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Capital Gains Changes for Individuals

As you may have heard by now on the news, effective for dispositions occurring on or after June 25, 2024, the capital gains inclusion rate increased from one-half (where it had been for many years) to two-thirds. The inclusion rate determines how much of a capital gain is included in your income that is subject to tax. Since a higher proportion of a capital gain will be subject to tax, obviously this could result in a higher tax burden for you. However, up to $250,000 (per year) in capital gains may remain eligible for the one-half inclusion rate. This article is intended to provide a brief overview of what these changes are and how the new exemption will work.

Please note that all the tax changes discussed in this article are proposed, which means that the federal government has not yet enacted them into law.

Refresher: What Is a Capital Gain?

A capital gain is a type of taxable income that results from the disposition of a property. They are subject to preferential treatment. Until recently, only one-half of capital gains were included in income as taxable capital gains and one-half of capital losses were allowable capital losses that could be deducted against taxable capital gains. Since only a portion of a capital gain is included in income (unlike business income or employment income), a capital gain is advantageous by comparison. A capital gain or loss is calculated, very generally, by determining the difference between the proceeds of disposition and the property's original cost plus any disposal costs. The capital gain or loss is subject to the "inclusion rate", which was one-half for many years.

Increased Capital Gains Inclusion Rate

Effective for dispositions occurring on or after June 25, 2024, the capital gains inclusion rate increased from one-half to two-thirds. Two-thirds of your capital gains for the current year net of two-thirds of your capital losses for the year (if any) are now taxable. For example, if you realize a capital gain (net of any capital losses) of $100,000, two-thirds of that amount, or $66,667, is your taxable capital gain that is included in your income. Since more of the gain will be included in your income, your taxable income would be higher and so would your taxes payable. However, you would also be potentially eligible to have your income reduced due to the $250,000 exemption that is discussed below.

Moreover, there are transitional rules applicable to 2024 that will calculate a blended rate where you have gains/losses occurring before and after the time that the inclusion rate increased. These are also discussed below.

Does the Increase Affect Me? The $250,000 Threshold

When increasing the capital gains inclusion rate, the federal government implemented an exemption that allows individuals to continue benefitting from the old one-half inclusion rate on up to $250,000 of capital gains. There is no cumulative limit to this exemption, so up to $250,000 in capital gains can benefit from the lower inclusion rate every year. Capital gains allocated to you from a trust or partnership are also eligible for this reduced inclusion. If jointly-owned property is disposed of, you and the other joint owners (who are individuals or eligible trusts) can each access their own $250,000 limit.

While this $250,000 exemption may appear straightforward, the way the rule was implemented is a bit complex, so it is explained in some detail here.

First, you must understand that the official inclusion rate is always two-thirds. The exemption for the lower one-half inclusion rate is implemented by a separate reduction to the amount of net taxable capital gains that would otherwise be included in your income. Using the example above, if you realized a $100,000 capital gain, a $66,667 taxable capital gain is included in your income by virtue of the two-thirds inclusion rate. However, obviously only $50,000 should be included in your income because your gain is much lower than $250,000, and that is where the reduction is needed.

The calculation is much more complex than the simple reduction above as it accounts for other variables, but the important thing to know is that effectively one-sixth of your capital gains (up to $250,000) is deducted from your income, which reduces your inclusion from two-thirds to one-half.

Thus, to return to the very simplified example, $16,667 is deducted from your income. Consequently, the taxable capital gain of $66,667 that was included in your income is reduced by $16,667 with the final income inclusion being $50,000, which represents a one-half inclusion rate applying to a capital gain of $100,000.

There also exists an income add-back to make the regime function properly. Since certain capital gains deductions are computed under the assumption of a two-thirds inclusion rate, the amount of these deductions would be excessive since those gains may also eligible for the one-half reduction discussed above. Thus, an income add-back is needed to adjust for excessive deductions. Again, the calculation is very complex. The purpose of the add-back is to ensure you are not reducing your income (per the reduction for a one-half inclusion rate) more than was necessary in the first place. The net result of the income reduction (and possibly add-back, if applicable) is that up to $250,000 of your capital gains are eligible for a reduced inclusion rate.

2024 Inclusion Rate Increase — Capital Gains Distributions

If in 2024 you receive capital gains allocated from a trust, partnership, mutual fund corporation, mortgage investment corporation, or segregated fund, the distribution payer should inform you which portions of the distributions are subject to the one-half and two-thirds inclusion rates. The one-half inclusion rate is for dispositions that occurred before June 25, 2024.

2024 Inclusion Rate Increase — Transitional Rules

There are many transitional rules that determine the inclusion rate for 2024 in the computation of taxable capital gains, allowable capital losses, and business investment losses. For gains and losses incurred in 2024, your inclusion rate is not necessarily one-half or two-thirds, but is calculated via these transitional rules. Essentially, the year is dividend into two periods: January 1 to June 24 (“first period”) and June 25 to December 31 (“second period”).

If you have only net capital gains or only net capital losses in both the first and second periods, your inclusion rate for 2024 is a blended rate between one-half and two-thirds that is based on the proportion of net gains or losses realized in each period that is of the total net gains or losses realized in the year.

If your net capital gains in the first period exceed your net capital losses in the second period, your inclusion rate is one-half. Similarly, if your net capital losses in the first period exceed your net capital gains in the second period, your inclusion rate is one-half.

If your net capital gains in the first period is less than your net capital losses in the second period, your inclusion rate is two-thirds. Similarly, if your net capital losses in the first period is less than your net capital gains in the second period, your inclusion rate is two-thirds.

For these purposes, your net capital gains for a period is the amount by which your capital gains exceed your capital losses, and your net capital losses for a period is the amount by which your capital losses exceed your capital gains.

Any capital gains reserve included in the year is deemed to occur on the first day of the year.

What Is Not Changing

The government is maintaining existing capital gains exemptions and creating new exemptions, including:

- maintaining the principal residence exemption;
- increasing the lifetime capital gains exemption (“LCGE”) to $1.25 million, effective June 25, 2024, from the current amount of $1,016,836 on the sale of small business shares and farming and fishing property; and
- a new Canadian Entrepreneurs’ Incentive that reduces the inclusion rate to one-third on a lifetime maximum of $2 million in eligible capital gains.