Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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2024 Federal Budget — Planning for the proposed increase to the capital gains inclusion rate

Canada's recently unveiled 2024 federal budget proposes to increase the capital gains inclusion rate to 66.67% from 50%. Knowing tax efficiency plays a key role in building wealth, you're likely wondering how this change may affect you. This article details what's known about the proposed changes at the time of writing; it also outlines planning strategies you may wish to consider before the proposed June 25, 2024, effective date and going forward.

While the budget document outlined the capital gains changes in a general way, there are still many unanswered questions given there was no accompanying draft tax legislation on the changes. This leaves uncertainty about the precise implementation and interpretation of the changes. The government stated in the budget document that additional design details will be released in the coming months. Quebec has announced its intention to harmonize with the federal increase.

Before taking any steps in anticipation of the proposed changes, it will be important for you to determine whether there are any significant updates to the proposals and whether the budget implementation bill has received royal assent.

Any reference to a spouse in this article also refers to a common-law partner.

Table of contents

Process for budget implementation bills

The Parliament of Canada's website on House of Commons Financial Procedures explains the process for budget implementation bills:

1. Before delivering the budget speech, the Minister of Finance will move a ways and means motion that the House of Commons approve in general the budgetary policy of the government.
2. There may be up to four days of debate and the opportunity for the opposition parties to present an amendment and a sub-amendment.
3. The House of Commons will then vote on the minister's motion. Adoption of this motion does not authorize the government to change taxation or to spend funds, which must come through the ways and means and supply processes. Rather, it indicates general approval of the government's financial plan.
4. A budget implementation bill can become law only once the same text has been approved by both Houses of Parliament and has received royal assent.[1]

The first appointed day for budget debate was April 18, 2024. The second, third and fourth appointed days are scheduled April 29, 30 and May 1, 2024. The status of the budget implementation bill and parliamentary business can be followed at www.ourcommons.ca.

History of the capital gains inclusion rate

You have a capital gain when you sell, or are considered to have sold, a capital property for more than the total of its adjusted cost base (ACB) and the outlays and expenses incurred to sell the property. Capital gains have preferential tax treatment, as only a portion of the gain is taxable. The capital gains inclusion rate is the percentage of taxability that's applied to a capital gain. The result, known as a taxable capital gain, is included in taxable income. Since tax on capital gains was introduced in 1972, this inclusion rate has changed several times.

The proposed higher inclusion rate on capital gains would effectively increase the average federal-provincial marginal tax rate on capital gains above $250,000 at the top marginal tax rate to 33.8% from 25.3%.

Capital gains inclusion rate changes over time[2]

Time period	Inclusion rate
1972 to 1987	50%
1988 to 1989	66.67%
1990 to February 27, 2000	75%
February 28 to October 17, 2000	66.67%
After October 17, 2000	50%
On or after June 25, 2024 (proposed)	66.67%

The effects on individuals

Any capital gains realized prior to June 25, 2024, (Period 1) will have an inclusion rate of 50%. Any capital gains realized on or after June 25, 2024, (Period 2) will have an inclusion rate of 50% on the portion up to $250,000 (regardless of the amount of capital gains realized in Period 1) and an inclusion rate of 66.67% on any portion above $250,000.

The proposed higher inclusion rate on capital gains would effectively increase the average federal-provincial marginal tax rate on capital gains above $250,000 at the top marginal tax rate to 33.8% from 25.3%. Refer to Appendix 1 for the current top marginal tax rate on capital gains by province/territory.

The annual $250,000 threshold for individuals would be fully available in 2024 (i.e., it would not be prorated) and would apply only in respect of net capital gains realized in Period 2.

The $250,000 threshold would effectively apply to capital gains realized by an individual, either directly or indirectly via a partnership or trust (further discussed later in this article), net of any: current-year capital losses; capital losses of other years applied to reduce current-year capital gains; and capital gains in respect of which the lifetime capital gains exemption, the proposed employee ownership trust exemption or the proposed Canadian Entrepreneurs' Incentive is claimed.

1 Parliament of Canada website. Financial Procedures - Our Procedure - ProceduralInfo - House of Commons of Canada (ourcommons.ca). Accessed April 19, 2024.

2 Government of Canada website. Inclusion rates for previous years - Canada.ca. Accessed April 21, 2024.

There was no mention of grandfathering unrealized capital gains accrued prior to June 25, 2024, so it's assumed if accrued capital gains are realized after June 25, 2024, the entire amount (less the $250,000 threshold) will be subject to the increased inclusion rate. There was also no mention of the $250,000 threshold being indexed to inflation.

Employee stock options

The taxation of employee stock options mimics the taxation of capital gains. If certain criteria are met, you can claim a stock option deduction that results in the stock options employee benefit being effectively taxed at capital gains tax rates. The budget proposes to decrease the stock option deduction to 33.33% (from 50%) of the taxable benefit to reflect the new capital gains inclusion rate, to the extent you exceed a combined limit of $250,000 for both employee stock options and capital gains.

The taxation of employee stock options mimics the taxation of capital gains. If certain criteria are met, you can claim a stock option deduction that results in the stock options employee benefit being effectively taxed at capital gains tax rates.

Consider alternative minimum tax (AMT)

It's important to consider the impact that AMT may have on any personal capital gains you will trigger. AMT is a parallel tax calculation that prevents high-income earners and certain trusts from paying little or no tax as a result of certain tax incentives, such as claiming certain tax deductions and credits. You pay the AMT or regular tax, whichever is highest.

