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A TALE OF TWO SISTERS, A TAX HORROR STORY

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness…"

This introductory line from the famous Charles Dickens novel, *A Tale of Two Cities*, seems to be apt to describe what is happening today in the world of private company tax.

Here is an example. Father, let's call him Charles, has built up a successful business that he operates through a private corporation. Charles has two daughters, Rena and Rhonda. Rena is married to Bob and Rhonda is married to Bill. Neither Rena nor Rhonda work in the business, but both of their husbands work for the company.

After a long successful career, Charles wants to retire to turn over the business to his children. Charles will undertake an estate freeze, where his common shares of the company will be converted to preferred shares.

Charles naturally wants his two daughters and their families to benefit from the continued operation of the business. Like most parents, Charles is concerned about the strength of his daughters' marriages. Charles is aware that many of today's marriages end in divorce and wants to be sure that if Rena or Rhonda get a divorce, they do not lose the shares of the company. Not surprisingly, Charles decides to give shares of his company only to his daughters, and not to his two sons-in-law. This way, the shares are protected if Rena or Rhonda get divorced.

As the owners of the company, under the present tax rules, any dividends that Rena and Rhonda receive from the company would be taxed at their applicable marginal tax rate. If they sell the company, the gain would be taxed as a capital gain, which would be taxed at a maximum of approximately 27%, and they could potentially qualify for the lifetime capital gains exemption.

Under the proposed new tax rules released by the Department of Finance on July 18, 2017, the situation is entirely different. As neither Rena nor Rhonda work for the company, all the dividends they receive from the company, as the owners thereof, will be taxed at the top marginal income tax rate, or approximately 45%. If they sell the company, rather than the gain being a capital gain, taxed at 27% (and possibly eligible for the lifetime capital gains exemption), the full amount of the gain will be taxed as a dividend at approximately 45%. This huge tax increase arises because neither Rena nor Rhonda work for the company, even though their father built the business and both of their husbands work in the business.

So, Charles, Rena and Rhonda have a choice to make. Protection in case of divorce and a punitive tax regime or a normal tax rate, but loss of family law protection. Under the proposed new rules, Rena and Rhonda can't have both family law protection and regular tax rules.

Does this make any sense to you? It doesn't to me.

As was written long ago, it was the age of wisdom, it was the age of foolishness…