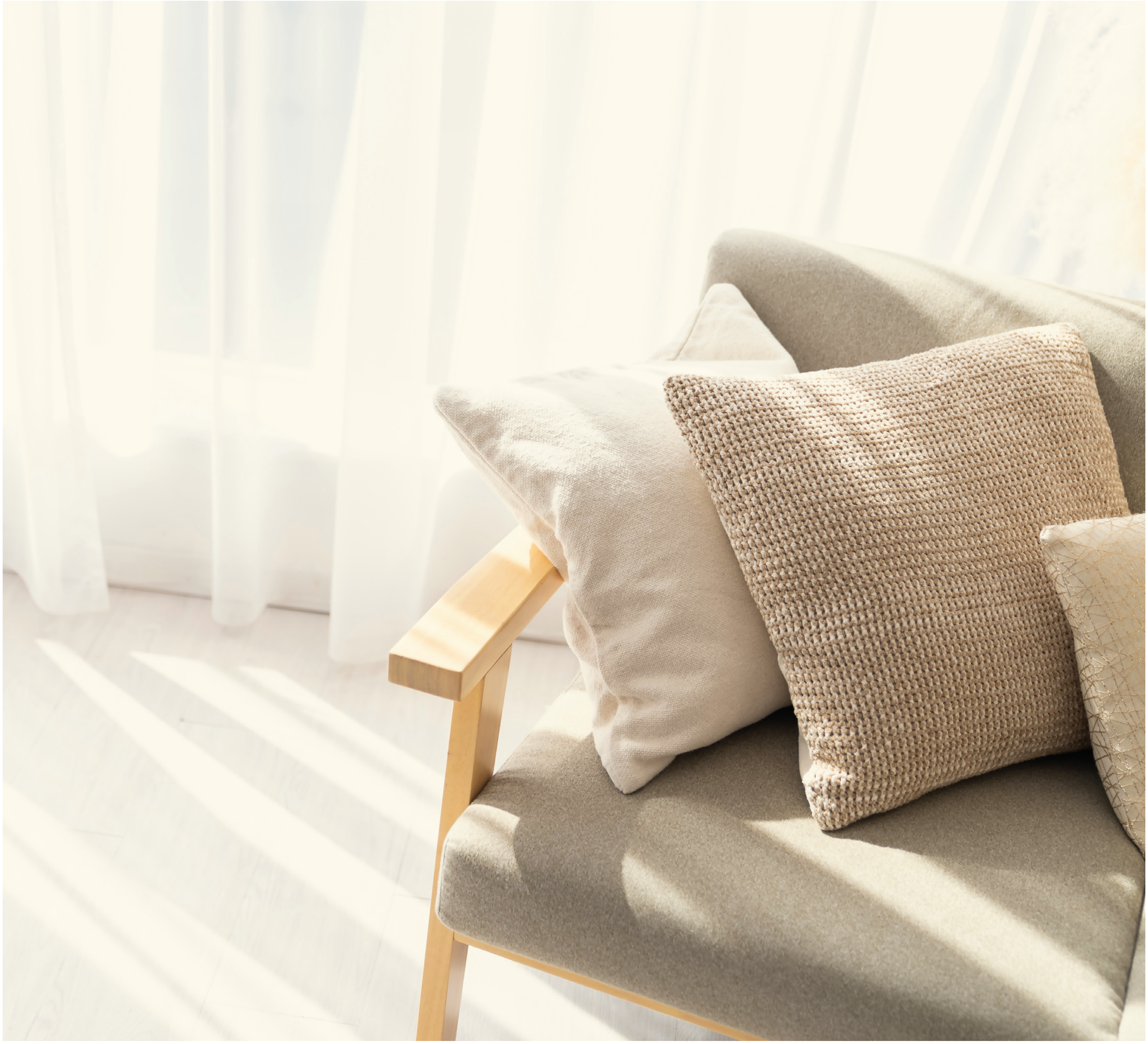

Increased capital gains inclusion rate and the impact on Clients

Sun Life

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In the 2024 Federal Budget, the Department of Finance proposed to increase the capital gains inclusion rate from one-half (50%) to two-thirds (66.67%). The new rate applies to:

- **corporations and trusts** that realize capital gains on or after June 25, 2024 and
- **individual** gains over $250,000 realized on or after June 25, 2024.

