Ahead of the curve

Reducing capital gains taxes before the 2017 Federal Budget

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The tax hit on capital gains has not changed much in Canada over the last sixteen years. That might change, however, when the Canadian government releases its upcoming budget.

Higher inclusion rate = higher tax rate

For many years, the gap between the tax rate on dividend income and capital gains has been widening. For example, in 2009, the top marginal rate for Ontarians receiving eligible dividends was 23.06%, versus 23.20% for capital gains. By 2016, the eligible dividend rate had jumped to 39.34% versus only 26.77% for capital gains.

The capital gains tax is low relative to dividend income, because only half of a realized capital gain is included in a person's taxable income. If that inclusion rate was increased to either two-thirds or three-quarters, the top marginal rate would increase for Ontarians to 35.68% or 40.15%, respectively.

We believe there is a strong likelihood that the capital gains inclusion rate will increase when the next federal budget is released. This would not be the first time the inclusion rate has been higher than 50%. The capital gains inclusion rate was two-thirds between 1988 and1989, and it was three-quarters between 1990 and 1999.

How can you protect yourself?

Typically, changes to the *Income Tax Act* are effective on the date of the budget announcement or at a future date, and are rarely retroactive. Therefore, we believe that if the capital gains inclusion rate is increased in the upcoming federal budget, it will be effective as of the budget release date.

Based on this conclusion, disposing of capital property with unrealized capital gains before the federal budget release is the best way to avoid paying more capital gains taxes in the future. It is acceptable to sell a property and buy it back on the same day to "crystallize" the capital gain; no waiting period is required. In addition, the sale does not have to be to an arm's length party; it can be to a family member, corporation or trust, providing the correct forms or applicable tax elections are prepared and filed with the Canada Revenue Agency.

Capital property for most individuals would include stocks, bonds and mutual funds held in their unregistered investment accounts. That said, this strategy could equally apply to all other types of capital property such as foreign currency, commodities, or real estate.

Can you use this tax strategy?

The strategy might be of particular interest to elderly individuals who will not have a surviving spouse on death, as they can trigger the capital gain at the lower inclusion rate if done before the budget release and avoid paying a potentially higher tax on capital gains in the event of death after the budget release date. The strategy might also be of interest to those that foresee the need to sell property to raise cash in the near future, those considering rebalancing their stock portfolios, or as part of an individual's overall estate plan. It should also be noted that an increased capital gains inclusion rate affects not only individuals, but rather all Canadian taxpayers including corporations and trusts.

If you wish to discuss this strategy further, please contact your Zeifmans advisor at 416.256.4000 or **Nathan Choran**, CPA, CA, Tax Partner, at nc@zeifmans.ca.