

Cost estimate of Election Campaign Proposal

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Short title: Raising the Inclusion Rate of Capital Gains for taxation

Description: This policy would raise the portion of capital gains that are included in taxable income from 50 per cent to 100 per cent on corporations (excluding small businesses) and individuals with a net worth over \$3 million.

Operating line(s): Corporate income tax revenues, personal income tax revenues

Data sources:	<u>Variable</u>	<u>Source</u>
	Personal capital gains:	SPSD/M 27.1
	Corporate capital gains:	2015 T2 corporate income tax return
	Corporate capital losses:	2015 T2 corporate income tax return
	Household property income:	PBO economic projection
	Household assets:	PBO economic projection

Estimation and projection method: The cost was estimated for the proposed policy to be retroactively applied to capital gains realized on (or after) June 30, 2019.

Corporate Income Tax Changes

The 2015 T2 corporate income tax return database was used to compute the impact on corporate income tax revenues. It was assumed that the capital gains inclusion rate would increase from 50 per cent to 100 per cent for corporations reporting taxable capital gains that were not eligible for the small business deduction. The change in non-refundable federal tax payable due to the policy change was estimated in order to determine the impact on corporate income tax revenues.

Next, since corporations can distribute capital gains to shareholders as dividends, the change in personal income tax payable was calculated, accounting for refundable tax on investment income. Two assumptions were made: dividends are paid to shareholders in the same fiscal year as they are realized in and shareholders pay the top federal personal income tax rate on eligible dividends.

Personal Income Tax Changes

SPSD/M was used to compute the impact of this policy change on personal tax revenues.¹ A person's annual investment income was used to approximate his/her net worth and therefore the eligibility for partial or full inclusion rate. For those with annual investment income above \$150,000 (consistent with 5 per cent rate of return on \$3 million in financial assets), an increase from 50 per cent to 100 per cent inclusion of capital gains in taxable income was simulated. The value of a person's principal residence was not included in the net worth threshold. For the behavioural impact, PBO's estimate of the elasticity of taxable income for high-income earners (0.38) was used.

The cost estimate is projected forward over 2019 to 2025 using SPSPD/M and thereafter using PBO's June 2019 baseline projection for household assets.

This estimate also accounted for the interaction with an increased corporate income tax rate from 15 per cent to 21 per cent on large firms.

Uncertainty assessment: This estimate has high uncertainty due to the likelihood of aggressive tax planning and evasion. Tax literature suggest that higher income individuals are more responsive to tax policy changes. Depending on the timing and final design of this policy, there could be significant volatility in personal and corporate income tax revenues particularly in the short term.

In addition, the approximation of an individual's net worth based on his/her annual investment income could contribute to the uncertainty of the estimate.

¹ This analysis is based, in part, on Statistics Canada's Social Policy Simulation Database and Model (SPSD/M). The assumptions and calculations underlying the SPSPD/M simulation results were prepared by the Office of the Parliamentary Budget Officer (PBO) and the responsibility for the use and interpretation of these data is entirely that of the PBO.

Cost of proposed measure

\$ millions	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026	2026-2027	2027-2028	2028-2029
Raising inclusion rate	-8,122	-11,388	-12,073	-12,685	-13,244	-13,843	-14,467	-15,109	-15,765	-16,432
Interaction effects	-618	-896	-950	-998	-1,042	-1,089	-1,139	-1,189	-1,241	-1,293
Total cost	-8,740	-12,284	-13,023	-13,683	-14,286	-14,932	-15,606	-16,298	-17,006	-17,725

Notes:

Estimates are presented on an accruals basis as would appear in the budget and public accounts.

Positive numbers subtract from the budgetary balance, negative numbers contribute to the budget balance.

"-" = PBO does not expect a financial cost