How it affects Clients

Individuals

The increased capital gains inclusion rate applies to those with more than $250,000 in unrealized capital gains. This can be through non-registered investment portfolios or multiple properties. The change increases the amount of tax they'll have to pay if they sell those assets.

Let's compare the old rules and new rules to see the impact. Consider an individual who sold an investment portfolio or second property with $1 million in unrealized capital gains.

Old rules

The old rules would treat $500,000 of those gains as taxable income. At a combined 53.53% marginal tax rate*, the individual would owe $267,650 in tax. The effective tax rate on the capital gain would be 26.77%.

New rules

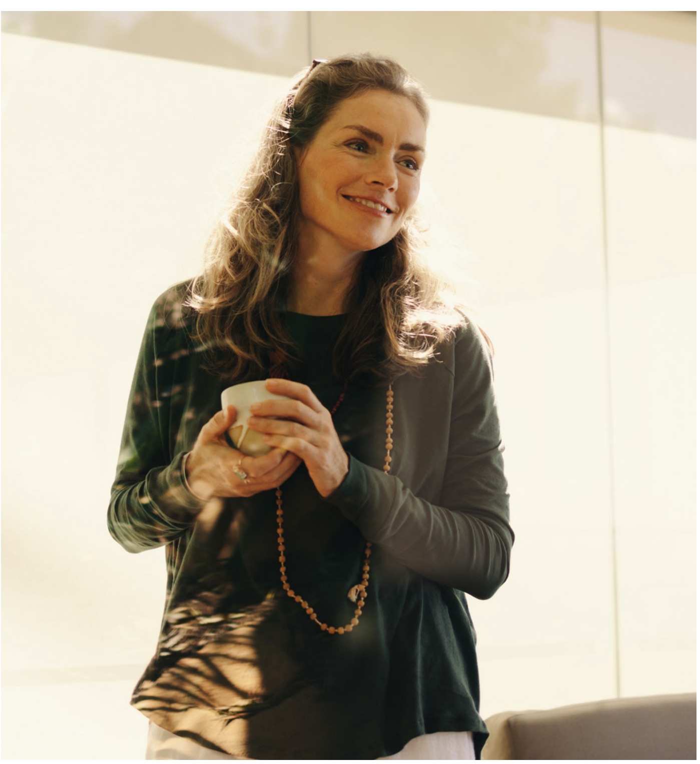
The new rules treat half of the first $250,000 of capital gain as taxable income ($125,000) plus two thirds of the remaining $750,000 ($500,000). This totals $625,000 as taxable income. At a combined 53.53% marginal tax rate*, the individual would pay $334,563 in tax. This is **$66,913 more than under the old rules.** The effective tax rate on the capital gain would be 33.46%, or 6.70% more.

Another way to look at it

The change to the inclusion rate increased the effective tax rate on the $1 million capital gain by 25%. This percentage grows as the amount of the capital gain increases and becomes subject to the higher inclusion rate.

	Death before June 25, 2024	Death after June 24, 2024
Fair market value at death	$1,100,000	$1,100,000
Adjusted cost base	$100,000	$100,000
Capital gain	$1,000,000	$1,000,000
Inclusion rate for first $250,000 of the capital gain	50%	50%
Inclusion rate for the rest of the capital gain	50%	66.67%
Taxable capital gain for the first $250,000 of the capital gain	$125,000 (half of $250,000)	$125,000 (half of $250,000)

	Death before June 25, 2024	Death after June 24, 2024
Taxable capital gain for the rest of the capital gain ($750,000)	$375,000 (half of $750,000)	$500,000 (2/3 of $750,000)
Total taxable capital gain	$500,000 ($125,000 + $375,000)	$625,000 ($125,000 + $500,000)
Tax rate*	53.53%	53.53%
Tax on taxable capital gain	$267,650 (53.53% of $500,000)	$334,563 (53.53% of $625,000)
Net proceeds after tax	$732,350 ($1,000,000 - $267,650)	$665,438 ($1,000,000 - $334,563)
Difference in tax paid		**$66,926 more tax**
Effective tax rate on capital gain	26.77%	33.46%
Percentage difference in tax paid		**25% more tax ((33.46%/26.77%)–1) *100**



An opportunity

The increase to the capital gains inclusion rate may be an opportunity for more individual insurance coverage. Here's an example that demonstrates this opportunity.

