Intelligence MEMOS

From: Vincent Thivierge and Alex Laurin

To: The Honourable Bill Morneau, Minister of Finance

Date: March 17, 2017

Re: **CAPITAL GAINS WIDELY ENJOYED, NOT JUST BY TOP EARNERS**

Rumours abound that Ottawa may be considering changes to the tax treatment of capital gains (and possibly dividends) in the next federal budget. An option that seems to be considered is to lower the capital gains exemption and dividend credit.

A key rationale for the policy change, supported by some researchers, labour and trade unions, is to reduce income inequality. The reality, however, is that higher capital gains taxes are not likely going to be a very effective policy change to increase income equality in Canada.

This is because the statistics used to show that most capital gains and investment income accrue to high-income individuals are biased by the inclusion of occasional capital gains in the income definition used to classify individuals. By including investment income in total income, families can appear artificially "rich". A potentially better indicator of working families' steady income level is income from employment.

Take for example a middle-class family who owns a rental property. When the family sells its property and registers an important capital gain, they will be considered among high-income families for the year capital gains are received. But that is not representative of their underlying situation as represented by employment income. When sorting families by income from employment (i.e. excluding their investment income), we find a more equal distribution of investment income than when sorting families by total income (see Table 1). The bottom 30 percent of the employment income distribution for working adults aged between 25 to 64 - i.e. singles earning less than $20,000 or spouses of a family earning less than $40,000 - own a share of investment income (31 percent) nearly as identical to the top 10 percent.

**Table 1: Distribution of Taxable Investment Income, by Income Groups for Individuals Aged 25 to 64 (*percent*)**

| | | Group Share | Investment Income | Dividend Income | Capital Gains | Interest and Other Investment Income |
|---|---|---|---|---|---|---|
| **Total Family Income** (average per adult) | Below $30,000 | 27 | **3** | 2 | 1 | 11 |
| | $30,001 to $55,000 | 33 | **8** | 9 | 4 | 19 |
| | $55,001 to $100,000 | 30 | **17** | 21 | 9 | 24 |
| | Above $100,000 | 9 | **73** | 68 | 86 | 46 |
| | All | 100 | **100** | 100 | 100 | 100 |
| **Family Employment Income** (average per adult) | Below $20,000 | 29 | **31** | 32 | 25 | 42 |
| | $20,001 to $45,000 | 29 | **16** | 16 | 17 | 18 |
| | $45,001 to $90,000 | 33 | **20** | 20 | 21 | 18 |
| | Above $90,001 | 10 | **33** | 33 | 37 | 23 |
| | All | 100 | **100** | 100 | 100 | 100 |

Source: Author's calculation using SPSD/M (v. 22.1)

The difference is even starker when comparing capital gains realized by these two income groups. Classified by total income, the bottom 30 percent realized only 1 percent of all capital gains while the top 10 percent realized 86 percent. More appropriately classified by employment income, the bottom 30 percent earned 25 percent of capital gains, and the share of the top 10 percent is reduced by more than half to 37 percent.

While top income earners do enjoy a relatively larger share of investment income and capital gains, a proper comparison shows that such gains are clearly much less concentrated at the top than is widely assumed. Heavier taxation of capital gains (and other investment incomes) would thus be felt by many families not generally sitting at the top of the income scale.

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