mandatory reporting requirements and registration both for income tax and GST/HST purposes and for corporate governance.

## **Complexity**

The Canadian tax system and in particular the rules governing both big and small corporations are complex, and successive governments have strived to simplify them over time. The proposed tax changes have a level of complexity that is counter to what the present government has been promoting by eliminating boutique tax provisions.

The proposals create a bigger disparity between small business corporations eligible for the small business deduction and small public corporations that provide many of the same benefits to family shareholders.

## **Passive investments**

Passive income is already taxed at higher levels than active business income. Working capital is just as necessary in a small business corporation as it is in a public corporation.

Investing passively in a private corporation has been a legitimate practice for many generations of Canadian business owners. The method of taxing passive income has been in effect since 1972. Investing passively within a corporation accommodates business owners who assume risk and responsibility not otherwise assumed by employees. A few important accommodations are noted below:

- Investing passively provides a business owner with efficient access to capital so that opportunities can be seized, creating growth and employment for our economy.
- Business owners are more likely to accept the risk associated with making investments if they have access to more capital.
- Investing passively allows a business owner to manage risks assumed when one goes into business for oneself. These risks are not otherwise assumed by employees.

- Investing passively allows a business owner to diversify risk by investing in assets that are very different than private corporation shares.
- Investing passively allows a business owner to provide for retirement and unforeseen circumstances that may need to be self-funded.

Physicians, like other small business owners, retain capital in their corporations to weather the financial ups and downs that are inherent in self-employment. Because physicians do not have employer-sponsored pension plans or health, disability or maternity benefits or statutory vacation leave, they rely on retained earnings and make passive investments to build up the capital to fund these eventualities. Similar to other businesses, medical practices have to respond to the ups and downs of the business cycle – in the medical practice context, provincial and territorial governments will implement expenditure caps and cuts that will affect the medical practice's bottom line.

### **Fair, simple and efficient tax system**

As noted by CPA Canada, fairness in our tax system is an essential principle and it is doubtful that the recent proposals will improve this. Investing passively in a private corporation has in some cases been a mechanism available to business owners of all sizes since 1972.

It will be important to consider the fact that many small business owners have legitimately organized their affairs by investing passively in their corporation and have not contributed to registered retirement savings plans (RRSPs), tax free savings accounts (TFSAs) and registered education savings plans (RESPs). Fundamentally changing the tax system will in some cases require physicians to:

- work for more years to save for retirement with after tax dollars;
- evaluate whether Canada's tax system is competitive with that of other economies; and
- alter practice decisions, such as opting to retire completely versus easing into retirement or reducing hours of work in favour of other career pursuits.

Applying a 50% permanent income tax rate in the corporation to passive income assumes that all small business owners are high-rate taxpayers. This is not the case, and this assumption would inadvertently punish many small business owners who are not subject to the highest rates of income tax. In some cases, applying a high rate of personal income tax to corporate income that has already been subject to tax at 50% will result in a combined income tax rate of approximately 71%.

Canada's tax system is already complex and the proposed methods of accounting for passive income will in all cases add further complexity, reducing taxpayer compliance. Tracking and pooling sources of income to account for investments will be both time consuming and costly. There will need to be simple mechanisms for both grandfathered investments and those impacted by the new rules.

Lastly, making significant changes to legitimate tax structures that have been in use for 45 years requires careful consideration, material stakeholder involvement, carefully considered grandfathering provisions and the appropriate amount of time to plan and implement.

The proposals concerning passive income in a private corporation represent a significant change in tax policy. If implemented as proposed by the government, the changes could act as a disincentive for those looking to invest in small business, decreasing job creation. Furthermore, the tax policy changes as proposed could make it difficult for Canada to attract, recruit and retain highly skilled professionals, which will significantly impact the quality and availability of health care in the short and long term.

### **For consideration — prescribed allowable assets for passive investment**

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 lifetime capital gains exemption (LCGE) and the small business deduction (SBD), which accommodate a self-employed individual's realities when compared with an employee. In the CMA's 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 appropriately taxed.

Existing passive assets and any income or related capital gain thereon should not be impacted by any new system that is implemented. Regarding a transition, a taxpayer should have the ability to elect to have existing or substituted assets and the related income or capital gains taxed under the current regime resulting in no change.