In the 2023 federal budget, the government proposed several changes to the AMT calculation that were also aimed at high-income individuals. One consequence of the change was that generating a significant amount of capital gains would likely trigger AMT. Although the AMT you pay is creditable against regular income tax for up to seven years, if you don't have sufficient regular taxes payable in the next seven years, the AMT you paid becomes a permanent tax. That said, the 2024 proposed increased inclusion rate for capital gains will lessen the impact of AMT.

The effects on corporations

The budget proposes that all capital gains realized in a corporation on or after June 25, 2024, will have an inclusion rate of 66.67%, regardless of whether the corporation is an operating, holding or professional corporation. As further clarification, there is no 50% inclusion rate available to corporations for the first $250,000 of capital gains.

Investment income earned within a corporation is ultimately taxed at two levels — once at the corporate level and also at the personal level when the income is distributed to shareholders. A portion of the corporate tax paid is refundable to the corporation when taxable dividends are paid out to the shareholders. The purpose of this pre-payment and refund of tax is to achieve an important principle of the Canadian tax system commonly referred to as "integration". When a tax system is perfectly integrated, an individual will be indifferent to earning investment income in a corporation versus earning it personally.

Appendix 2 shows, by province and territory, the current and proposed corporate tax rates on various types of income earned and retained in a corporation, as well as the combined corporate and personal tax rates for capital gains earned in the corporation and distributed as dividends compared to capital gains earned personally, assuming the shareholder is subject to tax at the top marginal tax rate.

With the increase in tax on the first dollar of capital gains realized in the corporation, when looking at the passive investment income tax rates in a corporation, there is now an almost equality when earning eligible dividends and capital gains in almost every province and territory in a corporation. This should be considered when determining the makeup of your portfolio in your corporation.

Further, when comparing the combined corporate and personal tax rates on capital gains that are earned in the corporation and then distributed to the top marginal tax rate on capital gains earned personally, there's a significant tax cost to earning the capital gains inside the corporation, especially where the individual is subject to the 50% inclusion rate.

It's not yet known whether the refundable portion of taxes paid by a corporation on passive investment income will be adjusted to allow for better integration given the proposed capital gains inclusion rate changes.

Using a corporation to plan for U.S. estate tax

It has often been suggested to transfer personal U.S. situs property (i.e., shares in publicly traded U.S. corporations) to a Canadian corporation to insulate oneself from U.S. estate tax. The main drawback of this strategy is that earning U.S.-sourced income, such as U.S. dividends, in your corporation may result in a larger tax liability when the income is paid to you as a shareholder than if this income was earned personally due to the current combined Canadian corporate and personal tax rate that applies to foreign income. Now, with the increase in the capital gains inclusion rate, this adds a second disadvantage to this type of planning.

The effects on trusts

As noted earlier, any gains realized by a trust on or after June 25, 2024, that are taxed in the trust will be subject to an inclusion rate of 66.67%. There is no $250,000 threshold as there is in the case with an individual. The budget did not exclude any specific type of trust, such as a graduated rate estate, life interest trust or qualified disability trust, from the 66.67% inclusion rate.

When a properly structured trust earns a capital gain, the taxable portion of the gain would be included in the trust's income. If the trust pays or makes this capital gain payable to a beneficiary of the trust, it can claim an offsetting deduction, so it's not taxed in the trust. The capital gain would then be taxed in the beneficiary's hands. A beneficiary of the trust who earns a capital gain may benefit from the 50% inclusion rate to the extent their total gains for the year do not exceed $250,000.

When considering the proposed change to the inclusion rate, trustees will want to consider whether a capital gain realized by the trust can and should be allocated to a beneficiary of the trust to potentially benefit from the lower inclusion rate. The trustee would need to review the terms of the trust document to determine whether the trust allows for such an allocation to a beneficiary. They would also want to consider whether making such an allocation is in line with the objectives and purpose of the trust. Distributing more income than necessary to the beneficiaries may not be what the settlor of the trust intended.

There are still questions, however, that remain unanswered at this time. For example, if the trust realizes a capital gain prior to June 25, 2024, but is only allocated to the beneficiary on or after June 25, 2024, at what inclusion rate will these gains be included in the beneficiary's income? As well, the Canada Revenue Agency (CRA) has previously commented that only the taxable portion of the trust's capital gain realized in a year that has been allocated to a beneficiary needs to be paid or made payable to the beneficiary, and not the non-taxable portion. Would the trust owe the beneficiary 66.67% of the capital gain, even if the beneficiary's inclusion rate is 50%?

In terms of an alter ego trust (AET) or joint partner trust (JPT), it's common that the settlor (and contributor) to the AET or JPT will be a sole trustee and/or a capital beneficiary of the trust. In this situation, subsection 75(2) of the Income Tax Act (the super attribution rules) would apply to this trust. If the super attribution rules apply to this trust, all income/losses and capital gains/losses earned in the trust are attributed back to the settlor/contributor and taxed in their hands. The settlor/contributor may be able to use their 50% inclusion rate on the first $250,000 of capital gains attributed to them annually (assuming they have no other gains); however, draft legislation is still needed for clarification.

There are still questions, however, that remain unanswered at this time. For example, if the trust realizes a capital gain prior to June 25, 2024, but is only allocated to the beneficiary on or after June 25, 2024, at what inclusion rate will these gains be included in the beneficiary's income?

If the AET or JPT is not subject to the super attribution rules, the trustee may be able to, pursuant to the terms of the trust, pay or make payable the taxable capital gain to the trust beneficiary (beneficiaries) and get a deduction on the trust tax return so that the taxable capital gain is not taxed in the trust. The beneficiary may then be able to use their 50% inclusion rate for the first $250,000 of capital gains.

