the SmallBiz Builder

your monthly newsletter

Padgett

MAY 2024

New Capital Gains Tax Rate

The recent Federal Budget announced changes to the taxation of capital gains. It's important to note that at the time of this writing, there isn't any draft legislation yet for us to review the details of these changes.

What was announced:

- Currently only 50% of capital gains are included in income subject to tax. The budget proposes to increase the tax on capital gains by including 66.7% of capital gains in income if those capital gains are realized on or after **June 25th, 2024**.

- For individuals, there is some relief as only capital gains more than $250 000 each year will be subject to the 66.7% inclusion rate. If you realize capital gains below that amount, the inclusion rate will remain at only 50%. One area of concern that has been raised has to do with deceased taxpayers. When a taxpayer dies, unless the property transfers to a surviving spouse, there is a disposition triggered for tax purposes (even if the asset isn't sold), and any gains realized at the time of death are included in the final return for the deceased. We are hoping that the draft legislation will provide an exemption or increased threshold for gains realized in the year of death.

- For corporations, and trusts, the 66.7% income inclusion begins with the first $1 of a capital gain realized after June 25th. It is unknown how graduated rate estates will be taxed on gains – like a regular trust or like an individual.

There may be some benefit to triggering capital gains prior to June 25th

When a corporation realizes a capital gain, the non-taxable portion of the gain can be paid out as a tax-free dividend to shareholders by making a special tax election. Corporate taxpayers will have to weigh the benefit of realizing gains prior to June 25th to minimize taxes and maximize the payout of this non-taxable dividend, against the cost of lost tax deferral and foregone future investment gains. The same issue concerning tax savings vs tax deferral holds true for individuals who will exceed the $250 000 threshold.

Another option to consider for individuals who own small business shares with accrued value, is to use a special tax election to be able to trigger the unrealized gains and claim the capital gains exemption. This would increase the cost base of the shares and therefore reduce the gain on a future sale of those shares.

[continued…]

Other considerations and planning

- Planning to sell and repurchase assets can be considered as a sham by the tax authorities. This could completely undo the benefit being sought, so the manner in which this is done is important.

- We have previously written about the taxation of flipping residential property (ref: our March 2024 issue of the SmallBiz Builder). If a residential property is sold before being held for a 365-day period, 100% of the gain will be taxed as business income, rather than 50% (or 66.7%) as a capital gain, unless you fall under one of the exceptional circumstances.

- The effect of alternative minimum tax rules should be considered.

- Estate planning can be impacted. For example, if there won't be an exemption for deceased taxpayers, in some cases the automatic transfer of assets at cost to a surviving spouse may not be the best option if total gains of that surviving spouse will likely exceed the $250 000 threshold.

You should speak with your Padgett Advisor for an analysis of your specific situation.

Padgett

Padgett Business Services is dedicated to meeting the tax, government compliance, profit & financial reporting and payroll needs of businesses with fewer than 20 employees in the retail and service sector of the economy. This publication suggests general business planning concepts that may be appropriate in certain situations. It is designed to provide complete and accurate information to the reader. However, because of the complexities of the tax law and the necessity of determining whether the material discussed herein is appropriate to your business, it is important you seek advice from your Padgett office before implementing any of the concepts suggested in this newsletter.