On a prospective basis, passive assets accumulated over and above a prescribed threshold could be subject to new investment income rules. The prescribed threshold would allow business owners to accumulate passive assets commensurate with the amount of risk they accept or assume. Alternatively, the prescribed threshold would allow a taxpayer to opt out of the onerous and costly rules that are not conducive to small business.

Business owners have raised the concern that they need to retain capital in their corporations for valid business purposes. These include saving for economic downturns, future growth and contingencies such as an illness of the principal business owner. Allowing a prescribed amount of passive investments to be held by private corporations will permit them to save for these valid business reasons without facing excessive tax rates, while still meeting the government's policy objective of preventing individuals from using corporations to save beyond government tolerance. A prescribed threshold provides greater certainty for planning and ease of administration.

These ideas are worth exploring but require time and the engagement of small businesses to ensure that the changes do not produce unintended consequences while meeting public policy objectives.

## **Converting income to capital**

### **Anti-tax avoidance rules**

We are in support of targeted measures to curtail abuse. Non-arm's length manipulations of cost base to reduce or eliminate capital gains are not appropriate, and such abuses should be curtailed.

Use of mechanisms to avoid double taxation such as the so-called pipeline strategy that has been accepted by the Canada Revenue Agency (CRA) to avoid double taxation should be encouraged, not legislated against.

### **Estate planning**

CRA has issued numerous favourable advanced income tax rulings with respect to pipeline planning. The proposed changes in ITA section 84.1 are especially troublesome for those nearing retirement and those who have planned for their final estate tax liability under the current income tax regime.

For example, assume an owner of a private corporation dies in Ontario and the shares are not inherited by a spouse. If the private company shares have a fair market value of \$2,000,000 with minimal adjusted cost base, the estate's final income tax liability will increase by approximately \$360,000 if the fair market value of the private corporation must be realized as a dividend rather than as a capital gain, as contemplated by proposed subsection 84.1(2).

In addition, there would be limited opportunities for retired or near-retirement business owners to acquire life insurance or otherwise reorganize their affairs.

Lastly, the proposed changes would effectively require each estate to wind up the affairs of a private corporation within a very short period of time (12 months) to avoid double taxation.

### **For consideration**

Subsection 164(6) of the Act should be extended to coincide with the graduated rate estate rules that were recently introduced. On this basis, an estate would have three years to properly wind up the affairs



of a private company, realize a capital loss and carry it back to the terminal return of the shareholder to avoid paying income tax twice.

### **Income sprinkling**

The practice of income sprinkling within the use of a professional corporation has been supported by judgments issued by the Supreme Court of Canada. It is also true that in some cases provincial governments have amended legislation governing professionals to allow a professional to introduce family members as shareholders of their professional corporations. Such amendments were made in the context of negotiating contracts for service deliverables and remuneration and in recognition of the family involvement in running a small business, such as a medical office in the case of physicians.

Upon incorporation the entity that has been created in support of a specific business activity has nominal value. The corporation builds and expands through bank borrowing, expenditures and the sweat capital of spouses/partners. The value of that sweat capital is difficult to quantify but in many respects is no different than the sweat capital provided by unrelated entrepreneurs in developing a high technology idea into a working venture.

The proposed changes could result in more stringent requirements for a family shareholder to demonstrate their contribution of capital or value to an entity than would be required of a non-family member shareholder. Spouses/partners are integral to the risk and development of a business enterprise that, as a family, they have an interest in: pension income splitting recognizes the family unit and similar considerations apply here.

Tax policy reflected in the ITA has always permitted a certain level of income based on the personal amount and the dividend tax credit to be received without tax cost. In 2017 the amount was approximately \$32,000.00. There is no abuse in using those provisions just as there is no abuse in pension income splitting to share the tax obligation within a family.

### **Subjectivity of reasonability criteria**

Regarding the application of tax on split income (TOSI) and the “reasonableness test,” the CMA is concerned that in practice, the proposed rules will result in inconsistent application, as the reasonableness test requires a subjective self-assessment after considering labour and capital contributions.

