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The 2024 Federal Budget proposed to increase the capital gains tax inclusion rate effective June 25, 2024. With this change, yearly capital gains exceeding $250,000 for individuals will be taxed at an inclusion rate of 66.67%, up from the current 50%. Gains below this threshold will maintain the existing 50% inclusion rate. For corporations and trusts, all capital gains will be subject to the higher inclusion rate of 66.67%. The tax rate increase for individuals on capital gains exceeding $250,000 is approximately 7-9%, varying based on your province of residence.

Given the short window of time to act, it's crucial not to make hasty decisions. Instead, focus on understanding the potential impacts and planning strategically. Let's explore three client scenarios to illustrate how different strategies can help mitigate the effects of these proposed changes.

Mark

Capital Gains Tax Changes and Strategies

1. The Cottagers

Client A, age 70, and her husband own a cottage purchased for $500,000 twenty years ago, now valued at $1.5 million. They intend to leave the cottage to their two children. Upon their passing, the cottage will be subject to a deemed disposition, triggering capital gains tax on the $1 million increase in value as they are using the principal residence exemption on another property. This tax burden also applies if they gift or transfer the property to their children during their lifetime.

Option 1: Gradual Transfer

They can transfer portions of the cottage valued below $500,000 to their children annually, which keeps the capital gains within the 50% inclusion rate. However, this method is administratively complex and requires taxes to be paid on these transfers each year on top of administrative fees.

Option 2: Insurance Policy

A more straightforward option is for the couple to purchase a permanent, joint, last-to-die insurance policy that covers the estimated tax liability. Upon their passing, the insurance payout can be used to pay the capital gains taxes, preventing the

need to sell the cottage. Although the parents can pay for the insurance, considering the significant tax savings, it may be reasonable for their children to bear this cost.

It may be helpful for Client A and her husband to discuss whether they or their children are willing or able to pay for the insurance. We also recommend they discuss their children's plans with the property. For example, if the children plan to sell the cottage, the sale will cover the taxes owed, and there's no need for an insurance policy. Open discussions ensure everyone is aligned and avoid any financial surprises.

Tax expert Jamie Golombek released a video about this topic: From Cottages to Condos – Proposed Changes to the Capital Gains Tax

2. The Investor

Client B, a 90-year-old widow and savvy investor, has $2 million in unrealized capital gains in a non-registered investment account that she intends to leave to her daughter. With the proposed increase in the capital gains inclusion rate, our tax expert estimates it might take 6-8 years to recoup the additional tax costs, assuming a 6% return rate. Given her age, Client B wants to reduce her daughter's future tax burden.

Option 1: Crystallize Gains Before Deadline

Client B could realize her gains before June 25 to lock in the current 50% inclusion rate, but it may trigger the Alternative Minimum Tax (AMT), which has recently increased from 15% to 20.5%.

Option 2: Gradual Offloading

Another strategy is gradually selling shares, ensuring the realized capital gains stay below $250,000 annually. This approach avoids the higher inclusion rate but requires planning to manage other potential sources of capital gains.

Option 3: Charitable Donations

Client B can consider a combination of crystallizing and donating some of her investment account. The donation tax credit can offset some or all of the tax arising from crystallized gains, providing a tax-efficient solution. Client B can then gift her funds remaining at her death (post-tax and post-donation) to her daughter, although her inheritance will be less significant.

3. The Professional

Client C is a 40-year-old doctor with a professional corporation. He is planning for retirement and wants to minimize the impact of the proposed tax changes. He has already maximized his RRSP contributions and has no student debt. His corporation generates $400,000 in income, and he pays himself an annual salary of $150,000. We recommend a combination of the following strategies:

Maximize RRSP Contributions

Continuing to max out RRSP contributions each year can significantly reduce taxable income. The investments within the RRSP grow tax-deferred until withdrawal, potentially in a lower tax bracket during retirement.

Individual Pension Plan (IPP)

At 45, opening an IPP account may be more beneficial in the long run than contributing to an RRSP, but he can't have both. Setting up an IPP allows for larger contributions than RRSPs, which are tax-deductible for the corporation. IPPs also accommodate past years of service, allowing substantial initial contributions. The funds grow tax-deferred, are protected from creditors, and do not necessitate selling corporate assets for retirement income. Learn more about IPPs by watching our Webinar.

Managing Corporate Earnings and Personal Income

Investing corporate earnings within the corporation can defer taxes until the gains are realized. To manage personal taxable income, Client C can consider paying himself dividends, which often have a lower tax rate than salaries. He can also prioritize using capital dividends, which are tax-free. However, choosing between salary and dividends involves more than just comparing dividend tax rates.

Corporate-Owned Life Insurance

Corporate-owned life insurance policies offer tax-free growth. These policies can fund retirement or provide a tax-efficient way to transfer wealth to Client C's spouse. Upon death, the insurance proceeds can cover taxes or may be able to be distributed tax-free to beneficiaries through a capital dividend account.

Please note that this is a simple overview of complex financial planning strategies. We strongly recommend consulting your tax advisor.

Navigating potential tax changes effectively requires staying informed and consulting with your financial advisor. Strategic planning can mitigate the impact of these changes and help align your financial goals. Always seek expert advice before taking any action to ensure your plans are tailored to your specific situation and needs. Protecting your financial future amidst an ever-changing tax landscape means making well-informed decisions with professional guidance. If you have any questions or concerns, please reach out to the Slater team: SlaterFinancialGroup@cibc.com

Reach out to us

At Slater Financial Group, we're happy to speak with you or your family members, friends or colleagues trying to navigate many of these details. In addition, our clients have the benefit of tapping into the many resources available to us here at CIBC.

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About us

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So, if you're approached by a friend, neighbour or family member, or if you know someone who needs a sympathetic ear, please let them know we always have time to listen, and do our best to help. By making ourselves available this way, we're striving to make people's financial lives less stressful and better, knowing that we're *"doing well by doing good."*

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