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Let me tell you a story about a man named Jed, the tax man, and the discriminatory impact of the proposed new tax rules for private companies

This story is based on actual clients and will illustrate the unfairness of the July 18, 2017 proposals to change the tax rules for private companies.

Our story starts with father, call him Jed, who owned all the shares of a private company through which he built up a successful business. In the mid-1980s, Jed did an estate freeze, converting all of his common shares of the company to fixed value preferred shares. Jed then subscribed for 100 new common shares and gifted 50 of the common shares to his adult son, Samuel, and his adult daughter Debbie. Sam worked with Jed in the business but Debbie had her own career and did not work in the family business.

Jed's plan was that while Sam would get a salary for his work in the business, he desired that his two children share equally in the value of what he had built up during his lifetime.

During Jed's life, some of his preferred shares were redeemed and he paid tax on the dividends. When Jed passed away, the company used the proceeds of a life insurance policy to buy out the remaining preferred shares of the company. This left Debbie, who is now a single mother, and Sam as the equal owners of the shares of the company.

Sam and Debbie have adhered to Jed's wishes. Sam continues to work in the business, receives a salary for his work, and the profits are shared equally by Sam and Debbie by the payment of dividends on their shares. Sam and Debbie's plan was that they would leave things as is until Sam is ready to retire, at which time the shares would be sold.

Based upon the tax rules that applied until now, dividends that Sam receives and dividends that Debbie receives are both taxed the same way, at their respective marginal tax rates. If Sam and Debbie sell the shares of the company, they expect that each will receive $835,000, tax free, using their lifetime capital gains exemption, and that the balance of any proceeds would be taxed as capital gain (approximately 27% in Ontario in 2017). This is a plan in place for many years on which Sam and Debbie have relied on for retirement planning.

The proposed tax changes will significantly affect this planning but only for Debbie.

Since Sam works in the business, his tax rules do not change. However, since Debbie does not work in the business, any dividends that she receives from the company will be taxed at the top tax rate of approximately 45% rather than her own marginal tax rate which would be lower. Later, when she sells the shares of the company, all of her sales proceeds will be taxed at the top tax rate applicable to dividends, approximately 45% and she won't be entitled to claim any amount as capital gains while Sam will get to claim the lifetime capital gains exemption for $835,000 and pay

tax at a maximum of 27% on the remaining capital gain. As a single parent, this proposed tax change negatively impacts Debbie's retirement plan. Debbie does not consider herself to be rich and is not part of the 1%. Needless to say, Debbie does not understand how this tax change, which is said by our government to be made in the name of fairness, is fair to her. Truthfully, neither do I.

This is one example of what is hopefully, the unintended consequences of the Department of Finance's proposed broad based tax change for private companies. I am sure that there are many other Debbies out there who will be negatively affected. Perhaps it is time for Finance to undertake a rethink of these proposals.