STEP Canada
ADVISING FAMILIES ACROSS GENERATIONS

May 7, 2024

Robert Demeter
Director General
Tax Legislation Division, Tax Policy Branch
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Dear Mr. Demeter:

Subject: Federal Budget 2024 – Capital Gains Inclusion Rate

STEP Canada endorses the May 1, 2024, submission (attached), made by The Joint Committee on Taxation of The Canadian Bar Association and Chartered Professional Accountants of Canada, titled *Federal Budget 2024 – Capital Gains Inclusion Rate*. We highlight our support of the various issues and concerns raised in the submission, and we ask that the Department of Finance consider these items when finalizing changes to the *Income Tax Act* (Canada) ("the Act") related to the proposed increase in the capital gains inclusion rate, as announced in the Federal Budget 2024.

We also wish to set out some of our concerns as to how the proposed change in the capital gains inclusion rate will adversely affect trusts and estates for middle-class and vulnerable Canadians and trusts more generally.

To put our comments in context, there is a perception in Canada that trusts are used only by the wealthy to unfairly reduce or eliminate their Canadian tax liabilities. This view is divisive and inaccurate. Canadian trusts (both resident and deemed resident) are closely scrutinized by government regulators and are required to comply with Canadian tax laws and pay the appropriate tax in accordance with those laws. Further, the existence of the 21-year deemed disposition rule for most personal trusts means that Canada's trust regime precludes the deferral of tax for multiple generations.

Trusts:

There are both tax-related and non-tax-related reasons why Canadians, regardless of income or asset levels, create trusts. For example:

1. Qualified disability trusts allow a person to create a trust in their will, to hold assets for beneficiaries with disabilities who may not be able to administer their inheritance on their own. These trusts are clearly encouraged by the government, as evidenced by the fact that, under the Act, they are permitted to access graduated rates of tax – a treatment that since 2017 has been unavailable to other ongoing testamentary trusts.

2. Similarly, discretionary trusts known as Henson trusts are designed to hold assets for a person with a disability, to allow the person to continue to receive government benefits and entitlements (such as benefits under some Provincial disability support programs).
3. More generally, trusts may be created to protect the assets of vulnerable Canadians who may not otherwise be able to manage their own financial affairs or who are at risk of financial abuse. Trusts of this nature are used to protect the interests of the individuals for whom they are created.
4. Personal trusts enable taxpayers to make assets available to others for specific purposes, and to ensure that the distributed assets may be used only for those intended purposes (for example, to help with the cost of post-secondary education, to fund the acquisition of a home, or to help the parents of young children pay for the cost of childcare).
5. Finally, testamentary spousal trusts allow a person to provide their spouse with investment income after they die, and at the same time protect the financial interests of their children, who may eventually inherit the assets. These commonly used trusts can be particularly important in second-marriage situations.

The examples listed above are not exhaustive, but they highlight some of the critical uses of trusts that result in solutions – often for the protection of some of Canada's most vulnerable individuals – that have nothing to do with wealth, tax planning, or tax benefits.

As you are aware, the $250,000 safe harbour annual limit announced in the Federal Budget 2024 is not proposed to be extended to trusts. In our view, this approach unfairly penalizes individuals who, often because of immutable personal characteristics, are incapable of holding investment assets in their own name, and who are thereby compelled to hold such assets through a trust. Further, in almost all situations, such trusts are already subject to tax at the top marginal rate, unlike the individual beneficiaries of those trusts. This budget proposal also perpetuates discriminatory attitudes toward and treatment of disabled individuals, by imposing a more punitive capital gains regime on arrangements that are necessary to ensure their well-being.

<u>Estates and Estate Planning:</u>

The proposed increase in the capital gains inclusion rate will have a substantial impact on Canadians' estate (tax-on-death) planning. Canadians already pay capital gains tax on the appreciation of their capital assets at death (assuming that their assets are not left to their spouse or qualifying spousal trust at death). Among other effects, the increase in the capital gains inclusion rate will increase substantially the amount of tax that Canadians pay on death if their capital gains at death, and their capital gains realized in the year prior to death, exceed the proposed $250,000 safe harbour annual limit.

As trust and estate practitioners, STEP Canada members have helped families plan for the inevitability of paying tax on death at the 50% capital gains inclusion rate. Canadian families have budgeted, made life and death decisions, perhaps purchased life insurance to fund the future tax, and taken countless other steps to transition their finances to the next generation on the assumption that a 50% inclusion rate will apply. Canadians who have prudently planned on the basis of an inclusion rate that has been the norm for more than 50 years (except from the 1988-2000 during which time the inclusion rate increased to 75% before ultimately being reduced back to 50%) will not be able to make the necessary arrangements to restructure their planning if they now lack the capacity to make changes to their affairs. The existence of a valid power of attorney will not allow a representative to change the will of an incapable testator. And even if taxpayers have the legal capacity to effect new planning, they may find that they are no longer insurable, have frozen their asset values based on the 50% inclusion rate, so for those or a myriad of other reasons, their estates may not have enough liquid assets to pay the additional capital gains tax on death.

An increase in the capital gains inclusion rate may also compromise the retirement planning of hard-working, self-employed Canadians who count on the savings within their corporations to make up for the fact they will not receive any pension beyond CPP. To them, an increase in the inclusion rate is tantamount to having their pension reduced retroactively.

In light of these concerns, it should be clear that applying the increased capital gains inclusion rate to estates, trusts, and private corporations without allowing access to the annual safe harbour of the relevant individual is unduly punitive, and in reality, affects far more than the 0.13% of Canadians cited in the budget materials.

Finally, we note that the budget proposals do not refer to the indexation of the $250,000 safe harbour amount. We trust that this is an oversight and hope to see it corrected in the implementing legislation.

We hope that our submission will be of assistance to you when drafting complex and difficult legislation within your challenging time frame. We would be happy to speak with you directly at your convenience.

We thank Ali Spinner and Ian Lebane for their significant contributions to the preparation of our submission.

Rachel Blumenfeld, LLB, TEP
Chair, STEP Canada

Peter Weissman, FCPA, FCA, TEP, CEA
Chair, STEP Canada Public Policy Committee

cc: Trevor McGowan, Associate Assistant Deputy Minister, Finance Canada