While this is, at the time of writing, believed to be how the proposed change may work with trusts based on current income tax rules, waiting for the release of the draft legislation is needed for clarification.

The effects on estates

In the year of death, a final (terminal) tax return must be filed by an executor (liquidator in Quebec) that includes the deceased's net capital gain recognized under the deemed disposition rules. These rules treat all capital property owned by the deceased as if it was sold immediately prior to death. Thus, generally all unrecognized capital gains and losses are triggered at that point with the net capital gain included in income and taxable at the capital gains inclusion rate in effect at the time of death. There are provisions to defer the taxes owing when assets are transferred to a spouse. However, without proper planning for larger potential future capital gains, the value of your assets could be reduced by the proposed changes. It's important to consider if your estate will have enough liquid assets or cash on hand to pay the tax obligation. Life insurance may be the least costly method of compensating for the taxes that are payable at that time.

AET and JPT trusts are also subject to the deemed disposition rules at the death of the beneficiary or last surviving spouse. Under the proposed rules, for deaths occurring after June 25, the capital gains realized in the trust will be taxed in the trust at the 66.67% inclusion rate. These gains cannot be allocated to beneficiaries to be taxed on their terminal tax return. Furthermore, donations of securities from the trust are not exempt from capital gains tax, even though they are eligible for the donation tax credit. Trustees should consider managing the capital gains to reduce the gains subject to higher tax on death. Trustees may also wish to consider planning for the donation of securities at death from assets held outside of the AET/JPT.

Taxation of private company shares at death

Individuals owning shares in a corporation at death can be subject to double-taxation. First, there is tax on the capital gain, if any, resulting from the deemed disposition at death of the shares of the corporation owned by the shareholder. The amount of the capital gain is based on the fair market value (FMV) of the share of the corporation, which in turn gets its value from the FMV of the portfolio in the corporation. Second, when your beneficiaries withdraw funds from the corporation, there is tax on the sale of the underlying capital property within the corporation and tax on the withdrawal. Thus, the increase in value of the portfolio in the corporation may be subject to taxation at both the corporation and personal level.

It may be possible to defer this potential tax if the shares of the company were to pass to a spouse or a spousal trust. Furthermore, the tax can be minimized if the corporation is wound up within the first taxation period of the estate, especially where there are positive balances in the refundable dividend tax on hand (RDTOH) and capital dividend account (CDA) accounts. The proposed change to the capital gains inclusion rate will impact post-mortem planning to minimize double taxation.

The effects on those who previously claimed a capital gains reserve

When you sell a capital property, you usually receive the full payment at that time. A capital gains reserve strategy allows you to spread the recognition of capital gains from the sale of capital property. This capital gains reserve is calculated based on a formula and one of the factors is the amount of proceeds received. However, at a minimum, at least 20% of the capital gain must be reported each year over a five-year period. A 10-year reserve period is provided for a properly structured transfer of farm property or qualified small business shares to a child.

You may have previously claimed a capital gains reserve, for example, if you're a business owner who sold your business and took vendor take back financing. Until detailed legislation is released, it's not yet known if a previous reserve claimed must be taken into income in 2024 in Period 1 at the 50% inclusion rate or in Period 2 at the 66.67% inclusion rate. This will also impact the timing and calculation of the CDA and capital dividend. A historical version of the Income Tax Act from the year 2000 specified that the timing of the income inclusion due

Individuals owning shares in a corporation at death can be subject to double-taxation. First, there is tax on the capital gain, if any, resulting from the deemed disposition at death of the shares of the corporation owned by the shareholder.

to the change of the capital gains inclusion rate in 2001 was "first day of the year" after the capital gain is realized. Until detailed legislation is released, it's not yet known whether the treatment and timing will be similar.

The effects on becoming a non-resident of Canada

On the date you cease Canadian residency for Canadian tax purposes, you're deemed to have disposed of all the property you own worldwide at its FMV, subject to certain exceptions, and to have immediately reacquired the property for that same value. Property subject to this deemed disposition rule includes securities in your non-registered investment portfolios, real estate situated outside of Canada, shares of Canadian private corporations and partnership interests. These rules apply whether or not the property is physically moved outside of Canada.

The deemed disposition rule ensures that you're subject to tax in Canada in respect of capital gains that have accrued while you're a resident of Canada. The tax liability resulting from the realization of these accrued gains is often referred to as "departure tax." In addition, individuals who cease to reside in Canada and who make significant capital gains could face an increased tax burden under the new AMT rules. What's more, although the AMT is a temporary tax for most individuals, it's a permanent tax for most individuals who are subject to departure tax. For more information on moving from Canada, please ask your RBC advisor for the article on this topic.

Before taking action: ask "big picture" questions

It's important to consider the power of tax deferral as one of the fundamental tools of tax planning. A tax deferral takes advantage of the time value of money. All else being equal, the longer your tax can be deferred, the less the discounted present value of your tax liability. For example, $25,000 in tax deferred for 20 years at an assumed 5% interest rate has a discounted present value of $9,422.

With a tax-deferred investment strategy, the money that might otherwise go to pay current taxes remains invested for greater long-term growth potential and benefits from the power of compounding. In other words, selling now will result in a pre-payment of tax and a smaller after-tax amount to reinvest.

Given the importance of tax deferral, before acting, it may be helpful to revisit your goals and timelines before making a change. While Canadians all operate under the same taxation rules, the best approach for your unique situation will also be unique to you. Consider asking yourself:

Time horizon:

- Has my investment time horizon changed?
- Do I have a shortened life expectancy?
- Is advanced age a factor to consider in order to minimize the potential tax implications for my estate?

