Transcript: CIBC Private Wealth - Ask the experts. From cottages to condos - proposed changes to the capital gains tax. Jun 3, 2024

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[CIBC logo. CIBC Private Wealth - Ask the experts. From cottages to condos - proposed changes to the capital gains tax. Jun 3, 2024. To the right a family sits at a picnic table.]
[Margaret, Jamie and Scott sit at a desk and talk to one another.]
[00:03] >> Margaret Adaniel: Hello, I'm Margaret Adaniel, and I'm here with CIBC tax expert Jamie Golombek and experienced real estate investor Scott McGillivray. To answer your top real estate questions around the recent changes announced in the federal budget. Jamie, Scott, thanks for being here today.

[00:18] >> Jamie Golombek: Happy to be here.

[00:20] >> Margaret Adaniel: The 2024 federal budget announced a change to the amount of tax you may pay if you sell a property that is not your principal residence for profit as of June 25th. This has caused a lot of discussion, along with some concern, but it is also an opportunity to get ahead of the change by doing some proactive planning. Our clients and Canadians broadly have had many questions about the impact these changes will have. Both of our experts are trusted sources of insight and information and have been fielding many questions.

So let's jump in. Scott, one of the questions that you've actually received through social was, explain it all. It's so confusing. This sentiment is echoed by many Canadians. So Jamie, can we start with a simple breakdown of what are capital gains?

[01:12] >> Jamie Golombek: Well, very simply, I guess a capital gain is simply the profit on the sale of an asset. So if the asset was purchased for a certain price and it's now worth more, the difference between the value that you sell it for and the original cost is the profit, and that is a capital gain. And currently before the changes, those gains are includable in your income at 50%. So in other words, no matter what your tax rate is. You will pay tax on half that profit half that capital gain.

[01:40] >> Margaret Adaniel: Okay. Great. So now that we have the basics, can you also highlight the proposed changes and what that means from a capital gains perspective.

[01:50] >> Jamie Golombek: So the government has announced In the recent federal budget that the capital gains inclusion rate will be going up from 50% to two thirds. So rather than including only half the gain in your income, you'll now have to start including two thirds of the gain. Now this change only comes into effect as of June 25th, and that means that for any gains prior to June 25th. So as of June 24th and before, the inclusion rate is 50%, but as of June 25th, for individuals, any gains above $250,000 of gains per year will be taxed about the new inclusion rate of two thirds.

[02:29] >> Margaret Adaniel: Okay, that's extremely helpful. Thank you. These changes have actually sparked a lot of concerns amongst Canadians. Scott, I know you're hearing a lot from your network. Can you give us some insight to what you're actually hearing?

[02:42] >> Scott McGillivray: Yeah. Well, first thing that I'm hearing about the capital gains changes is a lot of confusion, and it is confusing. And there's, a lot of nuances to it as well. So people are paying attention. And overall I would say that it's not good. It's more tax being taken from people who are trying to save or be diligent or use an asset class and existing rules and regulations in order to generate some wealth for their families.

So, people have an understanding, they think that it's going to go from 50 to 67% tax rate. It's not quite, quite like that because it's more the inclusion rate. But some of I think that the confusion comes because there's this well not on the first $250,000, which okay, nice. But you can't control when you are, you know, when you're recognizing a capital gain, you

can't say, well, I'm going to sell the house and only claim 250,000. You have to claim it all at once.
And I think the other, the other challenging element here is this deadline. It's unrealistic. It's too fast. It's creating panic. You can't just put a house up and try to close really quickly, and you're trying to make the do the math. Like, you might take a loss that's greater than the capital gain increase that you're going to pay. So there isn't really you know, I don't think people should be panicking, number one, because that's the wrong reaction. You might actually lose more money trying to do something quickly and haphazardly than the actual increase in tax that you're likely to pay if you sell it later. But there's definitely some behaviour changes coming.

