How Capital Gains Tax in Canada Can Lower Your Effective Tax Rate

Description

Increasing your income from capital gains lowers your effective tax rate. One of the largest capital gains you can book in your life is selling your home. You realize a capital gain when you sell a capital property for more than what you paid for (including the cost of the property and additional costs incurred to sell it).

For example, you might have bought a condo for $300,000 years ago, and now you're planning to sell it for about $650,000. However, you'll be able to lower the capital gain by subtracting commissions, legal fees, transfer taxes, and most other expenses that were required to sell. So, the capital gain would be $350,000 minus the additional costs required for the sale. Currently, the government only taxes 50% of capital gains. So, the capital gains would be taxed essentially at half of your marginal tax rate, which is a lower tax rate than your employment or self-employment income.

If the property has been your principal residence all this time, then congratulations; you don't need to pay capital gains tax on it at all, as described here by the Government of Canada! However, the site also states that "If at any time during the period you owned the property, it was not your principal residence, or solely your principal residence, you might not be able to benefit from the principal residence exemption on all or part of the capital gain that you have to report." So, discuss this with a tax professional if you're in doubt.

Needless to say, if you're selling a rental property for capital gains, you'll need to pay capital gains tax.

Short-term capital gains tax in Canada

The short-term capital gains tax is the same as the long-term capital gains tax in Canada. Short-term capital gains refer to gains realized within one year of purchasing the asset. Usually, people don't buy a residential or commercial property to make a quick profit — that'll be property flipping and is risky, because there's no guarantee short-term price movements will be favourable, and real estate properties can be illiquid.

There are other ways to realize capital gains. With easy access to online brokerages, Canadians can book capital gains by buying and selling stocks for a profit. Since capital gains are taxed at lower rates than other income (employment, self-employment, interest, and foreign income), by increasing your income from realizing capital gains, you'll lower your effective tax rate. Investors might have a better chance of booking short-term capital gains from stock investing than real estate investing.

Long-term capital gains tax in Canada

Since the tax rate for long-term and short-term capital gains is the same, it doesn't matter if you sit on a stock or not, right? Well, there is a difference. If you hold stocks of quality businesses for a long time, essentially, the investments compound tax-deferred.

In other words, if you're booking capital gains every year, you'll pay income taxes on capital gains regularly. The tax becomes a part of the cost of investing and could potentially lower your wealth building compared with holding onto stocks for long-term, tax-deferred growth.

Notably, you'll only need to worry about capital gains tax when you invest in a non-registered (or taxable) account. Capital gains booked in TFSAs, RRSPs, RRIFs, RDSPs, RESPs, etc. don't trigger a tax event.

How much is capital gains tax in Canada and Ontario?

Canadians pay income taxes at a federal and provincial/territorial level. Capital gains are a source of income that we need to pay income taxes on. In Ontario, for the 2021 taxable income, capital gains are taxed as follows, combining federal and Ontario tax brackets, according to *TaxTips.ca*.

2021 Taxable Income	Other Income	Capital Gains Tax Rate
first $45,142	20.05%	10.03%
over $45,142 up to $49,020	24.15%	12.08%
over $49,020 up to $79,505	29.65%	14.83%
over $79,505 up to $90,287	31.48%	15.74%
over $90,287 up to $93,655	33.89%	16.95%
over $93,655 up to $98,040	37.91%	18.95%
over $98,040 up to $150,000	43.41%	21.70%
over $150,000 up to $151,978	44.97%	22.48%
over $151,978 up to $216,511	48.29%	24.14%
over $216,511 up to $220,000	51.97%	25.98%
over $220,000	53.53%	26.76%

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