UPCOMING FEDERAL BUDGET — APRIL 19TH PLANNING FOR POSSIBLE CAPITAL GAINS TAX INCREASE

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On March 22, 2021, the Finance Minister, Chrystia Freeland, finally announced the date of the federal budget (the "**Budget**") to be April 19th, 2021.

There has been much anticipation and speculation regarding the upcoming Budget, as the previous budget was tabled more than 2 years ago (on March 19, 2019). One of the biggest areas of speculation during the span of budgets delivered under the Trudeau government has been whether the government will announce an increase in the capital gains inclusion rate.

The capital gains inclusion rate is the percentage that is applied to a capital gain in order to determine the portion of the gain that is taxable. Currently the capital gains inclusion rate is 50%, meaning that only 50% of capital gains are taxable. For individuals in Ontario the highest marginal rate applied to capital gains is 26.76% while the highest marginal rate applied to dividends is 47.74% (technically it should be noted that capital gains are subject to the same top marginal rate of 53.53% as income but, given that only 50% of a capital gain is taxable, it is common shorthand to refer to capital gains as being taxed at a rate of 26.76%, being 50% of 53.53%). It would not be surprising, therefore, if the Department of Finance were to recommend to the Finance Minister that this tax rate differential be narrowed by increasing the capital gains inclusion rate.

Although an increase in the capital gains inclusion rate has been rumoured prior to previous budgets under the Trudeau government, the 2021 Budget is particularly concerning due to the general perception that the government may need to generate additional tax revenue as a result of the drastic increase in the government's expenditures in 2020 related to the COVID-19 pandemic. An increase in the capital gains inclusion rate would be an easy way to raise additional taxes and also address the aforementioned tax policy concern relating to the difference between capital gains and dividend tax rates.

Assuming that an increase in the capital gains inclusion rate in the upcoming Budget will not be retroactive, there are planning techniques which may be used to mitigate the effects of any such increase. One such technique is to "manufacture" a disposition of an asset that is expected to be sold in the short term (but after the Budget) to a related entity (such as a related corporation or partnership). The asset transfer would be made subject to a "rollover" election and, in the event that the capital gains inclusion rate is increased, the taxpayer could elect to trigger a capital gain on the transfer. If the Budget does not change the capital gains inclusion rate then the rollover election would be made at tax cost to avoid triggering a gain and being subject to tax. The related party transfer would need to occur, of course, before the Budget day (April 19). This technique allows a taxpayer to take a 'wait and see' approach since the deadline for making the election would not usually occur until after the Budget day. This planning can be seen as a form of insurance for those persons owning assets with significant accrued capital gains and which are intended to be sold in the near future.

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