answer is yes, then several analytical methodologies are available to estimate the outcome, but these are beyond this article's scope.

Tax policy: Correction of an undesired outcome? Tax policies, such as tax incentives, may have a great impact on a jurisdiction's economic activity and have been empirically proven to affect a jurisdiction's inbound investments by multinational enterprises (MNEs). An MNE will choose a jurisdiction with more advantageous tax benefits for its investment destination; to help attract the desired investment, a good tax policy ensures certainty of outcome and predictability of enforcement.

Like many transfer-pricing matters, TPM-17 is governed by the arm's-length principle, which, among many things, recognizes the "options realistically available" for an MNE investing in various jurisdictions and the inherent subjectivity in sharing tax benefits between the investor and the investee. Subjectivity in the principle's application arguably introduces uncertainty, but that may be mitigated by adequate analysis and documentation.

TPM-17 makes clear the CRA's bias against the erosion of the Canadian tax base. That bias may explain the introduction of the elusive reliable-evidence test, but it also raises the question of whether issuing a TPM is the best way to reverse the undesired outcome of an existing tax law. If Canada did not want to reduce relevant costs by tax incentives, a more prescriptive methodology might be advised, such as the thin cap rules for interest rate deductions. Making legislative changes is more complex than issuing a memorandum, but also likely provides much greater certainty. That certainty may prove better for inbound investment than adding more complexity to a highly subjective area like transfer pricing.

Corporate taxpayers must now deal with unanswered questions emanating from TPM-17. One hopes for much-needed clarity and certainty from another CRA announcement or a court decision.

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Ontario Announcement Throws a Wrench into Integration

In November 2018, Ontario announced that it would not adopt the federal government clawback (subsection 125(5.1) of the small business deduction [SBD]) when a CCPC's adjusted aggregate investment income (AAII) is more than $50,000. The federal SBD clawback is effective for a CCPC for a taxation year beginning after 2018, at a rate of $5 for every $1 of AAII when the AAII was more than $50,000 in the previous taxation year. The full $500,000 SBD is therefore eliminated once AAII exceeds $150,000 (that is, $500,000 − $5 × [$150,000 − $50,000]) in the prior year. The Ontario rules (Bill 57), which received royal assent on December 6, 2018, cause some unexpected integration results when corporate income is subject to the Ontario (not the federal) SBD and the after-tax amount is ultimately paid out as dividends. In 2019, a CCPC in Ontario earning ABI with access to the SBD is taxable at 12.5 percent (9 percent federal plus 3.5 percent Ontario). At general rates (not the SBD), a CCPC is taxable at 26.5 percent (15 percent federal plus 11.5 percent Ontario), and a CCPC that claws back the federal (but not Ontario) SBD is taxable at 18.5 percent (15 percent federal plus 3.5 percent Ontario). As a result, an Ontario CCPC subject to the federal SBD clawback (because its AAII is more than $50,000) regains access to the 8 percent Ontario tax deferral, valued at up to $40,000 in 2019 ($500,000 × [11.5% − 3.5%]).

When after-tax corporate income is paid out to the shareholder, a CCPC with access to the SBD has total (integrated) corporate and personal taxes of 53.97 percent. A CCPC taxed at the general tax rates is subject to integrated taxes of 55.54 percent, and the CCPC (with AAII in excess of $50,000) that claws back the federal (but not Ontario) SBD is taxable at the combined integrated tax rate of only 51.33 percent. The result is a breakdown of integration, as seen on the accompanying table.

	General rates (no SBD)	SBD rates (≤ $50K AAII)	ON SBD only (> $150K AAII)
Active business income	$10,000	$10,000	$10,000
Corporate taxes: federal (A)	(1,500)	(900)	(1,500)
Corporate taxes: Ontario (B)	(1,150)	(350)	(350)
After-tax income available for dividends	7,350	8,750	8,150
Personal tax: federal (C)	(1,828)	(2,412)	(2,048)
Personal tax: Ontario (D)	(1,076)	(1,735)	(1,235)
Net cash to shareholder	$ 4,446	$ 4,603	$ 4,867
Total integrated tax (A + B + C + D)	$ 5,554	$ 5,397	$ 5,133
Integrated tax rate (%)	**55.54**	**53.97**	**51.33**

When the federal SBD is clawed back because of AAII, dividends paid by the CCPC to an individual will be eligible dividends as a result of the increase to the general-rate income pool (GRIP) account. Since each province does not have its own independent GRIP balance, there is no adjustment for the fact that Ontario tax is being paid at the lower SBD rate. (Ontario could, theoretically, create its own Ontario GRIP at the cost of additional complexity in an already overbearing tax system.)

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The result of paying eligible dividends from GRIP (defined federally in subsection 89(1)) is that a CCPC whose AAII exceeds $50,000 has a lower integrated tax rate and the federal government enjoys increased revenue at Ontario's expense.

A similar situation occurs in Saskatchewan: since January 1, 2018, a CCPC has had access to the provincial SBD on ABI up to $600,000, although the federal SBD limit is only $500,000. A Saskatchewan CCPC that earns ABI between $500,000 and $600,000 has a GRIP account addition, even though the Saskatchewan corporate tax rate paid on this income is only 2 percent. As a result, that Saskatchewan CCPC has an integrated tax rate of 42.78 percent in 2019 (in this $100,000 range); a CCPC taxable at general rates both federally and provincially (on income above $600,000) has an integrated rate of 48.75 percent.

In Quebec, a CCPC's ABI may qualify for the federal SBD but not the Quebec SBD (unless its employees worked at least 5,500 hours during the taxation year). Consequently, there is no addition to the GRIP account, and dividends from the CCPC are taxed as other-than-eligible dividends to the individual. This results in a 2019 integrated tax rate of 57.32 percent. Alternatively, if the CCPC chose to forgo the federal SBD, the 2019 integrated tax rate would drop to 56.05 percent. If the 5,500 hours test is met and the SBD is thus available both federally and in Quebec, the 2019 integrated tax rate is 54.31 percent. (See Hiren Shah and Manu Kakkar, "Coming to Grips with Quebec's Lack of GRIP" (2017) 17:2 *Tax for the Owner-Manager*.)

The policy for an Ontario corporation and its shareholders means that it will take about nine years to break even on the upfront tax cost, using a 4 percent compounded after-tax return on the 6 percent deferral inside the CCPC. (From the accompanying table, a CCPC that earns AAII under $50,000 provides a tax deferral of 6 percent [$8,750 − $8,150] that comes with a 2.64 percent tax cost [53.97% − 51.33%].)

A taxpayer and its advisers may want to reconsider investment and remuneration strategies and determine whether the tax deferral of 6 percent or the lower overall integrated rate of 51.33 percent better supports the shareholders' objectives and the corporation's business.

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