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The increased capital gains inclusion rate – Quantifying the hit

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We've given you our technical perspective on the increased capital gains inclusion rate: **2024 Federal budget – Reflections on the increase to the capital gains inclusion rate through an insurance lens – Tompkins Insurance** Now let's look at it from a practical perspective.

What is the impact?

Over the last few weeks, I have had conversations with family office and other tax professionals about the change in the inclusion rate and I have encountered two different commentaries.

"It is an 8-to-9 percentage point change" vs "It is a 30%+ change"

The proposed new capital gains inclusion rate of 2/3rd's (lets call it 66.66%) brings the tax rate on capital gains from the current 26.76% to 35.68% in Ontario (above the $250,000 threshold for individuals and on every dollar for corporations and trusts). That is a difference of 8.92 percentage points, however is the actual *impact* 8.92% or is it 33%? It depends on your perspective.

Consider the following example:

If you have a capital gain of $4,000,000 at a 50% inclusion rate, your tax payable is $1,070,400. At a 2/3rd's inclusion rate, your tax payable is $1,427,200. This is a 33% increase in the tax that you will pay.

For corporations, the capital dividend account credit on a $4,000,000 capital gain at a 50% inclusion rate is $2,000,000 and at a 66.6% inclusion rate, is at $1,320,000 – a reduction in CDA of 34%.

An 8.92 percentage point change sounds somewhat mild, however a 33% increase in the tax payable is far from what we consider mild, rather we think that is extra spicy!

The advantages of life insurance

Life insurance policy advantages have not changed. Life insurance continues to provide:

- tax-free death benefits;
- tax-exempt internal growth in cash values; and
- a capital dividend account credit to private corporations for the death benefit received minus the adjusted cost basis of the policy.

With this increase, what has changed for life insurance is the relative position it holds in comparison to alternative investments. The rate of return on life insurance in comparison to a taxable portfolio has been enhanced because the taxable portfolio will return a lower after-tax amount.

Using life insurance to fund estate tax liabilities delivers instant liquidity at the moment it is needed. Life insurance tax efficiently grows tax-sheltered. Every dollar of death benefit received in excess of the adjusted cost basis credits the capital dividend account. Relative to alternative investments, life insurance has become an even greater preferred solution to fund these estate tax liabilities.

FOOTNOTE:

Should you wish to discuss this or any other TOMPKINSights article, please contact
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