I think that people who do, understand how capital gains works and have used that as an investing tool are frustrated because they've made decisions 20 years ago and they're now going to be penalized. It's like the government's moving the goalposts on you, and you've learned how to play the game a certain way. So there’s frustration, there's confusion.
The most important thing is we need to have a conversation. It's great that Jamie's here because he knows the tax laws. He knows the facts, which I've seen a lot of content out there that is flawed. People are like, oh, here's what it means. I'm like, no, that's not what it means, right? And here's what you should do. I'm like, no, that's not what you should do. So I think for my network, I work with a lot of investors, and I know that, you know, there's some, some statements that have been thrown out that, capital gains only affects a very small portion of the population, but typically somebody who's planned around a capital gain event at some point in their life is representing a lot more people than just themselves. They could be representing their family. They could be representing three generations of a family who have owned a cottage or a vacation property. And they've they've put their equity and effort into those properties. And now it's been eroded all the work they've done in the past.

So, yeah, people are frustrated. People are confused. We need to have a real conversation about what the capital gains changes really mean. And what impact it's going to have on Canadians all across the board.

[05:45] >> Margaret Adaniel: Yeah. That's, really great insight. And I, I agree with you wholeheartedly. You know, capital gains and taxes in general will drive behaviour. So we're thankful to have Jamie here to, to help bring some, some clarity to the situation. Jamie, you're talking to clients all the time. So what are you hearing from clients? And it might be similar to what Scott's hearing, but what are you hearing from clients who are most affected by these changes?

[06:11] >> Jamie Golombek: Well, I would say clients just don't know what to do. Or if, in fact, they should do anything right. Like, it affects clients who have investments in the stock market, and it obviously affects clients with real estate, other than a principal residence. So, you know, people with vacation homes, with, rental properties, things like that. They're asking me like, should I do something? I'm not gonna sell it by June 24th. That's not practical. But, you know, should I engage in some kind of reorganization or should I transfer to a corporation? So I elect to trigger a gain, right? Move it into a trust. Like there are ways of triggering or gain prior to June 25th without actually selling it on the market. But in most cases, after we have this conversation, most clients say, you know what, I don't want to pay the tax and therefore they're going to do nothing. But, you know, we're having these conversations every day.

[CIBC logo. Wealth planning strategies. To the right a woman writes on a document.]
[06:50] >> Margaret Adaniel: Yeah, absolutely. So, Jamie, you recently came out with a report that was called: should I sell or should I hold? Which, is fantastic, and it's a great report. The question that's on a lot of Canadians minds right now is what are the factors that they should consider, when making the decisions for being proactive with regards to their capital gains?

[07:19] >>Jamie Golombek: Again, so if we're talking about real estate, again, not really practical to sell by June 25th, there's not really a lot of time. But again, you could trigger the gain by transferring it, to a trust or to a family member, things like that. I think the consideration will come down to number one. Do you want to pay that tax upfront? Right. Because when you do that transfer, by June 25th, the tax on any gain is going to be due when you file your 2024 tax return, which is going to be April 30th, 2025. So do you really want to come up with the cash from somewhere? Because if you're not really selling the

property, you don't have any cash. So do you really want to pay that tax early in other words, before you ultimately sell it and realize those proceeds? What is the opportunity cost? What is the rate of return that you could get on that cash otherwise? If that's otherwise invested, then if it's now sent to the government, you're not going to get that rate of return. So those are the kind of things that we look at breakeven points, length of time, rates of return in that report.

[08:17] >> Margaret Adaniel: That's great. Thank you. Scott, you own multiple properties across Canada and in the US. You know, you're you're a known real estate investor that many people lean on for insight and advice. What are you considering when it comes to planning around some of these changes? And how do you see that impacting the choices of Canadians? And I think you alluded to it a little bit, about short term, short term decision making. But but what do you think that that's going to impact from behaviours overall?

[08:50] >> Scott McGillivray: It's a very good question. You know, the cap, the new capital gain changes. I think that, there will be some people who panic and make some bad short term decisions regarding it. I think that for now, the best decision is to wait and see. Changes of government mean changes in some of these rules, and this is a change that might not be forever. The rules changed back in the late 90s as well. It used to be two thirds. It went to 50%. Now it's going from 50% to two thirds. So a change is possible again in the future. However, for me personally, it doesn't make sense for me to just start selling off assets. There's a few, properties and portfolios where I do have a lot of, you know, built up potential capital gains. And I do have the means to be able to maybe trigger some of those now, hedge my bets and realize that maybe the opportunity cost of that money isn't worth, necessarily what it could be versus the savings I'll get now.