Rebalancing:

- Are my goals the same as when my portfolio was constructed?
- Is my portfolio aligned with my risk tolerance?
- Does my portfolio have an appropriate level of diversification?

Liquidity and available cash flow:

- Do I have a liquidity need for the sale proceeds in the short-term?

Financial picture:

- Do I expect to have more than $250,000 in realized net capital gains personally this year?
- Do I expect to have lower or higher overall taxable income this year? Would a sale take advantage of using lower marginal tax brackets?
- Do I plan to gift assets to my family members during my lifetime?

Lifestyle:

- Do I plan to leave Canada and live in another country?

Considerations for a sale of securities prior to June 25

If, in your regular review of your portfolio, you determine that a portfolio rebalancing is appropriate, consider whether to implement the rebalancing before the increase to the inclusion rate. If there is a high probability that the inclusion rate for the future capital gain is likely to be 50%, because of your ability to take advantage of the $250,000 threshold for individuals, it's not recommended to realize an early capital gain.

Keep in mind that the trades would need to settle before June 25; therefore, ensure that trading dates are factored in to meet this deadline. This way, any capital gains triggered from the rebalancing would be subject to the current 50% inclusion rate. Although this rebalancing may

Given the importance of tax deferral, before acting, it may be helpful to revisit your goals and timelines before making a change. While Canadians all operate under the same taxation rules, the best approach for your unique situation will also be unique to you.

be appropriate from an investment standpoint, it does result in a pre-payment of tax (albeit at a potentially lower tax rate) and loss of tax deferral. Furthermore, triggering capital gains tax in 2024 may result in increased instalment payment reminders from the CRA.

For securities you've not previously considered disposing of this year or next, the decision to sell should be analyzed with a detailed cost/benefit analysis based on your specific circumstances to determine your "break-even holding period". This is the point in time when, assuming all other things being equal, your after-tax portfolio value will be the same regardless of whether you sell prior to June 25, 2024, or maintain your portfolio and sell in the future.

Break-even analysis example: Individuals and trusts

Let's look at an example of an individual selling securities before June 25 at the 50% inclusion rate, versus holding the security until a future date and selling when the inclusion rate is 66.67%. This example assumes the individual has already realized capital gains this year, and the additional sale of securities would result in capital gains entirely in excess of the $250,000 threshold.

Let's assume:

- The FMV of the securities is $300,000.
- The ACB of the securities is $100,000.
- Their marginal tax rate today and in the future is 50%.
- The expected future rate of return is 5% (100% deferred capital gains, no interest, no dividends).
- AMT does not apply.

If the individual were to sell today, they would be subject to capital gains tax of $50,000, leaving them with only $250,000 of after-tax proceeds for reinvestment. Alternatively, the individual could hold/not sell and keep the full $300,000 invested.

The following table shows the difference in after-tax value between selling now at the 50% inclusion rate versus holding and selling the security at a future date at the 66.67% inclusion rate.

Option 1: Sell now at 50% inclusion rate and reinvest proceeds				Option 2: Hold and sell at 66.67% inclusion rate				
Year of sale	Future value	Tax on future gain at 66.67%	After-tax value	Year of sale	Future value	Tax on all gain at 66.67%	After-tax value	Difference in after-tax value
1	$262,500	$4,167	$258,333	1	$315,000	$71,670	$243,330	$15,003
5	$319,070	$23,025	$296,046	5	$382,884	$94,300	$288,585	$7,461
8	$369,364	$39,790	$329,574	8	$443,237	$114,418	$328,819	$755
9	$387,832	$45,946	$341,886	9	$465,398	$121,806	$343,593	($1,707)

The preceding table shows the individual can expect the difference in after-tax value to be the same sometime between the eighth and ninth year. Therefore, if the individual expects to keep the securities for at least nine years, they will be better off not selling now and rather holding the investment. In other words, if the individual plans to hold the security for less than nine years, they will be better off to sell before June 25 at the 50% inclusion rate.

The following table shows the break-even holding period for the preceding example using the same assumptions but at various capital growth rates of return.

Rate of return	Break-even holding period*
3%	14 years
5%	9 years
7%	6 years
9%	5 years

*Rounded to the nearest whole year

If you're deciding whether to sell before June 25 or continue to hold, important considerations will be the expected rate of return, your time horizon and the potential incremental capital gains tax.

In conclusion, the lower the future expected rate of return, the longer the break-even holding period will be. Conversely, the higher the future expected rate of return, the shorter the break-even holding period (as such, if you hold a security with a higher rate of return and you plan to hold on to this security for the long term, it likely doesn't make sense to sell just to take advantage of the lower inclusion rate).

Break-even analysis example: Corporations

If you're a business owner, you may be retaining a surplus in the corporation that's not needed to fund your daily expenses. Where you have no plans to withdraw the surplus from the corporation in the short or medium term, the break-even calculation is similar to the calculation for individuals. However, in the case where the surplus will be withdrawn from the corporation, the calculation differs.

Let's look at an example of a corporation selling securities before June 25 at the 50% inclusion rate and investing the proceeds, versus holding the security until a future date and selling when the inclusion rate is 66.67%.

Let's assume:

- The FMV of the securities is $1,000,000.
- The ACB of the securities is $500,000.
- The shareholder's tax rate is 45% on ineligible dividends.
- The corporate tax rate is 50%.
- The expected future rate of return is 5% (100% deferred capital gains, no interest, no dividends).
- AMT does not apply.

If the corporation were to sell today, it would be subject to capital gains tax of $125,000, leaving it with only $875,000 of after-tax proceeds for reinvestment. Alternatively, the corporation could hold/not sell and keep the full $1,000,000 invested. It's assumed the shareholder will withdraw the proceeds from the sale of the portfolio after the break-even period as a combination of taxable ineligible dividends and tax-free capital dividends.

