

Intelligence MEMOS



From: William B.P. Robson, Alexandre Laurin and Nick Dahir
To: Potential Payers of Capital Gains Taxes
Date: May 22 2024
Re: **IT'S PAST TIME TO WALK BACK THOSE CAPITAL GAINS CHANGES**

It is 35 days since the 2024 federal budget announced major changes to capital gains taxes. The centrepiece, replete with “make-the-rich-pay” rhetoric, was higher inclusion rates.

Other announcements, framed (with no apparent sense of irony) as supporting risk-taking and investment, promised a lower inclusion rate on some gains for some business owners and an increase in the lifetime capital-gains exemption for Canadian owners of farming and fishing properties and small businesses. Many of these changes, most notably the higher inclusion rates, are to take effect June 25.

June 25 is now only 35 days away. That timeline is a big problem, getting bigger every day. Right now, the budget’s announcements are all we know. It contained no draft legislation and the budget implementation bill, tabled May 2, contained no details. The government is expecting affected taxpayers to sell a lot of assets before June 25. It’s counting on a one-time, \$7-billion revenue bump from the sell-off – far above the changes’ ongoing yield – to help it hit its deficit and debt targets this year. But lack of legislation or clarification of the changes may mean the government itself has not figured out how this is all going to work.

Changing the inclusion rate for capital gains sounds simple. But nothing in modern taxes is simple, and the details we don’t yet have will matter.

For instance, the budget’s proposals suggest that tax-filers with capital gains that currently expose them to clawbacks of Old Age Security and other benefits might get relief under the new regime. Currently, the net income calculation that determines clawbacks includes taxable capital gains, with deductions for prior-year capital losses and the lifetime capital gains exemption coming later. The budget suggests that deductions for prior-year losses and the lifetime exemption might now be part of the net income calculation. Is that the government’s intention? We don’t know, and the Canada Revenue Agency may not know, either.

The capital gains inclusion rate interacts with other tax provisions. The changes may expose charitable donors to more tax. Individuals making charitable donations from capital gains above \$250,000 will have higher taxable incomes, but the charitable donation tax credit will not change. Businesses donating the proceeds of any capital gains will also have higher taxable incomes, but their charitable donation tax deduction limits will not change, either.

Among the budget’s announcements were changes to the employee stock option deduction to reflect the new inclusion rate. Will the same be done to business investment losses? Probably yes, since business investment losses have been deducted at the capital gains inclusion rate in the past. But, unlike previous occasions when the inclusion rate changed, the budget did not say. Again, we don’t know, and the CRA may not know, either.

Subjecting trusts to different inclusion rates than many of their beneficiaries creates other complications. Suppose a trust realizes a gain prior to June 25 and pays the one-half rate, but the income flows to a beneficiary subject to the two-thirds rate? Or a trust realizes a gain at the two-thirds rate, but a beneficiary faces the one-half rate? Which rate will apply? Does anyone know?

The bigger question is why a government announced major tax changes before figuring out how they will work. The answer seems to be that this is a pattern of modern politics, and certainly a trait of the current federal government. The announcements – talking points and slogans that will grab attention on social media – are policymakers’ main focus. The Prime Minister’s May 13 video on the changes featured more messaging about why a 50-percent inclusion rate is too low, and provided no help understanding the changes. Implementation is an afterthought and considering advice from the government’s own officials and outside experts a low priority.

Let’s recall the recent last-minute walkbacks of the requirement for tax-filers in “bare trust” arrangements like joint bank accounts to file trust returns, and for homeowners to report potential liability for the Underused Housing Tax. These ill-advised initiatives caused tens of thousands of tax-filers months of anxiety, effort and cost before the government, realizing it had an implementation nightmare on its hands, rescinded the requirements at the last minute. Will the same occur with the capital gains tax changes?

The early deadline and lack of rules are not the only problems with these proposals. Retroactive taxation of accrued gains – especially after a bout of inflation – sends a terrible signal to savers and investors. The federal government is making its hostility to wealth creation even more obvious. The best course of action, to avoid the immediate pain and the lasting economic damage, would be to abandon the proposals.

If another walkback looms, the time is now, not June 25.

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