But realistically, I think that for those of us who are buy and hold investors for the long term, this is just another hurdle. It's not going to stop us. It just means we need to be really diligent. People who take real estate investing seriously as a way to generate wealth, should know and understand that, you have to be monitoring your capital expenditures as well, right? So a capital gain doesn't just happen on the amount above and beyond your purchase price. It happens above and beyond your purchase price plus all your capital expenditures. So if you're purchasing a, a vacation property and you're renovating it, the

cost of that renovation as a capital expenditure will be deducted before your capital gain is triggered.
So I think that for, you know, for the average Canadian, there's a little bit of work to do. I think it's worth and I say this whether there's a capital gain change or not, you know, the the standard curriculum that is in our education system doesn't teach us about, you know, these complicated tax rules. And you need to make sure that as you're putting your money towards your future, your family, your savings, that you're thinking about these things and really doing the calculations. You have to use certain tools and calculators or, or talk to an advisor, like, say, what is it really going to mean? You need the facts because opinions shouldn't be driving your financial decisions. It really has to be the facts. So for me, I'm going to maintain the course. I think that this might just be something temporary, that in the long term, isn't going to have a major effect on people who are managing large portfolios with steady tenants.

But I think at a, at a more micro level, you're going to see real estate behaviours change, people are going to game the system. And now the system is the first $250,000 is at an advantage versus everything above and beyond that. So people will be looking at real estate and asset options that allow them to do more transactions that are smaller versus larger transactions over time, which personally I believe is bad for the entire economy. Because if you buy and hold a property for 25 years and you have steady tenants, you're providing housing for people, you're doing a long term investment. There aren't a lot of transaction fees driving up the future value of that property. So you preserve integrity and, and opportunity for the future. But if the first $250,000 of capital gains is going to be at a preferred rate, people are going to start flipping properties faster before they cross that $250,000 threshold. So real estate becomes more transactional. And every time a property changes hands, there's added expenses land transfer taxes, realtor fees, closing costs, all of those get added to the future value and you see housing prices go up. It becomes a struggle for people trying to get into the real estate market for homeownership.

So there some challenges here. I think that, I don't think that this is going to be the final solution for trying for the government trying to raise more taxes and generate more, more money. I think that this is going to drive a behaviour that the real estate market really doesn't need at this time. And, and so that, again, this is what I'm hearing at it's very early

days, but from investors, from people who are looking at real estate and other assets as a form of generating wealth, they're now thinking more, more, smaller transactions, because every year, if you've got if you're $200,000 - $250,000 every year is now a tax advantage to $1 million once every four years.

[13:38] >> Margaret Adaniel: Well, and to your comment around people, buying and holding and renting, it also has a knock on impact to, to tenants and potentially people paying more in rent.

[13:49] >> Scott McGillivray: Absolutely. Every time a property turns over. You know, if, if somebody's buying it for their own primary residence, they can get vacant possession. Which means a tenant loses their home every time a property changes over to a new owner. But the other challenge as well is a lot of these homes that are purchased and used as, like a flip, for instance, they there's usually nobody living in them because they're under renovation. They're sold vacant. And now the price point has been pushed potentially further out of reach for average individuals. Because somebody is trying to take advantage of the cap, new capital gains rules, which are pushing people to make more, smaller profits, rather than one large one.

[Considerations fo ryour unique situation. CIBC logo. To the right an older couple review information on a laptop of a younger man.]
[14:38] >> Margaret Adaniel: That’s super helpful. Thank you. So let's jump into a few scenarios because we've had a lot of feedback from our clients. And, when we went out for questions, a lot of people came back with personal situations and saying, how do I deal with this? So, we had several clients when reaching out, we're talking about transferring of property. So, really to the younger generation, and how to designate your property so a principal versus a secondary, when moving properties to a trust. Jamie, if you can maybe give us some insight into what are some of the considerations around that property transfer?