The following table shows the difference in after-tax value between selling now at the 50% inclusion rate versus holding and selling the security at a future date at the 66.67% inclusion rate.

Option 1: Sell now at 50% inclusion rate and reinvest proceeds					
Year of sale	Future value	Corporate tax on future gain at 66.67%	CDA	Personal tax on ineligible dividend	After-tax value
1	$918,750	$5,638	$264,583	$326,342	$663,445
5	$1,116,746	$31,153	$330,582	$374,259	$788,010
9	$1,357,412	$62,167	$410,804	$432,502	$939,418
10	$1,425,283	$70,913	$433,428	$448,928	$982,117

Option 2: Hold and sell at 66.67% inclusion rate						
Year of sale	Future value	Corporate tax on all gain at 66.67%	CDA	Personal tax on ineligible dividend	After-tax value	Difference in after-tax value
1	$1,050,000	$70,877	$183,333	$358,106	$621,018	$42,428
5	$1,276,282	$100,037	$258,761	$412,868	$763,377	$24,633
9	$1,551,328	$135,481	$350,443	$479,432	$936,415	$3,003
10	$1,628,895	$145,477	$376,298	$498,204	$985,214	($3,097)

The preceding table shows the shareholder can expect the difference in after-tax value to be the same sometime between the ninth and 10th year. Therefore, if the corporation expects to keep the securities and the shareholder will not extract the funds for at least 10 years, they will be better off not selling now and rather, holding the investment. In other words, if the corporation plans to hold the security for less than 10 years and the shareholder will be withdrawing the proceeds, they will be better off to sell before June 25 at the 50% inclusion rate.

The following table shows the break-even holding period for the preceding example using the same assumptions but at various capital growth rates of return.

Rate of return	Break-even holding period*
3%	16 years
5%	10 years
7%	7 years
9%	6 years

*Rounded to the nearest whole year

If you're deciding whether to sell before June 25 or continue to hold, important considerations will be the expected rate of return, your investment time horizon and the potential incremental capital gains tax.

In conclusion, the lower the future expected rate of return, the longer the break-even holding period will be. Conversely, the higher the future expected rate of return, the shorter the break-even holding period (as such, if you hold a security with a higher rate of return and you plan to hold on to this security for the long term, it likely doesn't make sense to sell just to take advantage of the lower inclusion rate).

Consider timing for capital losses and carryforwards

Net capital losses can be used to reduce your taxable capital gain in any of the three preceding years or in any future year. Your available net capital losses are shown on your Notice of Assessment. If you have a balance of unapplied net capital losses from previous years, the losses are adjusted back to their gross capital loss for the purposes of applying the loss against a current capital gain. For example, a $100,000 net capital loss claimed in the year 1990, when the inclusion rate was 75% (i.e., 3/4), would be multiplied by an adjustment factor of 4/3. The gross capital loss available to offset current capital gains would be $100,000 x 4/3 = $133,333.

Given the mechanics and adjustment factors to account for various previous inclusion rates, for tax purposes there appears to be no benefit to proactively realizing capital losses before June 25, 2024, in order to realize losses at the 50% inclusion rate. There also appears to be no downside to waiting to realize the loss on or after June 25, 2024, at the 66.67% inclusion rate. In addition, with regards to net capital loss carryforwards, without detailed legislation, it's unclear how capital losses from previous years may be allocated in 2024 between Period 1 and Period 2.

If the reason for selling a capital property at a loss is for taxation purposes, you may wish to consider waiting for clarifying details from the government to have more certainty before selling.

Consider the impact on the capital dividend account (CDA)

The CDA is a notional account for private corporations which allows private corporations to pay tax-free dividends to its shareholders. Generally, a corporation's CDA consists of the following: the non-taxable portion of the excess of capital gains over capital losses, capital dividends received from another corporation, and the proceeds of a life insurance policy received by the corporation in excess of the ACB of the policy.

Be careful when realizing losses in a corporation. The non-taxable portion of the capital gains realized in a corporation increases the CDA, while the non-allowable portion of capital losses immediately reduces the CDA. Since triggering a capital loss in a corporation will reduce the existing CDA balance, you may want to pay out a capital dividend from the CDA, if possible, before realizing losses in your corporation.

A capital gain realized prior to June 25, 2024, will have an inclusion rate of 50%, with the other 50% increasing the CDA balance. In contrast, a capital gain realized on or after June 25, 2024, will have an inclusion rate of 66.67%, meaning that only 33.33% will be added to the CDA balance. Similarly, a capital loss realized prior to June 25, 2024, would have a 50% non-deductible portion, as opposed to a 33.33% non-deductible portion after the rate changes. Without detailed legislation, it's unclear how the capital dividend account will be affected by capital gains and losses realized in 2024.

Given the mechanics and adjustment factors to account for various previous inclusion rates, for tax purposes there appears to be no benefit to proactively realizing capital losses before June 25, 2024, in order to realize losses at the 50% inclusion rate.

Strategies to consider to trigger a capital gain

Transfer appreciated securities to your spouse

If an unrealized capital gain has accrued in your name, you can consider transferring the appreciated securities to your spouse. Transfers between you and your spouse (where both legal and beneficial ownership are transferred) are generally not taxable for income tax purposes. The default option is that your spouse will receive the property at your ACB. However, you and your spouse have the option of electing to report the transfer at FMV. If the assets are in an accrued gain position and the election is made, you will need to report the capital gain on your income tax return. The deadline to file the election (there is no prescribed form) is the income tax return deadline for the taxation year in which the transfer occurred, generally April 30. The ACB of the property for your spouse will be the FMV of the assets on the date of the transfer. If the increase to the inclusion rate introduced in the budget receives royal assent, you may be able to elect to trigger the unrealized gain and be subject to the 50% inclusion rate. If the proposal doesn't pass into law, you can elect to transfer the security at cost.

