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TAX MATTERS

Change to capital gains taxes will catch many average Canadians

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I have a good friend, John, who works as a Canada Revenue Agency auditor. His favourite hobby is to referee hockey games, which he says is much like his day job - he looks for the bad guys and holds them accountable. On his wall at home, John has a plaque that reads "We've got what it takes to take what you've got." We joke about that – but it's a pretty apt description.

In this week's federal budget, the government announced yet another measure to take more of what you've got. I'm talking about the change to the capital gains inclusion rate.

The changes

Since the fall of 2000, Canadians have been subject to a 50-per cent inclusion rate on capital gains, which means that one half of capital gains have been taxable. In the 1990s, the inclusion rate was 75 per cent for almost an entire decade. So, when the pandemic hit in 2020 and government debt levels soared, it was felt by many tax specialists that the inclusion rate could increase.

Well, the 2024 federal budget did just that. But as with most tax changes introduced by this government, it's far more complex than it should be. The proposed changes will increase the inclusion rate to two-thirds for all capital gains realized by corporations or trusts. For individuals, the rate will also increase to two-thirds, but only on capital gains that exceed $250,000 in a tax year. For capital gains of $250,000 or less, the inclusion rate will remain at 50 per cent for individuals. These rules become effective for capital gains realized on or after June 25, 2024.

If you happen to have capital losses from prior years carried forward to 2024, the allowable losses will continue to be deductible against capital gains in the future by adjusting their value to reflect the same inclusion rate applicable to the capital gains. So, if you had $100 in capital losses from last year, those losses will always offset $100 of capital gains, regardless of the inclusion rate.

The complexity

This government, in its attempt to apply this change to higher-income Canadians, has done two things: (1) it has caught far more middle-income Canadians than expected, and (2) has made our tax law unbearably more complex (if that was even possible).

As for middle-income Canadians, there are many who own cottages or cabins – perhaps inherited – that have appreciated in value, or own rural residential properties bigger than half a hectare (about 1.25 acres). These properties may be subject to capital gains taxes if they're sold or transferred to their kids now or upon death. If the inheritors don't have the cash to pay the much higher taxes, these properties may not make it to the next generation. It's going to take some careful planning, and perhaps life insurance dollars, to fund the higher tax liability.

As for complexity, it's possible a taxpayer could now face three potential capital gains inclusion rates: The new two-thirds rate on certain capital gains, the old 50-per-cent inclusion rate on other gains, or a 100-per-cent inclusion rate under the new alternative minimum tax (AMT) rules. It just depends on the situation. If you're the average Canadian hoping to legally minimize your taxes here, good luck trying to figure it out on your own.

The planning

So, what's a person to do? It's going to take those of us who are tax geeks a few days – or weeks – to think about how to best deal with the higher inclusion rate. So, there will be more said on this later, for sure. As for today, here are a few pointers to keep in mind:

- The new inclusion rate won't apply until June 25, 2024, so you might consider triggering some capital gains by disposing of certain assets or closing transactions before that date. It doesn't have to mean giving up control or beneficial ownership of the asset if you, for example, sell to a corporation you control, or to a family member.
- You might consider whether certain assets should be owned personally rather than in a corporation or trust since the latter aren't eligible for the 50-per cent inclusion rate.
- Watch the timing of larger capital gains. You'd be better off reporting $250,000 in gains for two years in a row than reporting $500,000 in a single year now, for example.
- The new AMT may not apply on larger capital gains now since the new inclusion rate is so high. Speak to a tax pro for more.

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