[15:17] >> Jamie Golombek: So I think people have to realize that when you transfer a property that is a deemed disposition for tax purposes. So if you gifted it away, if you transfer it to your kids, it's as if you've sold it. So you're basically triggering the capital gains tax. And the problem is that there's no cash. So again, if you are going to make a gift, you're

going to make a transfer and you're willing to do that. You do it. Let's say that some clients are actually looking at giving that cottage, to the kids before June 25th. There is a gift effect, essentially, and you'll be deemed to have sold it at fair market value, less your cost, plus any additions. that would be your capital gain. You'll pay at a lower inclusion rate, but you got to have the cash by April 30th next year. So I think that's the most important consideration.

It may make sense, but again, you know, it really depends on when were you otherwise planning to, transfer it or in some cases, the age of the client? We had a client a couple weeks ago. That was in their 90s, and they sort of asked about triggering gains before June 25th, and I sort of jokingly asked them, well, how long do you plan to live? And they said well I'd said, be happy If I lived another couple of years. I said, well, maybe you want to transfer before June 25th, because that way you accelerate the gain you paid at the low inclusion rate. And then if you pass away in the next couple of years there's a disposition, at fair market value. So those are some of the considerations.

[Jointly-owned properties. CIBC logo. To the right a couple go over documents with a woman in a new home.]
[16:30] >> Margaret Adaniel: Thank you. So, Jamie, if we can stay with you for just a minute, when parents are actually thinking about, pooling resources with their adult children to buy a property together, where they each pay part of the mortgage. But only the adult children live in the home, and it's an actual investment opportunity for the parents. How would the gain on the sale be taxed?

[16:57] >> Jamie Golombek: Well, I think the good news is, in most, in most cases, typically a gain is proportionate to what each person contributed. But in this particular case, if the kids are actually living in it as a principal residence, then they could claim the principal residence exemption on the home, on their gain on their portion. And again, the parents may also be able to do that because even though the parents aren't living there, their children are living there. And the rules for the principal residence exemption include the kids. So as long as the parents don't have another home that they're claiming as their principal residence, perhaps they're renting, then they would also be able to exempt their portion of the gain. So that's kind of an interesting one.

[17:33] >> Margaret Adaniel: Okay. That's great. And if, just to build off of that, what if there's a joint property, that you have with your children and the parents are only a 1% holder, so they've really gone into that situation more to help their children qualify for the mortgage. So it's not as much a prin - it's not as much, about the investment property, but it was really to help their children in that situation. What are some of the considerations around full ownership versus that, that partial ownership as well as, you know, would those be actually subject to the capital gains?

[18:10] >> Jamie Golombek: Yeah. Again, good news on that one as well. I mean, we've seen this in some situations. There's different ways where parents help kids buy a property, which is their principal residence. And in some cases, you know, the parents will be a guarantor. But in other cases, depending on the type of mortgage, the parents will actually go on title for a 1% interest in the home. The good news is that if the kids are the beneficial owners of that particular home, then it can be considered the kids principal residence, and there'll be no tax at all when they sell it. And the parents shouldn't have to worry about any capital gains tax either, because they were never the beneficial owners of that.

[Investment and vacaction properties. CIBC logo. To the right, a family are on a cabin balcony together.]

[18:44] >> Margaret Adaniel: Okay. That's great. Thank you. Scott, something that's on the minds of a lot of cottage owners right now is, you know, as they're looking at either selling or passing down those properties. How could that affect the market?

[19:00] >> Scott McGillivray: I think that there's going to be obviously, some people are frustrated if they've owned a secondary property or a recreational property, and it's been in the family for 30 years. They've been accumulating this wealth that they think they've been handing down to their family for a long period of time. And now there's going to be an increase in the, in the tax obligation when they, when they do so. And I think for a lot of people, it's still a good news story. There's still equity to be passed down and a capital gain tax is still better than an income tax. So you're still at an an advantage over the way typically people try to generate wealth, in this country. However, there's a few things that

you can do. And I'm, I'm trying to help people prepare as best they can to be as diligent as possible when it comes to this transfer of wealth that might be coming in their family.