Transfer appreciated securities to a Canadian partnership or holding company

You may wish to consider transferring appreciated securities to a partnership or holding company before June 25, 2024. If you do not have a partnership or holding company, you must first consider the initial cost of setting one up and the ongoing tax compliance costs. In general, the steps for this planning strategy involve transferring securities to the partnership or holding company in exchange for units of the partnership or shares of the corporation. A tax election form (T2059 for partnership or T2057 for holding corporation) must be completed and filed if you're electing to transfer the securities at the ACB or somewhere between the ACB and FMV. The deadline to file form T2059/T2057 is the earliest date on which any of the parties to the election has to file an income tax return for the taxation year in which the transfer occurred (generally March 31 for partnerships, where all partners are individuals, or in the case of a holding company, April 30 for individuals or within six months of the corporation's taxation year).

If the increase to the inclusion rate introduced in the budget receives royal assent, you may be able to elect to trigger the unrealized gain and be subject to the 50% inclusion rate. If the proposal doesn't pass into law, you can elect to transfer the security at cost.

Considerations for private company business owners

With the proposed hike to the capital gains inclusion rate, capital gains surplus stripping may not be as attractive a strategy. Capital gains surplus stripping is a tax strategy where you, as a shareholder, withdraw cash from your corporation as a capital gain, which is tax-preferred, instead of a dividend, which would be less tax-preferred. It's also important to note, based on draft legislation released on August 4, 2023, it appears the government intends for these transactions to be caught by the proposed changes to the General Anti-Avoidance Rule (GAAR). GAAR is a concept which generally empowers the CRA to deny the tax benefit of transactions which do not have any commercial substance and where the only purpose is to achieve the tax benefit. As such, due to the increase in the capital gains inclusion rate coupled with the proposed changes to GAAR, it may be preferable to withdraw cash from your corporation as a dividend.

As a business or practice owner, you will also need to consider the broader implications of this pending inclusion rate increase on your longer-term sale planning. If you're contemplating selling your business or practice, the increase in the capital gains inclusion rate now influences whether an asset or a share sale makes more sense.

For example, as a business or practice owner, you may have access to the Lifetime Capital Gains Exemption (LCGE) and the new Canadian Entrepreneurs' Incentive (CEI) proposed in the 2024 federal budget if you sell your shares. The LCGE is available to individuals who dispose of shares of a qualifying small business corporation (QSBC). Further, you will be able to benefit from the $250,000 threshold for individuals if gains cannot be fully sheltered by the LCGE. In contrast, if you sell the assets of your corporation, the corporation will not have access to the $250,000 threshold that's only available to individuals. As such, the corporation will likely pay more tax on capital gains realized on the sale of your business.

With succession planning in mind, you may wish to consider an estate freeze. An estate freeze refers to a transaction where you lock-in or "freeze" the value of appreciating assets. The intent is to transfer the future growth of the assets and their associated tax liability to other taxpayers, usually family members. Estate freezes generally make sense only when there's an expectation that the corporation will grow in value, resulting in capital gains, and where there's a clear successor or next generation of owners.

If the value of the business will increase beyond the amount of LCGE available to you, you may want to consider implementing an estate freeze to transfer some of the growth to your family members. Each individual shareholder is entitled to claim an LCGE during their lifetime on the disposition of qualifying property. Therefore, if your family members are also shareholders, they may be able to make use of their exemptions and reduce the total taxes payable on the sale of your business. Further, given the proposed changes, your family members may be able to benefit from the lower inclusion rate on the first $250,000 of capital gains if the gains cannot be fully sheltered by the LCGE.

Considerations for your vacation property

If your intention is to keep your vacation property in the family, and if the time horizon for passing to your intended beneficiaries is in the near to medium term, you may want to consider whether to gift or sell your vacation property to your intended beneficiaries before June 25. This assumes the capital gain from the sale will not be excluded by your principal residence exemption. Gifting the vacation property to a beneficiary, other than your spouse, will trigger a disposition of the property at FMV. If the ACB of your property is less than the FMV of the property at the time of the transfer, you'll realize a taxable capital gain in the year of transfer. If you decide to go this route, set the sale price at least equal to the FMV of your vacation property, not a reduced or nominal price. The CRA will consider the property to have sold at the FMV, so reducing the price will not reduce the capital gains tax. Also, when your children eventually sell or pass on the cottage, they will be required to report the reduced purchase price as their cost base, possibly resulting in double taxation.

As part of this planning, you'll need to consider how you're going to fund the tax liability as well as whether any land transfer taxes or other fees will be payable as a result of the gift or sale.

Paying the tax liability from your own funds may result in a knock-on effect if assets need to be liquidated, thus triggering additional taxes. Another option could be to have your intended beneficiaries pay the tax liability on the sale, or you can structure the sale and the tax payment over five years using the capital gains reserve if you take a mortgage back from your kids. You may also consider forgiving the mortgage in your Will so that your beneficiaries will receive the property free of any debt.

If you choose to transfer your vacation property while you are living, either by gift or sale, it's important to consider that you're giving up control over the property, as well as the security of owning that property. In addition, you're possibly exposing the property to your beneficiaries' creditors, including matrimonial creditors.

