

# How Ottawa's so-called fair tax proposals could mean a tax rate of 90 per cent for some businesses



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SPECIAL TO THE GLOBE AND MAIL

SEPTEMBER 21, 2017 SEPTEMBER 21, 2017

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There's been much debate about the Liberal tax proposals released on July 18. I've been a supporter of the small business owner and professional through these debates, and I've received e-mails of thanks, and others not so kind. I had to laugh at one who suggested that I should take my story about Sally ([from last week's article](#)), print it onto sandpaper and place it where the sun doesn't shine. Ouch.

Regardless of where you stand on the debate, there's a fair question that needs to be asked: If the Liberals are going to raise taxes on business owners and professionals, how much tax is enough? Should the tax rate be 50 per cent? How about 70 per cent? What if the tax rate on business owners was more than 90 per cent – as one paper suggests? How high is fair?

## **The paper**

I know what you're probably thinking: "There's no way the changes will create a tax bill higher than 90 per cent for business owners. Clearly, anyone who claims this is massaging the numbers with some unrealistic assumptions and biased math to arrive at that conclusion."

I have to admit, I was skeptical, too – at first. Then I read the paper written by well-respected lawyer Michael Goldberg, of the firm Minden Gross, in conjunction with Mac Killoran and Jay Goodis, both of whom hold the chartered professional accountant (CPA) designation and are respected members of the profession. This trio wrote a paper (you'll find it at [mindengross.com](http://mindengross.com)), complete with all the technical tax calculations laid bare for all to scrutinize. The numbers they calculated add up. Let me summarize, in plain English, how in the world these proposals could result in such a high tax bill for a business owner. Consider Marie and Justice.

## **The story**

Marie started a business, Gardenco – a landscaping business – 10 years ago. She took steps at that time to allow her son, Justice, to acquire shares in Gardenco for a nominal

amount. Today, Justice's shares are worth \$6.65-million. He doesn't work in the business, but Marie does, and she's done a great job of growing the business.

Over the past ten years, Gardenco has earned \$500,000 annually, for a total of \$5-million. The company has paid just \$750,000 in taxes on that income over the years thanks to the 15-per-cent tax rate for eligible small businesses. After taxes, Gardenco has kept \$4,250,000. Marie received a reasonable salary over the ten years, and she's in the top tax bracket in Ontario.

Now, the \$4,250,000 after taxes earned by Gardenco has been reinvested in a portfolio inside the company, and has earned \$3-million of investment income over the past ten years. Gardenco has paid \$1,505,000 in taxes on this income over that time. As an aside, \$920,000 of this tax is refundable to Gardenco once the company pays sufficient dividends, but the recipients will face tax on those dividends, and will pay more than \$920,000 in personal taxes, so they've decided to keep the cash invested in the company to defer this tax.

So, Gardenco has earned \$8-million in total (\$5-million of business income plus \$3-million of investment income) and has paid \$2,255,000 in taxes (\$750,000 plus \$1,505,000) on that income. The effective tax rate for Gardenco has been 28.19 per cent. So far, so good.

Now, let's look at what happens when Justice dies (he could die before or after his mother; the math is the same either way). At that time, he'll be deemed to have sold his shares in Gardenco, which will trigger a tax bill. There will also be taxes when the assets of Gardenco are withdrawn from the company by his estate, to pay Justice's final taxes owing.

Under the current rules, the total taxes paid by Justice and his estate would be \$1,784,000 after his death. Add this to the \$2,255,000 paid by Gardenco over the past ten years, and the total taxes paid are \$4,039,000. On \$8-million of total income, this is a 50.5-per-cent tax rate – about the same rate as any employee would pay on high levels of income.

But under the proposed rules, the total taxes paid by Gardenco, Justice and his estate will amount to \$7,460,000 (a big difference owing to possible loss of capital gains treatment on his shares, no refundable tax available and changes to taxation of investment income in the corporation). On \$8-million of total income, this is a tax rate of just more than 93 per cent. You might believe that these proposed tax changes are fair because business owners should pay their fair share. But how high a tax rate is fair?

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