Number one is think about getting an insurance policy to the amount of which you're going to have to pay in capital gains. That's one of the best ways to mitigate any cash calls from your family. I see it all the time. We do shows about this, and I have families coming to me saying, we have to sell the cottage, it's being passed down. We don't have the money to pay the capital gain. We're going to lose the family. And they're struggling there. And I'm, you know, we're trying to find ways to get it rented out so that they can at least have some cash flow to cover the expenses. But people are devastated. Their memories and their, you know, legacy are in these properties. And now it's even harder to keep them in the family because the tax obligation is increasing. So the first thing that I would tell people to do is to get an insurance plan that is to the amount that's going to cover the capital gain portion. All right. So it's not the whole difference. You bought it for 500,000. It's worth a million now. And there's a deemed disposition or a transfer of title. You don't need to have a $500,000 insurance policy. You need to have approximately a $200,000 policy. My quick math, right. You got about a $200,000 capital gain on on $500,000. At the end of the day, let's call it. And and, you know, to have a $200,000 insurance policy isn't impossible. And it's worth the small premium to be able to seamlessly move forward. And now the new owners, the next generation have, they start at the million dollar valuation, right, and continue to accumulate your capital expenditures.

If you're doing things to your properties, you got to you can't just say, oh, it's the cottage, you know, it's fine. Just throw those receipts away. Absolutely not on every single property that I own. I have, you know, capital expenditures that I've been accumulating so that when I do go to sell it, this capital gain tax is less of an impact because I get to deduct those first. So those are the two things that I think every, every Canadian who owns more than just their primary residence needs to, number one, start being really careful about their capital expenditures and keeping track of those, because sometimes you have to go back ten, twenty years. And the other thing is to consider getting an insurance policy that's going to cover the capital gains amount when a deemed disposition does occur.

[22:25] >> Jamie Golombek: I'll just jump in for one second because, life insurance is a big opportunity if you plan ahead. And we see some cases where the kids will actually pay for the insurance because the kids. I mean, I'm not talking about like five year old kids, I'm talking about like 60 year old kids that are planning to inherit, their parent's cottage and they realize there's no cash. I mean, they will actually sometimes actually pay the premiums on the life insurance policy, on the parents, on, let's say, a joint last to die policy. So that when the cash comes in, comes in tax free death benefits, that's now available to fund the capital gains tax, which is now, let's say 9% higher. The kids have paid for it and they get the cottage and they get it, effectively tax free because the insurance has come in and paid off the capital gains tax. So that's also a great, great, great planning point.

[23:12] >> Margaret Adaniel: Yeah. That's, that's great insight around how, the insurance can help protect. And I think we sometimes think about life insurance in a very specific way. And I think what we're showing here is that there's a lot of different scenarios on how it can actually help you protect. And, Scott, to what you said, you know, it's not just investment properties. It's not just your your principal properties. Right? So some of these have long legacies within a family, and you want to keep those in the family. So that's great. Thank you both.

We actually had a couple clients reach out, asking how they can offset the capital gains. So, for example, if they sell the property and buy another one with all of the proceeds, does that still trigger the capital gain?

[23:55] >> Jamie Golombek: Yes, yes it does. I mean, there's some kind of replacement rule. I mean, I understand where people are getting this from. They're getting it from the internet. There's a lot of information on the internet that just does not apply here. So, yes, if you have a business and you have a warehouse and the warehouse was expropriated or caught on fire, then you buy a replacement warehouse. Like there are very specific rules for businesses that do allow a deferral of capital gain on a replacement property. That does not apply to personal residences, and it certainly doesn't apply to rental properties either. So I'll just dispel that myth. Right off the front.

[24:29] >> Scott McGillivray: Yeah. No, that's I think that's just one of those things. People think there's loopholes, right? There aren't necessarily loopholes into avoiding capital gains, but there's some really smart, you know, there's some really smart tactics that you can do in order to reduce your exposure or reduce the capital gain itself. So and that's something we definitely have to talk about, because I think at the end of the day, it's going to come down to people only want to pay as much tax as they have to. And I think that's a good way of approaching it. You're not going to avoid tax. There's no secret loophole to how do I avoid it completely. There's there's 2 or 3 things that you should be doing which will effectively grind down the amount of tax that you have to pay quite significantly.