If you transfer the vacation property to more than one person, keep in mind that certain issues may jeopardize the long-term sharing of the property, for example, disputes over the use of the property and who's responsible for the expenses related to its maintenance. You may want to encourage the new owners to enter into a co-ownership agreement. A co-ownership agreement may include terms dealing with the use of the property and how expenses and property improvements are to be handled. It may provide a decision-making process for the transfer or sale of the property on an owner's death, incapacity or relationship breakdown, and it may specify the individuals to whom the property can be transferred to, both during the owner's lifetime and on death.

Considerations for your investment property

If you own Canadian real estate for investment purposes, you may want to consider whether to sell the property before June 25, if it is practical to do so. A break-even analysis can be performed in a similar way to the analysis for a sale of securities, however, other non-income tax considerations should also be considered. For example, any potential land transfer taxes or GST/HST implications should be assessed by your qualified tax advisor prior to transferring or selling your investment property.

Potential planning opportunities post-June 25, 2024

Realize capital gains under $250,000 threshold

If you have a portfolio of investments with large accrued gains, consider disposing of your investments slowly over time to ensure you keep your capital gains realized below the $250,000 annual threshold. With this strategy, you'd again want to do a cost/benefit analysis of whether realizing $250,000 of capital gains annually to take advantage of the lower 50% inclusion rate going forward makes sense.

If the investments are held in your corporation, to extract funds tax-free, you can pay out a tax-free dividend to the extent that your CDA is positive. You can also repay any shareholder loans you made or reimburse yourself for any business expenses you paid personally.

Consider charitable donations

To encourage Canadians to increase their charitable giving, there's a tax incentive for those who donate publicly traded securities. The capital gains triggered upon the donation of these securities may be eliminated. As such, if you have appreciated securities, you may wish to consider donating these securities directly to charity instead. If you donate the security directly to the charity, the after-tax cost of the donation will be the same regardless of the capital gains inclusion rate. Further, AMT is a consideration when donating in-kind. Given the tax changes, it may be advantageous to make in-kind donations from a corporation rather than individually. This is because a corporation is not subject to AMT, the capital gain on the donation will be exempt from tax and the donation allows an addition to the CDA. The RBC Charitable Gift Program provides an efficient way to give during your lifetime and/or from your estate that combines immediate tax benefits with the flexibility to support your favourite charities over time and across generations.

> If you own Canadian real estate for investment purposes, you may want to consider whether to sell the property before June 25, if it is practical to do so.

Consider permanent life insurance

Re-allocating a portion of your corporate capital into permanent life insurance provide numerous tax and estate planning benefits. With life insurance, the deposits grow, and the death benefits are paid out tax-free. There is liquidity created at death to fund taxes. Where you have business partners, it can be a cost-effective solution to fund a buy-sell agreement. And, it can be used to equalize gifts to children not involved in the family business. Where life insurance is owned through a corporation, it allows most, if not all, of the death benefit to be paid out of the corporation's CDA as a tax-free dividend.

Consider an Individual Pension Plan (IPP)

An IPP is a registered defined benefit pension plan sponsored by an employer, usually for one individual and, in some cases, also for that individual's spouse if the spouse also works for the company. IPPs typically suit business owners, incorporated professionals or key employees who are age 40 or over. An IPP is an alternative to a registered retirement savings plan (RRSP) that enables your company to make larger tax-deferred annual contributions than would be permitted to an RRSP. These contributions are tax deductible to your corporation and not taxable to you. This allows you to defer your compensation and for it to grow in a tax-deferred registered plan until your retirement. For more information, ask about the article on IPPs.

Maximize the available room in your registered accounts

As income earned in registered accounts such as RRSPs, tax-free savings accounts (TFSAs), tax-free first home savings accounts (FHSAs) or registered education savings plans (RESPs) are not subject to tax, ensure you've maximized your contributions to these accounts, as appropriate. Consider gifting amounts to family members where they have not yet maximized their contribution amounts. For example, you may gift funds to your spouse or adult children and grandchildren and have them contribute those funds to their own TFSA or FHSA. Normally, if you gift funds to your spouse, the attribution rules apply so that all of the income earned and capital gains realized on those funds will be attributed back to you and taxed in your hands. However, for the TFSA and FHSA, there's an exception and the attribution rules will not apply to income earned and capital gains generated within these accounts that's derived from such contributions.

Maximize future income splitting with family members

If you have a spouse who earns less income than you or other family members with little to no income, you may want to consider implementing an income splitting strategy. Income splitting shifts income that would otherwise be taxed in your hands at a high marginal tax rate to your lower-income spouse, children or other family members in order to take advantage of their lower marginal tax rates. The following are some strategies you may want to consider implementing now to trigger any unrealized capital gains on your growth securities and for future income splitting opportunities.

Gift to adult family members

Since the attribution rules do not apply to outright gifts of property to adult children or grandchildren, consider gifting them funds which they can invest. Any income earned or capital gains realized on the investments will be taxed in your child's or grandchild's hands at their potentially lower marginal tax rate. If you gift an asset in-kind, you will realize a disposition at FMV, resulting in a capital gain or capital loss on the date of the transfer. You will need to report this gain or loss on your tax return.

Make an interest-free loan to a family trust

It's important to understand the impact of the "attribution rules" if you plan to split income with your family members. These rules have the effect of attributing taxable income back to the family member who supplied the capital for investment so that, in effect, no tax savings are achieved.

The attribution rules may be avoided by making a prescribed rate loan to a properly structured family trust or directly to a spouse using a formal loan agreement. The prescribed rate, set quarterly by the CRA, is currently 6%, which makes the potential for income splitting less attractive until the prescribed rate interest rate decreases.

