fACT Sheet

Capital Gains Increase Helps Us All

edmonton SOCIAL PLANNING COUNCIL

Introduction

With every new policy around taxation, citizens are rightfully interested and concerned about how their personal finances will be affected. As Canadians face pressing issues like inflation, stagnant wages, and rising living costs, the need for a fair and predictable tax system becomes increasingly important. A fair and predictable tax system supports individuals in making informed financial decisions, such as investments, business planning, and retirement. It also ensures they receive the benefits they are entitled to from their tax contributions.

In today's digital era, where misinformation can easily spread, it's essential to have a clear understanding of new tax policies to avoid misunderstandings and undue fear about their financial implications. The recent amendments to the Capital Gains Tax (CGT), introduced in the 2024 federal budget, are a prime example of such policy changes (Canada Department of Finance, 2024). While these amendments have sparked considerable discussion, some of which is based on misinformation, their purpose is to ensure that taxes are reinvested into the communities that need them most, rather than exacerbating financial concerns.

To address the widening gap in income inequality and to enhance funding for essential social services, the Canadian government has revised the Capital Gains Tax. This FACT Sheet provides a detailed overview of these policy changes, outlining who will be affected, the extent of the impact, and dispelling common myths surrounding the new regulations. It also emphasizes the role of the updated Capital Gains Tax in directing funds towards initiatives that benefit socio-economically marginalized Canadians.

What is Capital Gains Tax?

The Capital Gains Tax is the tax individuals pay when selling an asset or capital property, more specifically the profits made from the sale of these assets or properties. This includes a wide variety of capital properties such as cottages, securities (stocks, bonds, and mutual fund units), land, buildings, and equipment used in a business or rental operation. The tax is calculated based on the difference between the asset's original purchase price and its sale price, with the resulting profit reported as income on the seller's annual tax return.

In the 2024 federal budget, the Canadian government introduced amendments to the Capital Gains Taxation to enhance fairness and revenue generation. The key changes include:

- **Inclusion Rate:** In the context of capital gains the inclusion rate is the percentage of a capital gain that is considered taxable income. It determines how much of the profit from selling an asset is subject to income tax. For example, if the inclusion rate is 50%, then half of the capital gain is included in the taxpayer's income and taxed at the applicable rate. An increase in the inclusion rate means that a larger portion of the capital gain is taxable. With these changes, the inclusion rate is currently moving from one-half (50%) to two-thirds (66.67%) for gains exceeding $250,000 annually for individuals and all gains for corporations and most trusts (Dabu, 2024).

- **Net Capital Losses**: Occur when the total capital losses exceed the total capital gains in a given year. These losses can be used to offset capital gains in other years, thereby reducing the amount of taxable income. The Canadian tax system allows taxpayers to carry these net capital losses back three years or forward indefinitely. When carrying losses to other years, they are adjusted to reflect the inclusion rate of the capital gains being offset, ensuring that losses and gains are matched appropriately regardless of changes in the inclusion rate over time.

- **Lifetime Capital Gains Exemption (LCGE)**: The LCGE allows individuals to claim an exemption on a certain amount of capital gains realized during their lifetime. This exemption primarily applies to the sale of qualified small business corporation shares, qualified farm properties, and qualified fishing properties. The exemption is reduced by any net capital losses applied to offset the gain.

- **Employee Ownership Trust Tax Exemption:** This is a proposed tax exemption designed to support employee ownership trusts, which allow employees to own a business. The details and specifics of the exemption are yet to be fully defined, but it aims to encourage employee participation in business ownership.

- **Canadian Entrepreneurs' Incentive:** A proposed incentive to encourage investments in capital-intensive and high-growth sectors, making it more attractive for entrepreneurs to invest in these areas. The specifics are still under discussion but would likely include tax benefits or other financial incentives.

These changes, effective as of June 25,

2024, aim to make Canada's tax system fairer by narrowing the tax advantage between capital gains and other forms of income, particularly wages (Canada Department of Finance, 2024).

Myths Debunked

There are many common misconceptions suggesting the Capital Gains Tax seeks to undermine the hard work of Canadians. The Government of Canada has made clear guidelines to help Canadians understand what the Budget 2024 entails:

1. **Changes to the principal residence exemption:** One prevalent myth is that Canadians will now pay capital gains taxes on the sale of their primary homes. However, the principal residence exemption remains unchanged, meaning that profits from selling a home continue to be tax-free.

2. **Tax elections or on-paper realizations**: Capital gains are sometimes misunderstood as occurring during tax elections or on-paper transactions without actual sales. However, a capital gain usually happens when a person transfers their ownership interest in a capital property to someone else. Current income tax rules do not allow taxpayers to choose to realize a gain or loss on their

3. **Exemptions for specific assets or corporations**: No specific assets or corporations will be exempt from the two-thirds inclusion rate. The two-thirds inclusion rate applies uniformly across all sectors, ensuring fairness and preventing preferential tax treatment

4. **TFSA & RRSP**: Tax-deferred accounts like TFSAs and RRSPs remain untaxed, as do pensions, ensuring that retirement savings and investment growth within these accounts are not impacted. The amendments aim to reduce the preferential treatment historically given to capital gains compared to other income forms, thereby promoting fairness in the tax system.