Consider the practical difficulties that will arise in the following situations:

- Both spouses are involved in the business on a regular and continuous basis. However, at different points during their life, their involvement is limited because of health or maternity reasons.
- All family members (adult children and parents) are involved on a regular and continuous basis in the business. Similar to the example above, each family member has differing levels of involvement at different times and each family member makes unique contributions.
- In some cases, a household will be required to decide on the division of labour. The division of labour would consider both inside and outside duties, resulting in one family member being less active in the business for a period of time or permanently because he/she is directly supporting inside duties so that the other spouse’s involvement can exceed what would normally be required of an employee.

When assessing the reasonability of a dividend paid, both the taxpayer and CRA are required to evaluate a proper rate of return and assess the risk assumed. Independent data or proxies are not readily available when assessing risk assumed with respect to a private company investment.

In the case where a spouse and/or all family members are involved with the business on a regular and continuous basis, practical difficulty will constantly arise when attempting to ascertain with any degree of precision or certainty reasonable compensation in the circumstances.

In some cases, a physician's spouse will deliberately choose not to enter the workforce as a second income earner because it is not economically viable to do so given the day-to-day realities of managing a business, raising a family and planning for the future. Constraining income splitting will in some cases cause hardship for families who have organized their division of labour so that the family can fully support the professional's activities. This translates into physicians being more available to grow their practice and to care for patients. If the economics concerning the division of labour within and outside of the household are seriously altered, many small business owners could be motivated to work less and refocus their division of labour.

### **For consideration — prescribed threshold on income sprinkling**

Dividends are paid to shareholders as a return on their investment in the corporation. Since the distribution of the dividend is not determined by the quantum of a shareholder's contribution to the corporation, it is illogical to use contribution or labour as the criterion that determines when dividend income will be subject to TOSI. A small business is dynamic, and contributions to a family business are required at different times by different people and entail different amounts of effort. Documenting and measuring the many different contributions will undoubtedly create problems because a business owner and their spouse are often inextricably linked when it comes to valuing their contributions to a business.

Because of the complexity that the proposed changes would cause, the TOSI income rules should not consider a small business owner's spouse or common-law partner. In the alternative, a threshold should be contemplated that would recognize various contributions and eliminate the uncertainty and judgment required when applying the proposed rules.

The implementation of a prescribed threshold of allowable dividends to be paid to family members would alleviate many of the issues with the current reasonableness test. The primary concern with the current wording of the reasonableness tests is the inherent uncertainty because of the difficulty in determining the value of contributions made by family members. A threshold of allowable dividends would inherently acknowledge that family members contribute value and assume risk with respect to a family business.

This would eliminate the uncertainty about these amounts paid to family members, allowing small businesses to recognize the contributions of family members without fear of future reassessments at the top marginal rate of tax. This would also shift the focus of the proposals to higher income earners. Dividends above the prescribed threshold would still be subject to the proposed reasonableness test, preventing excessive amounts from being paid to family members where their contributions do not warrant these distributions.

These ideas are worthy of consideration but require the engagement of the small business community to ensure that the changes do not produce unintended consequences while achieving their public policy objectives.

## **Conclusion**

Canada's doctors are fully committed to improving health and health care by helping families, youth and women, growing the economy and ensuring we have thriving communities from coast to coast to coast. We know that these values are shared by governments. As health care providers and as owners of small businesses, Canada's doctors have been committed to these goals for decades. While the full impact of the proposed taxation changes is currently being assessed, every indication points to significant negative ramifications for frontline health care workers and the Canadian economy.

Physician medical practices contribute significantly to the local and national economy by directly employing 137,000 Canadians and providing needed medical infrastructure. These entrepreneurs are also responsible for providing a self-funded safety net.

These factors have, to a significant degree, been taken into account in settling fee structures for the medical professional on an overall after-tax basis. If those provisions cannot be relied on in the future, fairness would dictate that time be given for those in the relevant provinces to renegotiate their fee

structures so that new factors can be taken into account. Fairness would also dictate that other self-funded safety net provisions, such as retirement savings vehicles, be adjusted or created to cover planned and unplanned events.

The July 18, 2017, proposals represent the most significant tax changes since 1972. The CMA is concerned that the government may not be aware of the potential for far-reaching unintended consequences of the proposals and therefore strongly urges the government to:

1. suspend the current proposals;
2. conduct a comprehensive review of these proposals to ensure that legislation can meet policy objectives without significant unintended consequences; and
3. engage all Canadians in a comprehensive review of the tax system considering unique aspects of all sectors, including safety net provisions.

