Capital gains tax planning

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Should I sell, or should I hold now?
If I hold, there could be trouble,
And if I sell, it could be double!

- With apologies to The Clash[1]

The increase in the capital gains inclusion rate announced in the 2024 federal budget (Budget) has created a frenzy of discussion, worry and anxiety, and, in some cases, the opportunity to do some proactive planning annually. Here’s what happened, who may be impacted, and what you can do about it going forward.

The changes

Prior to June 25, 2024, if you disposed of capital property (other than your principal residence) for a profit, only half (50%) of the capital gain was included in your taxable income.

[1] The Clash. “Should I Stay or Should I Go” written by Mick Jones. Combat Rock, CBS Records, 1981. LP.

As of June 25, 2024, however, the capital gains inclusion rate increased to two-thirds (66.67%).[2] But an individual (and certain trusts) who realizes a capital gain on or after June 25, 2024 will still be able to take advantage of the lower, 50% inclusion rate on the first $250,000 of annual capital gains.

This $250,000 limit is not prorated for 2024, and only applies to gains realized on or after June 25. This means a 50% inclusion rate applies to all capital gains realized before June 25, 2024, as well as the first $250,000 of capital gains realized from June 25th onwards.

What are the new capital gains tax rates?

Individuals

For individuals, 66.67% of capital gains will now be taxable for dispositions on or after June 25, 2024; however, the 50% inclusion rate that applied up to June 25 will still apply to the first $250,000 of capital gains in a year[3] Consider, for example, an Ontario investor who pays tax at the top marginal rate. For capital gains realized before June 25, 2024, the tax rate was 26.76%[4]. Starting on June 25, the tax rate for capital gains has increased by 8.93 percentage points to 35.69%; however, the tax rate remains at 26.76% for the first $250,000 of total capital gains each year.

The increase in tax on capital gains varies by province or territory. Figure 1 shows the top 2024 marginal tax rates for individuals on capital gains at both the 50% inclusion rate (which applies before June 25, 2024 and for up to $250,000 of capital gains annually afterwards) and the 66.67% rate.

Figure 1: Highest marginal tax rates on capital gains for individuals in 2024

Region	50% inclusion rate	66.67% inclusion rate	Increase (percentage points)
AB	24.00%	32.00%	8.00
BC	26.75%	35.67%	8.92
MB	25.20%	33.60%	8.40
NB	26.25%	35.00%	8.75
NL	27.40%	36.53%	9.13
NS	27.00%	36.00%	9.00
NT	23.53%	31.37%	7.84
NU	22.25%	29.67%	7.42
ON	26.76%	35.69%	8.93
PE	25.88%	34.50%	8.62
QC	26.65%	35.54%	8.89
SK	23.75%	31.67%	7.92
YT	24.00%	32.00%	8.00

Source: Tax Templates Inc.

2 As proposed in the 2024 Federal Budget and related Notice of Ways and Means released on June 10, 2024. As of July 12, 2024, legislation has not yet been enacted.

3 This rate also applies to the first $250,000 of capital gains realized in the period starting June 25, 2024 and ending December 31, 2024.

4 The tax rate on capital gains for individuals is calculated as the tax rate on ordinary income, multiplied by the inclusion rate.

Corporations

As stated above, the capital gains inclusion rate for gains in a corporation has gone up for gains realized on or after June 25, 2024.[5] For example, in Ontario, the corporate tax rate for capital gains was 25.09% with the 50% inclusion rate, and has increased by 8.36 percentage points to 33.45% for gains realized on or after June 25, 2024 where the higher inclusion rate applies.[6]

The increase in tax on capital gains realized inside a corporation varies by province or territory. Figure 2 shows the tax rates on capital gains for corporations at both the 50% inclusion rate, and the new 66.67% rate.

Figure 2: Corporate tax rates on capital gains in 2024

Region	50% inclusion rate[7]	66.67% inclusion rate[8]	Tax rate increase (percentage points)
AB	23.34%	31.11%	7.77
BC	25.34%	33.78%	8.44
MB	25.34%	33.78%	8.44
NB	26.34%	35.11%	8.77
NL	26.84%	35.78%	8.94
NS	26.34%	35.11%	8.77
NT	25.09%	33.44%	8.35
NU	25.34%	33.78%	8.44
ON	25.09%	33.44%	8.35
PE	27.34%	36.44%	9.10
QC	25.09%	33.44%	8.35
SK	25.34%	33.78%	8.44
YT	25.34%	33.78%	8.44

Source: Tax Templates Inc.

