Investors Dodge Bullet on Capital Gains Tax, but Little Else to Cheer About in Budget 2016

Description

For Canadian investors, Tuesday's federal budget could have been worse. A rumoured rise in the capital gains tax inclusion rate beyond the existing 50% had affluent investors with large non-registered portfolios in high-anxiety mode. Fortunately, a feared hike to 67% or even 75% did not materialize.

However—and perhaps this was the origin of the rumours in the first place—there was a minor blow to mutual fund investors who used corporate class mutual funds to minimize the tax consequences of switching between sector or regional funds in taxable portfolios. As of September, such switches will no longer be tax free.

I'd hardly call the return of the 15% federal tax credit on Labour-Sponsored Investment Funds (LSIFs) adequate compensation. If anything, labour funds have proven to be almost guaranteed money losers, even after factoring in lucrative federal and often provincial tax credits. The Liberals should have left the stake firmly planted in the heart of the LSIF monster.

Entrepreneurs and owners of small businesses had little cause to rejoice. For one, the expected drop in the tax rate for businesses earning less than $500,000 a year will not be falling to 9% as expected over the next three years but will remain frozen at 10.5%. That's only a smidge below the general corporate tax rate of 11%. It's little wonder it was described as a "big fat broken promise" by Dan Kelly, president of the Canadian Federation of Independent Business.

In general, businesses can look forward to a tightening of the corporate tax system over the next five years, including tougher audits. Ottawa expects to collect more than $11 billion over that time from this "tightening," as well as the closing of some loopholes used by multinationals.

High-net worth investors and the accountants and tax professionals that advise them are also grappling with tightened measures related to life insurance death benefits and their use by corporations.

Robert Kepes, a partner with Toronto-based tax law boutique Morris Kepes Winters LLP., says one measure (found on an appendix dealing with tax measures) makes it harder for business owners to transfer life insurance policies to their corporations and also receive death benefits totally tax free.

Another “double-dipping” practice Ottawa considered “abusive,” involving selling life insurance policies to their corporations and taking back a promissory note with no tax consequences, has also been closed down, according to Kepes.

Businesses can also look forward to higher payroll taxes, since the budget has left the door open to further consultations to expand the Canada Pension Plan within the next 12 months.

The budget for 2016 also revealed that it no longer plans to limit benefits on employee stock options. During the election campaign last fall, the Liberals said they were considering placing a $100,000 cap on annual stock option gains; currently, 50% of gains on stock options can be deducted with no limit on the total amount.

Lower-income seniors do well under the budget, but high-income seniors do less well; the annual contribution limit for tax-free savings accounts was not reinstated to the hoped-for $10,000 under the Tories but stays at $5,500. Couple that with the retrenchment of corporate class mutual funds, and affluent seniors will find it hard to minimize tax on non-registered investments.

On the other hand, low-income seniors stand to gain up to $947 from a raise in the Guaranteed Income Supplement (GIS). Support is being raised for senior couples living apart, with GIS benefits based on individual incomes if they have to live apart for “reasons beyond their control.”

Note that GIS payments are tax free, as is the case for the new Canada Child Benefit, which replaces several older programs that attempted to deliver similar benefits (the National Child Benefit Supplement, Canada Child Tax Benefit and Universal Child Care Benefit).

As telegraphed before the budget, the age for receiving Old Age Security benefits will now be 65 for everyone.

While income splitting for couples with children under 18 has been eliminated, fortunately pension income splitting remains intact.

I guess we should be grateful for what crumbs are left to us.

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1. Investing

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