An insurance policy. The cost of an insurance policy is going to be a lot less than the cost of the capital gain. So capital gain is already a discounted tax rate. And then your insurance policy is going to be a discount to that. So effectively if you look at it as a tax, you're paying a very small tax rate to have insurance to cover the capital gain, which is a, a progressive tax anyway with your income. So that's kind of a crazy, really smart way to set yourself up to effectively. Like if you look at the end of the day, you're paying so much less than the average Canadian if you just set yourself up for success with.

[25:48] >> Margaret Adaniel: Yeah, so it's planning for it, not trying to find the loophole.

[25:52] >> Scott McGillivray: It’s planning and preparing for it 100%.

[Gifting or inheriting property. CIBC logo. To the right, a young woman hugs an older woman who is working on a laptop.]

[25:56] >> Margaret Adaniel: We'll wrap it here But, there are a lot of questions. And you've talked a lot about this where it's around inheritance, it's about gifting. So this is for both Scott and Jamie. What are you hearing from Canadians with regards to the inheritance and gifting and their concerns with the capital gains for that?

[26:24] >> Jamie Golombek: Well, again, I think from a tax perspective, the biggest issue, of course, is, you know, how are they going to pay the tax. So in other words, someone dies, there's a deemed disposition of all their property, including real estate at fair market value. so you've got these rental properties, you've got a vacation property, and you have a

principal residence, and ultimately there's going to be some tax. But again, do you want the kids or the inheritors to ultimately be forced to sell it? And if not, you know, you need to either have the cash somewhere, or you look at things like, like life insurance. Right? So I think those are the biggest concerns and, and really meet with an advisor. I mean, I think that's the bottom line that we're telling people, sit down with your financial advisor, with your tax advisor, have a balance sheet and calculate what is my estimated capital gains tax with the new changes as of June 25th, and how am I going to pay for it? How is my estate going to be paying for it? And ultimately, should I do some additional planning like life insurance, things like that?

[27:07] >> Scott McGillivray: Yeah, absolutely. I agree completely that, any time that the property is transferring title, you're going to have to deal with these things. So the best way is to prepare. I still I still believe that investing in assets has a competitive advantage in this country over, you know, income tax rates, for example. So it's worth looking into and doing the math.

I think I need to say this. I believe that one of the most important conversations regarding the capital gains changes has not been addressed on anything I've seen online, has not been addressed properly in the budget. I know, Jamie, you and I have talked about it. So I do think we need to clarify the fact that the first $250,000 in profit on the sale of an asset will still be taxed at 50% of your income tax rate, above the $250,000 it's going to two thirds, which is 66.666%, let's call it, 67%. Sure. So basically over $250,000 of a capital gain will now be included. Another 17% will be included in your tax rate. So if and your tax rate is progressive. So let's say you're in the highest tax bracket. What what does that mean tax wise.

[28:27] >> Jamie Golombek: So typically speaking I mean if someone is in a high bracket of, you know, 53, 54% depending on the province, currently the capital gains rate on the first 250,000, let's call it 26%. Yes. And then after June 25th, the amount over $250,000 will be taxed at approximately a rate of 35%.

[28:42] >> Scott McGillivray: So you're going to have an increase of about 9%, nine percentage point tax. So that's the real number. I think that Canadians need to sit down

and have a discussion regarding what do these changes really mean to me, what it means is that over any capital gain, over $250,000 will now be taxed at an increased rate of about 9% through your progressive income tax rate. So it's a 9% change to your tax obligation. It's not a 17% increase. It's not a 50% increase. So I've seen a lot of people online making claims that oh, you're gonna have to pay an extra 17%. That's not true. There'll be an inclusion of an extra 17% on anything over the $250,000, which may have up to a 9% increase, in tax obligation at the end of the year. That's the number that we're dealing with.

[29:35] >>Jamie Golombeek: Absolutely.

[29:36] >> Margaret Adaniel: Scott, Jamie, thank you again for being with us today. We really appreciate all the questions you've answered. We hope you found this information useful. And if you have any further questions, please connect with your advisor.

[Thank you!]
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