Impact on integration

The portion of the capital gains (either 50% or 33.33%) that was not taxed in the corporation may generally be distributed to shareholder(s) as capital dividends, which are generally received tax-free.[9] The corporation can distribute the remaining after-tax amount of capital gains (along with any refundable tax that may be recovered), as non-eligible dividends, which are taxable.

The integrated tax rate is the effective tax rate paid on income earned in a corporation and distributed to the shareholder(s) once both corporate and personal tax are paid. If the integrated tax rate on capital gains is lower (or higher) than the personal tax rate on capital gains, there is said to be a "tax savings" (or "tax cost").

The capital gains inclusion rate increased to 66.67% from 50% for dispositions on or after June 25, 2024 for both corporations and some capital gains for individuals. Figure 3 shows the integrated tax rates and tax costs

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5 This report discusses taxation for a Canadian Controlled Private Corporation (CCPC).

6 The tax rate on capital gains for corporations is calculated as the tax rate on aggregate investment income, multiplied by the inclusion rate.

7 For capital gains realized before June 25, 2024.

8 For capital gains realized starting June 25, 2024.

9 Due to an anomaly in the current draft legislative proposals released on June 10, 2024 governing the changes to the capital gains inclusion rate, for the 2024 taxation year corporations must average the inclusion rate to use for purposes of the capital dividend account. This may lead to less than half of capital gains realized during the period of January 1, 2024 through June 24, 2024 being added to the capital dividend account. If this issue is not resolved, realizing capital gains in 2024 after June 24, 2024 may impact the amount of capital dividends that may be paid out on a tax free basis for capital gains realized previously in 2024. It is hoped that this will be fixed when the draft legislation is finalized.

when these capital gains are earned through a corporation in 2024, for all provinces and territories, assuming the shareholder pays tax at the top marginal tax rate.

Figure 3: Comparison of 2024 integrated tax rates and personal tax rates for capital gains, when shareholder is taxed at the top marginal rate

Region	Integrated tax rate before June 25	Top personal tax rate before June 25	Tax Savings (Cost)	Integrated tax rate starting June 25	Top personal tax rate starting June 25	Tax Savings (Cost)
AB	25.77%	24.00%	(1.77%)	34.36%	32.00%	(2.36%)
BC	29.56%	26.75%	(2.81%)	39.41%	35.67%	(3.74%)
MB	28.67%	25.20%	(3.47%)	38.23%	33.60%	(4.63%)
NB	29.60%	26.25%	(3.35%)	39.46%	35.00%	(4.46%)
NL	30.83%	27.40%	(3.43%)	41.10%	36.53%	(4.57%)
NS	30.15%	27.00%	(3.15%)	40.20%	36.00%	(4.20%)
NT	24.57%	23.53%	(1.04%)	32.76%	31.37%	(1.39%)
NU	25.12%	22.25%	(2.87%)	33.49%	29.67%	(3.82%)
ON	28.96%	26.76%	(2.20%)	38.62%	35.69%	(2.93%)
PE	30.76%	25.88%	(4.88%)	41.00%	34.50%	(6.50%)
QC	29.35%	26.65%	(2.70%)	39.14%	35.54%	(3.60%)
SK	26.54%	23.75%	(2.79%)	35.39%	31.67%	(3.72%)
YT	27.62%	24.00%	(3.62%)	36.82%	32.00%	(4.82%)

Source: Tax Templates Inc.

As we can see in Figure 3, the tax cost of earning capital gains in a corporation versus earning them personally increased by 33% in all provinces and territories because the capital gains inclusion rate increased by 33% (from 50% to 66.67%) for both corporations and individuals. But, as we will see below in Figure 4, for capital gains realized in a corporation up to and including $250,000 annually and which realized on or after June 25, 2024, the cost of realizing those gains in a corporation versus personally goes up significantly.

Capital gains up to $250,000 in a year

Although the inclusion rate increased to 66.67% starting on June 25, 2024, the inclusion rate remains at 50% for the first $250,000 of capital gains realized by shareholders who are individuals. This difference in inclusion rates has an even greater impact on integrated tax rates and tax costs, as shown in Figure 4.

Due to the tax cost in all provinces and territories, it’s generally better to earn capital gains personally, rather than through a corporation. But, for capital gains up to $250,000 in a year, it may be even more desirable to earn those capital gains personally on or after June 25, 2024 due to the significant increase in the tax cost of earning those gains in a corporation.

