RBC Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

Managing the tax impact of realizing significant capital gains in 2024

Please contact us for more information about the topics discussed in this article.

Canada's 2024 federal budget proposed to increase the capital gains inclusion rate to 66.67% from 50% for gains realized on or after June 25, 2024. The new rate applies to net capital gains exceeding $250,000 per year for individuals. In planning for tax-efficiency, you may have decided to realize capital gains by disposing of shares, real estate, or even private company shares prior to June 25, 2024, at the lower inclusion rate. Now, you might want to turn your mind to some of the tax and financial implications of having realized those gains. This article focuses primarily on potential strategies that may help mitigate and manage the tax impact of realizing significant capital gains.

This article contains planning considerations for individuals that may or may not be appropriate for corporations or trusts. If you realized significant capital gains through your corporation or a trust, please discuss the potential impacts with your qualified tax advisors.

Strategies for reducing the tax impact

Realizing sizable capital gains in 2024 may result in a hefty tax bill for the year. For example, let's assume you determined that a portfolio rebalancing was appropriate, and you sold a large quantity of securities prior to June 25, 2024. If the aggregate fair market value of the securities you sold was $600,000 and the adjusted cost base was $100,000, you would have realized a capital gain of $500,000. Assuming your marginal tax rate for 2024 is 53% and given that those capital gains would be included in your income at 50%, your tax liability solely on the realization of these gains would be $132,500. To help mitigate and manage the tax impact, you could consider the following tax planning strategies.

Contribute to an RRSP

If you have unused RRSP contribution room, a simple way to reduce your taxes would be to contribute to your RRSP. If you contribute to an RRSP, you can deduct the amount of your RRSP contribution from your taxable income, up to your annual RRSP deduction limit. An RRSP contribution can be deducted against any type of income, including taxable capital gains. If you contribute to your RRSP anytime between now and March 3, 2025, you can reduce the taxes you have to pay for the 2024 tax year.

If you can no longer make RRSP contributions because you're age 72 or over or you're turning 72 this year, you may still be able to make a spousal RRSP contribution if your spouse is younger. Any contributions you make to a spousal RRSP utilizes your own RRSP contribution room and can be claimed on your tax return and deducted against your taxable income.

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Donate securities in-kind

Whether you've made a philanthropic commitment or simply want to assist a registered charity, consider donating securities in-kind, especially if you don't have the cash on hand at the moment. It may cost you less to donate securities than to donate cash. This is because when you donate securities in-kind, you benefit not only from an elimination of the capital gain accrued on the securities, but also from a donation tax credit based on the value of the securities. The donation tax credit may help reduce the tax liability on the capital gains triggered.

If the securities you donate happen to be in a loss position, you can still benefit by claiming the capital loss as well as the donation tax credit. Before donating in-kind, it's important to contact the registered charity and verify whether they can accept in-kind donations.

Although there's no limit to the amount you can donate in a year, for tax purposes, you can generally only claim a charitable donation of up to 75% of your net income in a taxation year. For residents of Quebec, this limit is 100% of your net income. If you're unable to claim the full donation in one year due to this limitation, all is not lost since you can carry forward your unclaimed donations for up to five years.

If you've thought about leaving a charitable legacy, consider establishing a private foundation or speak to your RBC advisor regarding the benefits of setting up your own charitable fund through the RBC Charitable Gift Program. The RBC Charitable Gift Program may allow you to combine the immediate tax benefits with the flexibility to support your favourite charities over time.

Carefully utilize capital losses

If your portfolio contains investments that have decreased in value and are no longer aligned with your investment strategy, you may be thinking of selling these investments before December 31, 2024, in order to realize a capital loss.

For 2024, you're required to separately identify capital gains and losses realized before June 25, 2024 (Period 1) and those realized on or after June 25, 2024 (Period 2). Gains and losses from the same period are first netted against each other. More specifically, any capital losses you realize in Period 2, prior to December 31, 2024, will first be offset against capital gains realized in Period 2. After the offset, if there are still excess capital losses, those net losses will be offset against capital gains realized in Period 1.

As such, you'd ideally want to use the capital losses you realize in Period 2 to reduce any capital gains realized in Period 2, to the extent the gains are over $250,000 and are subject to the 66.67% inclusion rate. Be careful with the amount of capital losses you realize in Period 2, as net losses may end up offsetting capital gains realized in Period 1; this may defeat what you were trying to accomplish by realizing significant capital gains that are subject to the 50% inclusion rate.

