Canada's Capital Gains Tax and the Exodus to the U.S.

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There may be a change coming to the way Canada taxes capital gains. While Prime Minister Justin Trudeau claims it will affect a minuscule percentage of Canadians, it has more than a minuscule percentage of Canadian taxpayers on edge. The new taxing regime is complex, with 56 pages of guidance. While some taxpayers are already subject to a capital gains tax inclusion rate (meaning the amount of capital gain that is currently included in computing a taxpayer's income) of 50 per cent on their realized gains, the capital gains inclusion rate under the taxing regime will exceed 66 percent on some assets in certain circumstances.

With the average home price in Toronto alone at over $1.1 million, the prime minister may be inappropriately trivializing the impact of these tax changes. This increased inclusion percentage may generate a maximum effective capital gains tax rate of around 35 per cent. As the U.S. maximum federal capital gains tax is generally 23.8 per cent and many states do not subject their residents to state capital gains taxes, this 35per cent is obviously higher than the U.S. rates. That said, for a resident of New York State, which is generally subject to a maximum 10.9 per cent state capital gains tax, the difference is much smaller. Furthermore, it's important to note that realized capital gains could be subject to state taxes based on a state's nexus laws, irrespective of the residency of the seller.

There have always been some Canadians looking to expand their interests to the United States. This has often been driven by the larger market in the United States, the proximity to Canadian offices, the nature of a specific product and sometimes by a desire for individuals and families to relocate to the United States. Since the introduction of this tax plan that is slated to take effect as of June 25(possibly retroactive to this date if/once the rule becomes law), more Canadians have been talking about leaving Canada to prevent the new taxing regime from affecting them and their assets and their families. There is also a possibility that the legislation doesn't pass, in which case the capital gains inclusion rate would remain the same as it has been. The bottom line: the Canadian tax regime is complex, and, as such, Canadians should carefully consider the cost-benefit analysis before undertaking any transactions to crystallize a capital gain at the current inclusion rate to avoid any possible unintended tax consequences.

The challenge of operating a socialist society like Canada can be exacerbated by a more capitalist neighbor, giving consumers choices in how they obtain products and services and permitting them to avoid the drawbacks to consumers. For example, for decades, Canadians have been avoiding the long wait times for medical procedures in Canada by travelling to the United States. For some, the expense is worth the better time frames. We are seeing loyal Canadians giving up Canadian residence or citizenship (once they can obtain citizenship elsewhere) for the prospect of lower long-term taxes— both income taxes and capital gains taxes. And few of those Canadians are headed to high-tax states like New York or California. Florida, for instance, has seen a healthy influx of Canadians who are grateful to no longer pay any state income taxes.

The U.S. federal government welcomes Canadians who are escaping the Canadian tax regime. There are numerous temporary work permit classifications for professionals, executives, managers and business owners, many of which can be obtained in days, weeks or months. While Lawful Permanent Residence ("green card" status) can take much longer, many Canadians are content in the meantime to hold working status. In a few of the temporary nonimmigrant statuses, L-1 Intracompany Transfer, E-1 Treaty Trader and E-2 Treaty Investor, the primary worker's spouse may also be able to work in any job that they want without any specific qualifications to prove or applications to file.

Lippes Mathias LLP has tax and immigration expertise to assist Canadians who are expanding their interests into the United States for any reason. It is highly recommended to speak with experienced professionals before making significant decisions about expanding interests or moving residences to ensure proper planning is in place to minimize the challenges along the way. Please contact Eileen M.Martin (emartin@lippes.com) or Devon R. McDonald (dmcdonald@lippes.com) with questions.

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