A Client wants to pass on as much wealth as she can to her family. This is more important than maximizing her portfolio's income for herself.

She knows that when she dies:

- there's a deemed disposition of her portfolio/properties for proceeds equal to fair market value,
- taxes apply to the capital gains, and
- she'll lose more of her portfolio's value to taxes because of the increase to the inclusion rate.

> *Purchasing extra life insurance to cover the increased capital gains tax can help her family inherit the same amount as planned. The death benefit will come to her family tax-free. This makes up for the amount of wealth she can't pass on because of capital gains taxes.*

Corporate Clients

Under the new rules, any capital gains realized on and after June 25, 2024 will have an inclusion rate of 2/3 (66.67%). Unlike individual taxpayers, there is no relief for the first $250,000 of capital gains. The new inclusion rate will increase the tax cost of realizing capital gains through a private corporation. That's because the corporation won't be able to credit as much of its capital gains to its capital dividend account. Capital dividends are paid tax-free to shareholders.

Impact on corporate Capital Dividend Accounts (CDA)

The CDA is a tax account that pays shareholders tax-free capital dividends. The non-taxable portion of capital gains realized in a corporation increases the CDA. The non-deductible portion of capital losses immediately reduces the CDA.

With the higher inclusion rate under the new rules, the corporation's CDA balance will only increase by one-third of realized capital gains. Under the old rules (before June 25, 2024), this was one-half. Therefore, the higher inclusion rate will reduce the amount of tax-free capital dividends the company will be able to distribute. If the corporation distributes the entire capital gain, more of that capital gain will be taxable in the shareholder's hands.

Shareholders pay 33% more in tax

Let's look at the impact of the corporate capital gains inclusion rate on a $1 million corporate capital gain. The table compares the old rate (before June 25, 2024) with the new, higher rate (after June 24, 2024).

	Capital gains realized before June 25, 2024	**Capital gains realized after June 24, 2024**
Capital gain	$1,000,000	$1,000,000
Inclusion rate	50%	66.67%
Taxable capital gain	$500,000	$666,667
Tax rate*	50.17%	50.17%
Tax on taxable capital gain	$250,850 (50.17% of $500,000)	$334,467 (50.17% of $666,667)
Capital dividend account balance (CDA)	$500,000	$333,333
Reduced CDA Balance		$166,667 ($500,000-$333,333)
Refundable tax (RDTOH)	$153,350 (30.67% of $500,000)	$204,444 (30.67% of $666,667)
Non-eligible dividend	**$402,500** ($500,000-$250,850+$153,350)	$536,644 ($666,667-334,467+$204,444)
Dividend tax to shareholders	$192,154 (47.74% X $402,500)	$256,194 (47.74% X $536,644)
Difference in tax paid		$64,040 more tax ($256,194-$192,154)
Shareholders income after tax	$710,346 ($500,000+$402,500-$192,154)	$613,783 ($333,333+$536,644-$256,194)
Effective tax on capital gain	28.97%	38.62%
Percentage difference in tax paid		**33% more tax** **((38.62%/28.97%)-1) *100**

*The marginal tax rate presented is for Ontario. Rates vary across Canada.

An opportunity

In general, Corporate Clients will see their tax liability rise. That's because the corporation will not be able to pay as much of the non-taxable part of its capital gains as tax-free capital dividends.

Having a corporation own life insurance can help make up for the additional taxes that will result from the lost capital dividend account room. A review of a Corporate Client's life insurance coverage is a good opportunity to ensure they have enough to cover the additional terminal tax liability.

Sun Life Illustration

Sun Life Illustration provides the flexibility for you to customize capital gain inclusion rate. Illustrating asset transfer, retirement and investment strategies using the new capital inclusion rate makes life insurance an even more attractive asset class compared to alternative investments.

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