5. **Middle-class entrepreneurs:** There is a myth circulating that Capitals Gains will target entrepreneurs, however the enhanced Lifetime Capital Gains Exemption and Canadian Entrepreneurs' Incentive specifically benefit middle-class entrepreneurs by encouraging investments in innovative sectors, supporting economic growth, and job creation (Canada Department of Finance, 2024).

Scenario

To illustrate the practical implications of the new tax policy, consider several hypothetical scenarios:

1. A homeowner selling their principal residence for $1 million after purchasing it for $300,000 will not face any capital gains tax due to the principal residence exemption.

2. Similarly, if an elderly homeowner transfers their home to their children, the principal residence exemption continues to apply, ensuring no capital gains tax or inheritance tax.

3. For those frequently moving due to work-related reasons, the sale of a primary residence remains tax-free, regardless of the frequency of such transactions.

4. On the other hand, for secondary properties like cottages, only the gains above the $250,000 threshold are taxable.

5. Large-scale real estate investors and individuals with substantial stock investments outside tax-deferred accounts may face higher taxes if their gains exceed the threshold. However, careful planning and strategic timing of asset sales can help mitigate the tax impact.For instance, an investor selling multiple condos valued at $750,000 each, purchased for $500,000, can manage their sales to remain within the annual threshold, thereby minimizing tax liabilities (MacDonald , 2024).

Who is Affected

The impact of these changes varies among Canadians, but it is essential to note that the new policy primarily affects the wealthiest 0.13% of the population. This group consists of individuals with significant capital gains exceeding $250,000 annually, who typically have an average income of around $1.4 million annually. In contrast, the vast majority of Canadians—approximately 28.5 million out of a total population of 39,126,131—do not pay capital gains taxes and will not be affected by these changes (MacDonald , 2024).

The government projects that these tax changes will generate an additional $19.3 billion over the next five years. This revenue will be instrumental in funding essential social programs and initiatives, particularly those focused on addressing housing affordability—a pressing issue for many Canadians (Lafortune, 2024). The reinvestment of tax revenues into these programs aims to provide much-needed support to younger generations and work towards reducing economic disparities across the country.

Today nearly 50 percent of Canadians are living paycheque to paycheque, food bank usage in Alberta is surging and one-tenth of the province's citizens are in core housing need. This reality shows just how misplaced concerns about the tax burden of the wealthiest Canadians are. The wealthiest Canadians have enjoyed a favoured system by accessing tax advantages that have allowed the rapid accumulation of wealth far outstripping the average worker. This has further encouraged the wealthiest Canadians with disposable income and generational wealth to invest in the financial market, while the average Canadian struggles to meet basic needs like food, utilities, and housing, let alone save for retirement or their children's education (Lafortune, 2024).

The amendments to the Capital Gains Tax provide clarity and predictability for taxpayers planning for retirement and businesses investing in Canada, reinforcing confidence in the tax system's stability. Specific exemptions and thresholds ensure that the changes do not create unintended loopholes or complexities in tax or retirement planning. Canada's updated capital gains tax regime represents a balanced approach to taxation, aligning with principles of fairness, revenue generation for essential services, and targeted support for middle-class entrepreneurs. By narrowing the gap between income types, these changes contribute to a more equitable tax system while sparing the vast majority of Canadians from additional tax burdens.

Concluding Remarks

The revised capital gains tax regime in Canada is a transformative policy designed to foster a more equitable society. By increasing the inclusion rate of capital gains and aligning it more closely with other forms of income, this policy addresses long-standing disparities and ensures that the wealthiest Canadians contribute fairly to the nation's social programs.

Despite concerns from some quarters about potential impacts on innovation and retirement savings, the government has strategically balanced these interests by safeguarding primary residences and retirement funds. This approach not only protects middle-class entrepreneurs and small business owners but also encourages investment in high-growth sectors, promoting economic development (Dabu, 2024).

The policy's emphasis on fairness is particularly crucial in a country where nearly half of Canadians are living paycheck to paycheck, grappling with rising food bank use and significant housing challenges. By targeting the wealthiest, the updated tax regime will generate significant revenue—projected at $19.3 billion over five years—which is vital for funding essential services and addressing socio-economic disparities.

In essence, Canada's capital gains tax reform represents a decisive step towards a fairer tax system. It narrows the benefits previously enjoyed by the wealthiest and redirects crucial resources to support socio-economically marginalized communities. This balanced approach not only enhances economic resilience and encourages entrepreneurship but also strengthens the social safety net. As such, this policy is instrumental in promoting a more just and prosperous society, ensuring that all Canadians benefit from a more equitable distribution of resources and opportunities.

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