

GOVERNMENT PROPOSING TO IMPOSE A 45% FLAT TAX ON RETIREMENT INCOME

Proposed Amendments to *Income Tax Act* re: Private Corporations

On July 18, 2017, the Department of Finance released Proposals to amend the *Income Tax Act*. While the government is touting the Proposals as being intended to close loopholes, the Proposals constitute major tax reform. If enacted, in their present form, the retirement plans of many Canadians will be adversely affected.

Let's take a common situation. A couple incorporated a private company, in the 1970s, to establish an active business. The company was owned equally by the two spouses, while only one spouse (the "**Working Spouse**") worked in the business. The business operated for many years, until the Working Spouse was ready to retire. When the Working Spouse retired, the business simply closed.

The couple's financial plan was that once the Working Spouse retired, they would start to withdraw the money built up in the company over the years, to use for their living expenses. The couple have carried through with the planning, and since the Working Spouse retired, each spouse has taken money out of the company, as a dividend, to pay for their living expenses.

Under the present rules, which have existed since the 1970s, each spouse pays tax at their applicable marginal tax rate on the dividend that is received. However, under the Proposals, the spouse that was not active in the business will pay tax at the top marginal income tax rate (currently approximately 45% in Ontario) on every dollar of that is withdrawn from the company. In other words, the retirement income of the non-active spouse will now become effectively subject to a 45% flat tax. This will be the case, irrespective of the amount of other income, if any, that the spouse earns or receives.

The Proposals, if enacted in their present form, will impact the retirement plans of owners of every private corporation, where there is a spouse who owns shares of the company, but did not or does not work in the business.

In other forums, the government has expressed concern about the preparedness of Canadians for retirement. The Proposals, if enacted, will make the situation worse for many Canadians. Hopefully, this is an unintended result, which will be fixed by the government before the Proposals are enacted.