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Capital Gains Tax Increase: Impact on Planning

By James Bowden | 18 April 2024

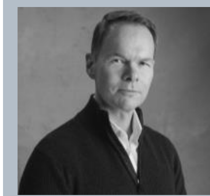
The Canadian federal budget was tabled on 16 April 2024. It included, among other things, a proposal to increase the capital gains inclusion rate for the first time since 2001, from one half to two thirds, with the increase coming into effect for dispositions (or deemed dispositions) occurring on or after 25 June 2024 (and for individuals, the increase applies to capital gains over CAD 250,000 in any year, with capital gains below that amount remaining subject to the existing 50 percent inclusion rate).

Taxable capital gains (or losses) are realized when a Canadian resident sells a capital asset outside of a registered plan or qualifying insurance policy, and subject to some exemptions (e.g. lifetime capital gains exemption, principal residence exemption, reductions of inclusion rate on charitable donations). It is a common goal in Canadian tax planning to characterize as much personal and corporate income as possible as capital gains rather than other forms of income, because of the 50 percent inclusion rate (the other 50 percent being received tax free). Such planning will remain relevant as long as the capital gains inclusion rate is less than 100 percent; however, the increase to the inclusion rate will erode the benefit of doing so.

Examples of events or transactions which will be impacted by the increase include corporate surplus stripping transactions (which aim to extract corporate surplus as capital gains rather than dividends), estate freezes, taxes on death, and taxes on becoming non-resident of Canada. In addition, many professionals in Canada practice their profession through a professional corporation and accumulate and invest their savings in those corporations, virtually always pursuing a capital growth strategy because dividend income is taxed aggressively. The increase will impact the taxation of capital gains realized in those corporations.

Canadians may wish to consider deliberately triggering accrued capital gains prior to 25 June 2024 while the existing 50 percent inclusion rate is still applicable. This could entail crystalizing gains in investment accounts, carrying out an estate freeze, making lifetime gifts of capital property to family members or charities, or expediting plans to become non-resident of Canada (which triggers a deemed disposition of certain capital property upon exit).

The Author



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James is the founder and Managing Director of Afridi & Angell's Toronto office, which primarily services the private client space in local and international estate planning, and creating structures using trusts and foundations.

Areas of expertise include succession planning, the use of trusts locally and internationally, tax planning, asset protection, tax-driven changes in residency, and estate structuring. The Toronto office also continues to provide corporate and commercial support in many instances.

Individuals with intentions to accumulate investment assets in private corporations and who would have otherwise planned to invest and grow their wealth in the corporation may now find that investing in corporate-owned life insurance is comparatively more attractive as well. Such policies and their in-policy growth continue to be tax-sheltered, and their comparatively conservative investment returns (versus unrestricted investment accounts) are less of a disadvantage in view of the higher capital gains inclusion rate.

Details of how the capital gains inclusion rate increase will be administered have not yet been released, particularly with respect to which transactions will be deemed to fall before and after 25 June 2024, and with respect to the inclusion rate for capital losses. It appears from the initial budget release that there will be an effort to match the inclusion rate for capital losses to capital gains at the same rate, likely to forestall triggering gains at the lower rate and losses at the higher rate on the same type of asset, such as public securities.

If you would like to pursue transactions to take advantage of the current 50 percent capital gains inclusion rate prior to 25 June 2024, or discuss becoming non-resident of Canada and related planning, please contact us and we will be glad to assist. ■