There is one notable exception. A shareholder who is not US person,[10] and who has a worldwide gross estate exceeding the US estate tax exemption (USD$13.61 million in 2024), may still wish to hold US securities in a Canadian corporation for US estate tax planning purposes, despite the high cost of doing so, to avoid the US estate tax, which can be up to 40% of the fair market value of US-situs assets held on death.[11]

Figure 4: Capital gains up to $250,000 – Comparison of 2024 integrated tax rates and personal tax rates, when the shareholder is taxed at the top marginal rate

Region	Integrated tax rate as of June 25, 2024	Top personal tax rate as of June 25, 2024	Tax Savings (Cost)
AB	34.36%	24.00%	(10.36%)
BC	39.41%	26.75%	(12.66%)
MB	38.23%	25.20%	(13.03%)
NB	39.46%	26.25%	(13.21%)
NL	41.10%	27.40%	(13.70%)
NS	40.20%	27.00%	(13.20%)
NT	32.77%	23.53%	(9.24%)
NU	33.49%	22.25%	(11.24%)
ON	38.62%	26.76%	(11.86%)
PE	41.01%	25.88%	(15.13%)
QC	39.13%	26.65%	(12.48%)
SK	35.38%	23.75%	(11.63%)
YT	36.82%	24.00%	(12.82%)

Source: Tax Templates Inc.

Although there is a high tax cost for earning capital gains in a corporation, there may still be a benefit to earning capital gains in a corporation, rather than personally, when the capital for investing in the corporation came from after-tax business income. The tax deferral on incorporated business income provides significantly more capital in the corporation than the shareholder would have if the after-tax business income was distributed as dividends. Having more capital to invest in a corporation may mean that more capital gains can be earned, and this may ultimately result in more after-tax income to the shareholder.

Trusts

Most trusts pay tax at the top personal tax rates shown in Figure 1, without the lower 50% inclusion on the first $250,000 of annual realized gains, though there are two notable exceptions: graduated rates estates[12], and qualified disability trusts[13].

10 US citizens and green card holders are usually US persons. This strategy is generally not recommended when shareholders are US persons, due to US tax rules for passive income earned in a non-US corporation.

11 For additional information, see the CIBC report US estate tax planning for Canadians.

12 A graduated rate estate is an estate within the first 36 months after an individual's death.

13 A qualified disability trust is a trust that arises on the death of an individual, and where at least one beneficiary qualifies for the disability tax credit. Other conditions must be met.

Although the higher 66.67% inclusion rate generally applies to all gains realized in trusts on or after June 25, 2024, it's usually less problematic since trusts often allocate their income as well as any capital gains to their beneficiaries. This allocation helps to reduce taxes overall when individual beneficiaries pay tax at graduated tax rates that are lower than the top marginal tax rate that applies to most trusts. Since individual beneficiaries can take advantage of the lower 50% inclusion rate for the first $250,000 of capital gains annually for gains realized on or after June 25, 2024, allocating capital gains to beneficiaries may now help to reduce taxes even further. Investors in mutual fund trusts will be provided information on the inclusion rate to use for capital gains distributed.

There are, however, some situations where capital gains cannot be allocated to beneficiaries. For instance, this could arise for alter ego trusts, spousal or partner trusts, and joint spousal or partner trusts, which are sometimes used for probate planning. With these trusts, an individual and/or the individual's spouse or partner[14] are the only beneficiaries during their lifetime(s), and there are other beneficiaries after their death(s). Upon the death of the last surviving spouse or partner who is a beneficiary, all remaining property in the trust is deemed to be disposed of at fair market value. Any capital gain realized at that time is taxed in the trust and is subject to the higher 66.67% inclusion rate starting on June 25, 2024.

For example, Sidney pays tax at the top marginal rate in B.C. Sidney transferred property with an adjusted cost base of $9 million (which was worth $10 million upon death) to an alter ego trust, which eliminated about $140,000 of probate fees.[15] The property in the alter ego trust had a capital gain of $1 million upon Sidney's death. Before June 25, 2024, tax from the deemed disposition (upon Sidney's death) would have been $267,500, either in the alter ego trust, or if Sidney had held the property personally. Using the alter ego trust would have reduced probate fees by $140,000 without any tax increase. As of June 25, 2024, however, the tax from the deemed disposition would be $357,700 in the alter ego trust but would have been only $334,400 ($22,300 lower) if Sidney had held the property personally.[16] Using the alter ego trust is still beneficial as it reduces probate fees by $140,000, but increases income tax by $22,300.

Impact on other income tax provisions

Lifetime capital gains exemption

Individuals who sell their qualifying small business corporation (QSBC) shares, or qualified farm of fishing property (QFFP), may be able to take advantage of the lifetime capital gains exemption (LCGE), which has increased to $1,250,000 from $1,016,836 as of June 25,[17] and will be indexed annually starting in 2026. This means that, as of June 25, the first $1.25 million of capital gains realized on the disposition of qualifying properties during your lifetime will not be taxed. Regular tax rates for individuals apply to total capital gains, after applying the LCGE.

