06. Deferral of Capital Gains Taxation

Issue

Budget 2016 under a Liberal Party government in their preamble reflects on "Investment is needed and the time to invest is now. Smart investments can strengthen and expand the middle class, reduce inequity among Canadians and position Canada for sustained economic growth", however, the taxation of capital gains is notably absent from Budget 2016.

Background

During Election 2006, a key Conservative Party election promise called for the elimination of the capital gains tax for individuals on the sale of assets when the proceeds are reinvested within six months. At the time of this proposal in the election platform, very little detail was provided to guide the development of this idea into potential legislation. In Finance Minister Flaherty's May 2nd, 2006 Budget, the Government of Canada introduced legislation to eliminate the taxation of capital gains on the donation of marketable securities to registered charities, but there was no mention of the campaign proposal of broad capital gains tax relief.

The Canadian Chamber of Commerce believes that the principle of reducing taxes on investment income (including capital gains) is positive and requires significant attention in the Government of Canada's undertaking in personal and corporate income tax reform. In particular, the Canadian Chamber of Commerce strongly believes that commitment to reform the taxation of capital gains must be a focal point in any upcoming fiscal announcement. However, due to the complexity of the issue, it is imperative that the Department of Finance carefully consider the parameters for the implementation of the deferral regime and be open to recommendations with respect to the defining principles and implementation process for any proposed legislation in this regard.

The Investment Industry Association of Canada (IIAC) reported in their 2016 pre-budget consultations on February 19, 2016, "The economic and financial environment remains challenging. Continued weak global economic conditions and depressed energy prices have placed a stranglehold on economic growth. The near-term outlook for both growth and commodity prices has deteriorated since the previous government presented its budget in April 2015. The strategic focus of the new government on infrastructure project spending as the backbone of economic growth should be commended, but the government should also consider more innovative approaches to improving access to external capital for new and emerging businesses. Specific incentives can be targeted to take advantage of Canada's deep and effective capital markets, excellent availability of quality investments and the expertise to identify them, and the savings to fund attractive opportunities with good returns." And is followed by a recommendation to "Implement legislation to provide for the deferral of income taxation on taxable capital gains incurred in a taxation year when the proceeds are reinvested in small business shares within a six-month period."

One important consideration is the fact that a good number of Canadians have investments in real property; however, these investments would not currently qualify as an asset for consideration in capital gains deferrals, investments in real property lack liquidity and portability due to the immediate application of capital gains, therefore making it difficult for investors to grow their real property investments. The result, as stated by the Canadian Real Estate Board, is a "lock-in" effect where real property owners do not sell assets that have increased in value and have a disincentive to maintain the overall quality of both commercial and residential investment properties. In addition, the Canadian

Chamber of Commerce recommends that the Government of Canada continue to review the taxation of all sources of investment income in order to develop strategies that encourage all Canadian to save and invest for their future and retirement.

Recommendations

That the federal government and specifically, the Department of Finance:

1. Move to implement legislation to provide for the deferral of income taxation on taxable capital gains incurred in a taxation year when the proceeds are reinvested within a one year period. Any amounts not re-invested within the stipulated period could be taxed on a prorated basis in consideration of the amounts actually re-invested.
2. Carefully consider the definition of a “qualifying asset” for the purposes of re-investment to ensure that no significant barriers to Canadians exist on re-investment of capital gains.
3. Ensure that all capital property, including real property, that currently gives rise to a capital gain on its disposition will frame the definition of a “qualifying disposition” for the purposes of the deferral of the capital gain on disposition.
4. Avoid adding unnecessary complexity to this proposed legislation by avoiding implementation of annual or lifetime limitations; term-certain limitations (akin to the 21 year deemed disposition rule) or complex adjusted cost basis determinations.