Carefully utilize capital loss carry-forwards

Any unused net capital losses (i.e. capital losses that were not able to be offset by current-year capital gains) can be carried back to be claimed against taxable capital gains realized in the three previous years or carried forward indefinitely to be claimed against taxable capital gains realized in a future year. If you happen to have an unused net capital loss balance carried forward from a previous year (the balance can be found on your Notice of Assessment or Reassessment), this unused net capital loss balance may be used to offset capital gains that are subject to the 66.67% inclusion rate.

When tax planning, it may now be more tax-efficient to carry forward unused net capital losses from prior years to offset a capital gain that's subject to the 66.67% inclusion rate rather than to carry back the loss to offset a capital gain that's subject to the 50% inclusion rate.

As a further benefit, net capital losses carried forward are first applied to offset capital gains subject to the higher inclusion rate. For example, assume you have a $25,000 unused net capital loss carry-forward (equivalent to a $50,000 capital loss) and expect to realize a $300,000 capital gain in Period 2. Since net capital losses carried forward are first applied to offset capital gains subject to the higher inclusion rate, the $50,000 capital loss will first be applied to the $50,000 of capital gains subject to the 66.67% inclusion rate. The remaining $250,000 of capital gains will be subject to the 50% inclusion rate.

Stemming from this, you can consider keeping capital losses on hand to trim back capital gains only where they exceed $250,000 in a year. Assume you instead have an unused net capital loss carry-forward of $200,000 (equivalent to a $400,000 capital loss) and expect to realize a $300,000 capital gain in Period 2. In this case, you can consider applying only $50,000 of the capital loss carry-forward to the capital gains realized in Period 2. This would allow the capital loss to offset capital gains subject to the 66.67% inclusion rate, while still taking advantage of the full $250,000 exemption, where gains will be subject to the 50% inclusion rate.

	Gross amount	Net amount
Capital loss carry-forward balance	$400,000	$200,000
Capital gain realized in Period 2	$300,000	
Apply capital loss carried forward	($50,000)	
Remaining capital gain (subject to a 50% inclusion rate)	$250,000	
Remaining capital loss carry-forward balance	$350,000	$175,000

You could continue to carry forward the remaining unused net capital loss of $175,000 to a future year and implement the same capital loss planning technique.

As a note of caution, if you intend to repurchase any investment you sold at a loss, it's important to ensure you don't trigger the "superficial loss rules." These rules prevent you from claiming the capital loss, defeating what you were trying to achieve. A superficial loss may occur when you sell property (say, shares or mutual funds) and then you or someone affiliated with you (including your spouse or common-law partner) acquires that identical property within 30 days and continues to hold it on the 30th day.

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Consider tax-advantaged investment choices

The government provides tax incentives to encourage investment in certain areas of the economy. For example, flow-through investments may provide you with tax deductions or tax credits that may offset the tax impact of realizing significant capital gains.

While evaluating investments based on the tax merits is important, you should also consider other factors such as the investment risk, diversification, opportunity for capital appreciation, liquidity and so on. It's important to recognize that flow-through investments are considered higher-risk investments and typically must be held for a set period of time. Also, certain investments, such as limited partnerships, require more complex tax reporting. You should factor in any restrictions and increased filing complexities when evaluating whether an investment is right for you.

Options for funding the tax liability

If you're left with a large tax liability, even after implementing some strategies to reduce your overall tax bill, it's important to ensure you can meet your tax obligations. Here are a few options for funding the tax liability.

Withdraw from your tax-free savings account (TFSA)

You can withdraw funds from your TFSA to pay the tax liability. You can generally withdraw any amount from your TFSA at any time, for any purpose, without tax consequences. Depending on the type of investments you hold within your TFSA, you may need to time your withdrawal accordingly. For example, if you invested in a non-redeemable guaranteed investment certificate (GIC), you may have to wait until it matures.

If you wanted to replenish your TFSA, you can recontribute the fair market value of the amount you withdrew from your TFSA at the beginning of the following year. If you withdraw, say $25,000 in April of 2025 to fund your 2024 income tax liability, you can re-contribute $25,000 (plus any new contribution room earned for the year) to your TFSA beginning January 1, 2026.

Use non-registered funds

You can use non-registered funds to pay for the income taxes owing. If you must liquidate investments in 2025 to come up with the cash, this may trigger additional capital gains or losses, impacting your 2025 tax year.

You can then decide whether borrowing funds to invest, to replenish the investments sold, makes sense. When you borrow money, the interest expense is deductible for tax purposes where the borrowed money is used for the purpose of earning income from property (which includes interest income, dividends, rents and royalties). The attraction of borrowing to invest is the ability to deduct your interest expense for tax purposes.