Suppose Rendi, who lives in B.C. and has never claimed the LCGE, owns QSBC shares with a value of $3 million and nominal ACB. If Rendi sold the shares in 2024 but before June 25, the tax bill would have been about $530,000[18]. If Rendi sells the shares in 2024[19] but on or after June 25, the tax bill will be about $602,000[20], a tax increase of about $72,000. Even though the LCGE will increase as of June 25, it won't be enough to offset the additional tax from the higher, 66.67% inclusion rate.

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14 In this report, spouse refers to someone to whom you are legally married. Partner refers to a common-law partner under the Income Tax Act, which means someone who cohabits with you in a conjugal relationship, provided the two of you have cohabited for the past 12 months or are jointly parents of a child.

15 Estate administration tax (commonly called probate fees) in B.C. is $150 + $14 for every $1,000 or portion thereof by which the estate's value exceeds $50,000. There are no probate fees on property held in an alter ego trust, since the property is not part of the estate.

16 Taxes are calculated as $1 million times 35.67% for the alter ego trust, and ($250,000 times 26.75%) plus ($750,000 times 35.67%) for Sidney.

17 Under proposals in the 2024 Federal Budget.

18 Calculated as $1,983,164 ($3,000,000 minus $1,016,836), taxed at 26.75%.

19 Starting in 2025, it may also be possible to claim the Canadian Entrepreneurs' Incentive that was announced in the 2024 federal budget.

20 Calculated as $1,750,000 ($3,000,000 minus $1,250,000), with $250,000 taxed at 26.75% and the remainder of $1,500,000 taxed at 35.67%.

Capital losses of other years

Investors who have net capital losses carried forward from prior years will still be able to deduct them against taxable capital gains in the current year by adjusting their value to reflect the inclusion rate of the capital gains being offset. This effectively means that a capital loss realized at a 50% inclusion rate will be fully available to offset an equivalent capital gain realized at an inclusion rate of 66.67%. For example, a $1,000 capital loss will always fully offset a $1,000 capital gain, regardless of the capital gains inclusion rates at the time of the loss and gain.

Net capital losses applied to taxable capital gains starting on June 25, 2024 will be applied first to taxable capital gains included at the higher 66.67% rate, with any remainder applied to taxable capital gains included at the 50% rate.

For 2024, net capital losses of other years can be applied separately to taxable capital gains realized from January 1 to June 24 (Period 1), or to taxable capital gains realized from June 25 to December 31 (Period 2). Net capital losses from Period 1 can also be applied to taxable capital gains in Period 2, and vice versa.

Capital gains reserve

When the proceeds of sale of a property are not all received in the year of the sale, a reasonable reserve may be claimed, and the capital gain may be included in income over a maximum period of five years (20% per year.)[21] The reserved capital gain is included in income in the next taxation year, when again a reserve may be taken if the five year period has not fully elapsed.

For 2024, for individuals, any reserved capital gain is deemed to be included in income on the first day of the taxation year, meaning that the gain will be eligible for the 50% inclusion rate. But, for future years (after 2024), any reserved gain brought into income will be taxed according to the rules above, so the lower 50% inclusion rate will only be available for up to $250,000 of capital gains annually.

Employee stock options

Employees who exercise employee stock options must include the stock option benefit (fair market value (FMV) of the shares received on exercise, less the option price for the shares) in employment income. In some circumstances the employee may claim a stock option deduction to reduce the employment income subject to tax. This stock option deduction allows stock option benefits to be taxed at the same rate as capital gains.

The stock option deduction is calculated in the same way as the non-taxable portion of capital gains. For example, for a $100,000 stock option benefit realized before June 25, 2024 when the inclusion rate was 50%, the stock option deduction is $50,000 [$100,000 times 50%)]. As of June 25, 2024, the stock option deduction is reduced to 33.33%, or in our example, $33,333.

Starting on June 25, 2024, an individual may still use the lower 50% inclusion rate for up to $250,000 of total capital gains and stock option benefits.

Situations when lower income Canadians could be affected

While the changes to the capital gains were said to primarily be aimed at high-income Canadians who regularly realize substantial capital gains in a non-registered portfolio each year, they may also affect others. Let's look at a few examples of who else may be impacted by the capital gains tax rate increase.

21 The reserve period is extended to 10 years in some cases, including transfers of certain farm or fishing properties and small business corporation shares to certain family members.