Given the current interest rates, consider making an interest-free loan to a properly structured family trust instead. Interest and dividend income will attribute back to you; however, capital gains may be taxed in the hands of your children or grandchildren either tax-free or at their much lower marginal tax rates. This may allow each child or grandchild to utilize their $250,000 threshold for capital gains at the 50% inclusion rate. These earnings can then be used to meet your children's or grandchildren's particular needs or expenses.

In order the fund the loan, consider selling your growth securities and lending the cash to the trust or selling your growth securities to the trust and taking back a note prior to June 25, 2024, to benefit from the lower inclusion rate.

Transfer future growth of a security to your spouse

If you hold a security that you expect will significantly increase in value and you'd like to have its future appreciation (and resulting future capital gain) taxed in the hands of your spouse in order to income split, there is a way to transfer the future growth to your spouse without triggering the income attribution rules. You may benefit from transferring the security to your spouse if your spouse is in a lower tax bracket or if they have unused capital losses. To the extent that your spouse has unused capital losses to fully offset any future capital gains from the transferred security, or to the extent they're not fully utilizing their $250,000 threshold for the 50% inclusion rate, this could potentially result in lower capital gain taxes. For more information on transferring future growth of a security to your spouse, please ask your RBC advisor for the article on this topic.

Sell assets to your adult children or third parties and claim a capital gains reserve

Claiming the reserve may help spread out your realized capital gains if this allows you to keep your capital gains under the $250,000 threshold. Note that a reserve cannot be claimed if you sold your capital property to a corporation that you control in any way.

Conclusion

The 2024 federal budget proposal to increase the capital gains inclusion rate has created questions and concern for many. With this proposed change and in continuing to proactively plan for the future, it's important to discuss your situation with your qualified tax advisors, understanding the significance of the potential impacts based on your personal situation and determining if it makes sense to take action prior to June 25, 2024.

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.

Appendix 1

2024 Top marginal tax rate for individuals for capital gains and dividends

The following table illustrates the current top marginal tax rate on capital gains by province/territory, as well as the top marginal tax rate on capital gains when the inclusion rate increases to 66.67%. The table also shows the top marginal eligible and non-eligible dividend tax rates for comparative purposes.

Province/territory	50% inclusion (current)	66.67% inclusion (on or after June 25)	Eligible dividends (current)	Non-eligible dividends (current)
Alberta	24.00%	32.00%	34.31%	42.31%
British Columbia	26.75%	35.67%	36.54%	48.89%
Manitoba	25.20%	33.60%	37.78%	46.67%
New Brunswick	26.25%	35.00%	32.40%	46.83%
Newfoundland and Labrador	27.40%	36.53%	46.20%	48.96%
Nova Scotia	27.00%	36.00%	41.58%	48.28%
Nunavut	22.25%	29.67%	33.08%	37.79%
Northwest Territories	23.53%	31.37%	28.33%	36.82%
Ontario	26.77%	35.69%	39.34%	47.74%
Prince Edward Island	25.88%	34.51%	36.20%	47.63%
Quebec	26.65%	35.54%	40.11%	48.70%
Saskatchewan	23.75%	31.67%	29.64%	41.82%
Yukon	24.00%	32.00%	28.93%	44.04%

Source for current rates: *Federal and provincial/territorial legislation, 2024. Speculative rates are calculated by RBC Family Office Services.*

Appendix 2

2024 capital gains and dividends tax rates for corporations

The following table illustrates the corporate tax rates on capital gains earned in a corporation by province/territory when the inclusion rate is 50% and when it increases to 66.67%. The table also shows the eligible dividend tax rates for comparative purposes.

Corporate tax rates – Income retained in the corporation			
Province/territory	**50% inclusion**	**66.67% inclusion**	**Eligible dividends**
Alberta	23.34%	31.11%	38.33%
British Columbia	25.34%	33.78%	38.33%
Manitoba	25.34%	33.78%	38.33%
New Brunswick	26.34%	35.11%	38.33%
Newfoundland and Labrador	26.84%	35.78%	38.33%
Nova Scotia	26.34%	35.11%	38.33%
Nunavut	25.34%	33.78%	38.33%
Northwest Territories	25.09%	33.45%	38.33%
Ontario	25.09%	33.45%	38.33%
Prince Edward Island	27.34%	36.45%	38.33%
Quebec	25.09%	33.45%	38.33%
Saskatchewan	25.34%	33.78%	38.33%
Yukon	25.34%	33.78%	38.33%

The following table illustrates the combined corporate and personal tax rates by province/territory if capital gains are earned in the corporation and then distributed as dividends, in comparison to an individual earning capital gains and being subject to the 50% and 66.67% inclusion rates.

Appendix 2 *(continued)*

Corporate tax rates – Integrated rates			
Province/territory	**Integrated corporate and personal tax rate**	**Personal capital gains tax rate at 50% inclusion rate**	**Personal capital gains tax rate at 66.67% inclusion rate**
Alberta	34.36%	24.00%	32.00%
British Columbia	39.41%	26.75%	35.67%
Manitoba	38.23%	25.20%	33.60%
New Brunswick	39.02%	26.25%	35.00%
Newfoundland and Labrador	40.46%	27.40%	36.53%
Nova Scotia	39.77%	27.00%	36.00%
Nunavut	33.49%	22.25%	29.67%
Northwest Territories	32.76%	23.53%	31.37%
Ontario	38.62%	26.77%	35.69%
Prince Edward Island	40.13%	25.88%	34.51%
Quebec	39.13%	26.65%	35.54%
Saskatchewan	35.13%	23.75%	31.67%
Yukon	36.82%	24.00%	32.00%

NAV0314 (04/2024)