Use borrowed funds

You can consider borrowing funds to directly fund the tax liability. For example, you can consider using a home equity line of credit as a means to supplement short-term cash flow in lieu of selling investments. Borrowing comes with costs and potential risks. You need to ensure you have sufficient cash flow to make interest payments. Also, if you borrow to pay the taxes owing, the interest on these borrowings will not be deductible since the borrowing would not be for the purpose of earning income from business or property.

As an alternative, to ensure the interest on your borrowings is deductible, you can consider selling some assets in your existing non-registered portfolio to pay the taxes and then borrow to replenish your portfolio. The interest on your borrowings may be deductible in this case because you'd be borrowing to generate income from property, by investing.

Other tax considerations

Will you have an alternative minimum tax (AMT) liability?

AMT is intended to prevent high-income individuals from paying little or no tax as a result of certain tax incentives, including earning mainly tax-preferred income such as capital gains. Consequently, you're required to compute your ultimate tax liability by determining your regular tax and your AMT. You pay whichever tax is the highest.

Generating a significant amount of capital gains at the 50% inclusion rate may trigger AMT for the 2024 tax year. The reason for this because the federal AMT tax rate of 20.5% is greater than the regular top federal tax rate on capital gains of 16.5% (33% x 50% inclusion).

If you're subject to AMT, you can carry forward the difference between the AMT you paid and your regular income tax liability as a tax credit for seven years, or until it's used up. In this sense, AMT is like a prepayment of tax. However, if you don't have sufficient regular taxes payable in the next seven years, your AMT credit will expire and becomes a permanent tax. If you have an AMT liability for 2024, speak to your qualified tax advisor on creating a plan to recover it over the next seven-year period.

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Will you be required to make tax instalments?

You are required to pay your income tax by instalments if your net tax owing is more than $3,000 ($1,800 for Quebec residents) in the current tax year and in either of the two preceding tax years. For example, if your net tax owing for either 2023 or 2022 is more than $3,000, you will have to pay instalments for 2024 if you realized a significant amount of capital gains in 2024 that result in your net taxes owing being over $3,000 (or $1,800 in Quebec).

Quarterly tax instalments are generally due on March 15, June 15, September 15 and December 15. If any of these dates fall on a weekend or holiday, the payment is due on the next business day. Instalments are essentially a pre-payment of tax and they are credited towards your actual tax liability for the year. If you owe more tax than your required instalments for the 2024 tax year, the balance is due on or before April 30, 2025. If your instalment payments are greater than your actual tax liability, the Canada Revenue Agency (CRA) will refund you the difference.

The CRA mails instalment reminders in February (for instalments to be paid in March and June, based on your 2022 tax return) and August (for instalments to be paid in September and December, based on your 2023 tax return). These reminders show an amount to pay and provide you with payment options and deadlines for making the payments.

If you received instalment reminders in 2024, and either haven't paid or are deciding whether to pay them, be sure to speak with a qualified tax advisor if you realized significant capital gains this year, to determine if need to pay instalments.

You may see the effect of realizing significant capital gains in 2024 on the CRA's instalment reminder in August 2025. That said, you don't have to pay the amount indicated on the instalment reminders. You can choose to calculate your instalment payments based on three different methods:

1) The no-calculation option;
2) The prior-year option; or
3) The current-year option.

The instalment reminders sent to you by the CRA are based on the no-calculation option. If you pay the amounts on the instalment reminders sent by the CRA, they will not charge you instalment interest or a penalty, even if the total of the payments you make is less than your actual tax liability.

However, due to this unique situation of generating large capital gains in 2024, your income in 2025 may be significantly lower in comparison. If this is the case, you may want to consider using the current-year option to calculate your instalments. This may allow you to better match your instalment payments with your actual tax liability for 2025, so you don't overpay in taxes. As a note of caution, if you choose to calculate your tax instalments using the current-year option and you underestimate how much you need to pay, you may be subject to instalment interest and potentially penalty charges. As such, it's advisable to obtain a tax estimate from a qualified tax advisor.

Plan ahead

As part of proactive planning for the future, it's important to discuss your situation with your qualified tax advisors, understanding the significance of realizing capital gains in 2024 and the potential impacts based on your personal situation. There may be opportunities to minimize tax and preserve your net worth. Speak with a qualified tax advisor to see if any of the tax planning opportunities discussed in this article are suitable for you in your circumstances.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.

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