Individuals with a second home or investment property

Consider someone who is planning to sell a secondary property, perhaps a vacation home or investment property. It's conceivable that the gain on that property could be more than $250,000, meaning that if the principal residence exemption can't be claimed because it is being used for a primary home, any gain in excess of $250,000 would be taxed at a higher rate.

Suppose Alexi lives in Alberta and inherited a family vacation home 20 years ago when it had a fair market value (FMV) of $200,000, which is Alexi's adjusted cost basis (ACB). The home has a FMV of $700,000 in 2024, so the capital gain would be $500,000. Let's assume Alexi has no other capital gains. Alexi's tax bill will be $140,000 if sold after June 24, 2024.[22] If the home had been sold before the change to the capital gains inclusion rate, for instance on May 1, 2024, Alexi's tax bill would have only been $120,000[23]. Alexi's tax bill rose by $20,000.

Planning tip

If property is owned jointly with a spouse or partner, where each person contributed equally to the purchase of that property, then each spouse or partner should have access to $250,000 of gains annually at the lower 50% inclusion rate. Upon sale, the 50% inclusion rate may apply for up to $500,000 ($250,000 for each spouse) of capital gains.

Year of death

In the year of death, there's a deemed disposition of all your capital property at FMV. This means that if there's a sizable non-registered investment portfolio, or second property, with some accrued gains on the day you die, only up to $250,000 of the capital gain would be taxed at the lower 50% inclusion rate. The capital gains would be calculated as shown in the examples above.

If your surviving spouse or partner is a beneficiary of your estate, the assets can generally be transferred to your spouse or partner at ACB. It may also be possible for your estate representative to elect out of this rollover for certain assets, to control the capital gains that are realized. This may help limit the amount of capital gains that are realized on your death, so they can be kept under $250,000.

Note that many Canadians may have all their financial assets in registered plans[24] and their principal residence, and for these people it is likely that capital gains would still be taxed with the lower, 50% inclusion rate.

Should individuals proactively crystalize gains?

Perhaps one of the biggest planning opportunities for individuals to consider, now that the new rules are in effect, is whether to trigger some capital gains annually to take advantage of the 50% inclusion rate on of the first $250,000 of capital gains.

For example, let's say you're an individual in Ontario. You pay tax on capital gains at the top tax rate and have assets that you expect will generate over $250,000 of capital gains in some years. You're trying to decide whether to sell or hold a property with a current capital gain of $100,000. If you sell in a year where total capital gains are less than $250,000, you'd pay tax of $26,760 (at 26.76%). If you sell in a later year when you realize other capital gains of $250,000 or more, the tax bill would increase by $8,930 to $35,690 (at 35.69%). To make it worthwhile to hold the property, you'd need to earn enough additional after-tax income to offset the additional tax of $8,930.

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22 Calculated as a $500,000 ($700,000 minus $200,000) capital gain, with the first $250,000 of the capital gain taxed at 24.00% and the remaining $250,000 taxed at 32%.

23 Calculated as a $500,000 ($700,000 minus $200,000) capital gain, taxed at 24.00%.

24 The federal government's Budget Plan 2008 estimated that TFSAs, in combination with existing registered plans, would permit over 90% of Canadians to hold all their financial assets in tax-efficient savings vehicles.

If the property earns only capital gains, the amount of time needed to reach the break-even point (earn an additional $8,930, after tax) depends on the rate of growth for the property. For example, if you expect the property to appreciate by 6% annually, it would take about 8 years.

Figure 5 shows the number of years it would take to reach the break-even point using various growth rates. This applies in all provinces and territories, for capital gains earned personally.

Figure 5: Number of years to the break-even point when property earns only capital gains

Growth rate (annual appreciation)	2%	3%	4%	5%	6%	7%	8%
Number of years	21	15	11	9	8	7	6

The bottom line on crystalizing capital gains

When deciding whether to sell capital property personally, keep these points in mind:

- Consider selling any capital property if you think you'll ultimately sell it in a year before the break-even point, and when the total of capital gains in the year may be more than $250,000.
- If the property earns only capital gains, the number of years it would take to reach the break-even point depends on the growth rate, as shown in Figure 5.

You should consult a tax adviser for further analysis before crystalizing any capital gains.

A final note

Although the changes are targeted at high-income taxpayers, there are others who could be hit with increased taxes as a result. That's left many Canadians wondering how their own situations could be affected by the changes for capital gains. To truly understand how the changes may impact you, be sure to consult with your tax adviser, who can perform an analysis that's tailored for you.

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