## Appendix A: Unintended consequences

There are several potential mitigating measures physicians may apply to offset reductions in net revenue, including the following:

- Physicians may decide to operate their practices on a leaner basis, offsetting their loss in net income by reducing practice spending. They may reduce their individual spending on staff and other costs, or they may elect to consolidate several practices into one.
- Physicians may decide to reduce their hours worked, or change their practice setting in response to the reduction in net income.

Scenario 1 provides an example.

### **Scenario 1: Private practice**

#### *Background*

Dr. Johns operates a private practice in rural Ontario. Understanding that there is a significant shortage of physicians in rural communities across Canada, Dr. Johns and her husband moved to their current rural community 10 years ago. Dr. Johns' husband, a teacher by trade, has been unable to secure full-time employment because of the limited number of jobs available in their community. Instead, he helps Dr. Johns by dealing with all operational matters for her clinics. This includes negotiating leases, buying equipment and hiring staff so that Dr. Johns can focus on delivering medical services. The children are involved too; they developed and maintain the clinic website.

Over the last 10 years, he has also handled all matters related to the household, including raising their two children. Dr. Johns' children are now 18 and 19 years old and are both starting university in 2018. Dr. Johns, Mr. Johns and their children are shareholders of the medical professional corporation.

#### *Outcome*

Because of the new changes, Dr. Johns worries that she will not be able to help her children pay for university. Dr. and Mr. Johns are now trying to decide if they should close the rural practice and move back to the city, where Mr. Johns could find employment to help pay for their children's education.

Scenario 2 illustrates how the proposed tax changes would affect a female pediatrician operating her practice through a corporation.

### **Scenario 2: Retirement**

#### *Background*

Dr. Grey is a 55-year-old pediatrician who operates her practice through a corporation. She is married and has two adult children. Her husband is a shareholder in the corporation. Her children are not. After finishing medical school and her residency, she started practising when she was 30. She spent the next three years making minimum payments on her student loans so that she could save enough to finance her maternity leave. Between ages 33 and 35, she had two children and was unable to work. When she returned to work, her husband stopped working to raise the children and manage the household. By age 40 she had finally paid off her medical school debt, but she spent the next 15 years saving to pay for her children's education and supporting the family. As a result, Dr. Grey has not been able to save any money for retirement before now.

#### *Outcome*

Dr. Grey has heard that her plans may be significantly impacted by the changes to both income splitting and passive investments. She has heard that existing portfolios of passive investments will be grandfathered, but she does not see how that will help her because she is only starting to save for retirement now.

As Dr. Grey's fees are set by the province she cannot increase the fees she charges to her patients and will therefore have to reduce costs, including staffing costs. Otherwise, she may never be able to retire comfortably.

### **Scenario 3: Married physician at an academic health science centre**

#### *Background*

Dr. Ritchie is an incorporated cardiologist working in an academic health science centre. Because of her sporadic schedule her husband is not able to work a traditional job. Instead, he manages the household, and when needed he helps with any administrative activities required for managing Dr. Ritchie's corporation. As Dr. Ritchie understands that medical research is not well funded in Canada, she donates \$25,000 per year to her local research institute.

Dr. Ritchie currently takes an annual dividend of \$135,000 out of her corporation and pays a dividend of \$35,000 to her husband.

#### *Outcome*

Under the proposed changes to income splitting, it is unclear what would be considered a "reasonable amount" that can be paid to Dr. Ritchie's husband for his contributions; therefore, Dr. Ritchie will have to take out all funds herself.

If the \$35,000 typically paid to Dr. Ritchie's husband is now paid to her, the family tax liability will increase by \$13,016/year. This means that if the family wants to have the same after-tax cash under the new rules, they will have to draw an additional \$23,400 out of the corporation as dividends, increasing total dividends to \$193,400.

To fund this additional outflow while still saving for retirement, Dr. Ritchie will have to reduce her practice's expenditures by an amount roughly equal to her annual medical research donation. She is strongly considering not making donations to medical research so that she can support her family.