



January 9, 2025

FISCAL AND TAX POLICY

## Do Not Resuscitate: Increasing the Capital Gains Tax Harms Us All

by Jack Mintz

- With Prime Minister Trudeau proroguing Parliament on January 6, plans to amend the *Income Tax Act* to increase the capital gains inclusion rate are now uncertain. While the government stated its intention to introduce the changes in its Ways and Means motion last September, legislation had not yet been introduced. When Parliament returns, Canadians cannot be certain that the amended capital gains tax measures will be passed, or simply be withdrawn altogether by a newly elected government.
- Meanwhile, tax planners and the affected individuals and corporations must await the outcome, even though the Canada Revenue Agency began administering the tax on June 25, 2024, after it was announced in the spring budget. At this time, taxpayers could be assessed interest and penalties if they do not comply with the proposed law. If the law is never passed, taxpayers will have to claim refunds. The provincial budgets reliant on the new revenues will be affected if the planned measure is ultimately withdrawn. It is now a chaotic process.
- Perhaps, the planned measure to increase the capital gains inclusion rate should never see the light of day when Parliament resumes after March 24, nor be revived thereafter by a new government. This E-Brief estimates that Canada's capital stock would decrease by \$127 billion; employment would decline by 414,000 jobs; GDP would fall by nearly \$90 billion; and real per-capita GDP would decrease by 3 percent with most of the adjustment within five years. It would be better to evaluate the role of capital gains taxation as part of a broader tax reform.

One of the most consequential policy changes in this year's federal budget was an increase to the capital gains inclusion rate. Specifically, starting June 25, 2024 (just more than two months after the initial announcement), the government proposed to increase the tax rate on realized capital gains from the disposal of assets by including two-thirds, instead of one-half, of gains as part of taxable income.

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The author wishes to thank Philip Bazel for research assistance and Daria Crisan for background analysis. He also wishes to thank Alexandre Laurin for extensive comments and James Fleming for editing the paper. Helpful comments were provided by William Robson, Jeremy Kronick, Don Drummond, Nick Pantaleo, Jeffrey Trossman, Kevin Wark and anonymous reviewers. The author retains responsibility for any errors and the views expressed.



**Table 1: Number of Tax Filers Who Had Net Capital Gains Greater Than \$250,000 in 2011 and the Number of Years Their Net Capital Gains Exceeded \$250,000 (2011 to 2021)**

Number of Years Reporting More than \$250,000 in Capital Gains	Number of Filers (total 25,100)	Portion of Filers (percent)
1	16,630	66.3
2	3,860	15.4
3	1,670	6.7
4	930	3.7
5	690	2.7
6	430	1.7
7	300	1.2
8	250	1.0
9	160	0.6
10-11	170	0.7

Source: Statistics Canada, Longitudinal Administrative Databank (LAD).

For individuals, this increase applies to realized capital gains net of losses in excess of \$250,000. For corporations, the higher rate applies to all of their net capital gains.<sup>1</sup> As of this writing, the measure is in limbo. However, the Canada Revenue Agency is administering the changes to the capital gains inclusion rate effective June 25, 2024.

The purpose of this E-Brief is to analyze the impact of the tax change on Canadian taxpayers and on the economy.

## The Tax Change Will Be Far-Reaching

The budget estimates that only 40,000 individual tax filers (0.13 percent of all filers) and 307,000 corporations (12.7 percent of corporate tax filers) would be impacted by the increased capital gains tax. The low number of personal filers hinges on the design of the tax change – including the above mentioned \$250,000 net capital gains exemption – which, the budget claims, limits its economic costs and restricts its impact to the wealthiest.

However, capital gains are often called “lumpy” because assets are not sold regularly. Many taxpayers may realize more than \$250,000 in capital gains infrequently. Significant asset disposals, such as selling real estate, farmland, business assets, secondary homes or during events like death or emigration, may occur only once or

1 The proposed increase in the capital gains inclusion rate was accompanied by a higher lifetime capital gains exemption and the introduction of the Canadian Entrepreneurs’ Incentive available to investments in private companies and subject to caps. (When capital gains are in excess of the cap, these incentives will not have behavioural impacts.) For some individuals, recently enacted measures to broaden the alternative minimum tax (AMT) may fully or partially offset the benefit of the annual \$250,000 personal exemption. This E-Brief focuses exclusively on the changes to the capital gains inclusion rate and, in particular, the impact on listed corporations.

twice in a person's lifetime. There is no averaging mechanism in the proposal, nor is there an ability to carry forward the unused portion of the annual \$250,000 allowance to the year of a lumpy disposal.

Longitudinal data from 2011 to 2021 show an average of 40,664 tax filers per year reporting capital gains exceeding \$250,000 (including those who have deceased), aligning with the budget's forecast (Mintz 2024a). If these were the same individuals each year, the affected group would be small. But further analysis reveals that nearly two-thirds of taxpayers who reported more than \$250,000 in capital gains in 2011 did so only once in the subsequent 11 years (Table 1). Only about 3.5 percent reported such gains in seven or more years. Table 1 indicates that most affected individuals experience large capital gains infrequently.

Importantly, many of these taxpayers have middle-class or modest incomes aside from their capital gains. In 2018, Statistics Canada's Social Policy Data Base and Model data reveals that 50 percent of those with more than \$250,000 in capital gains had taxable income (excluding capital gains) below \$117,592, with 10 percent having only \$18,131 or less (Mintz 2024a). This finding, when combined with the infrequent nature of large capital gains shown in Table 1, demonstrates that significant capital gains can occur for individuals who are not consistently high earners.

Far more Canadians would be affected by the tax change than the government seemed to anticipate. Based on the data used for Table 1, I estimate that 22,088 unique Canadians per year, or 1.26 million Canadians on a lifetime basis (4.3 percent of taxpayers) would be affected by the increase in the capital gains tax on individuals, half of whom earn less than \$117,000 per year (Mintz 2024a).

## Significant Macroeconomic Effects

The previous analysis of the incidence of the tax change does not assess the macroeconomic effects, specifically for investment, employment and economic output. Yet, a key government assumption is that the tax increase would have a limited effect on Canada's economy. In particular, the budget stated: "Increasing the capital gains inclusion rate is not expected to hurt Canada's business competitiveness."

The International Monetary Fund reached a similar conclusion with its focus on the capital gains taxes paid by individuals. It observed that, "It [the Canadian tax change] is likely to have no significant impact on investment or productivity growth (IMF 2024)."

These claims conflict with a large body of research on the economic costs of capital gains taxes. While studies often focus on capital gains taxes paid by individuals, they typically fail to account for the increase in the corporate capital gains tax rates that would undoubtedly affect many companies that rely on equity financing.

It is important to note that financial traders are not affected by the budget measure since their gains are not treated as capital gains in the first place, but rather are fully taxed as a source of business income. Banks and insurance companies also pay taxes on gains in most portfolio investments on a mark-to-market basis (which is a tax on market-value increase in their portfolio, net of losses), rather than only upon realization. These latter points were missed by a recent Centre for Future Work paper that claimed financial intermediaries had declining employment despite their supposed capital gains preference (Stanford 2024). That conclusion is flawed since corporate gains derived by financial intermediaries from portfolio investments are already fully taxed and thereby unaffected by the budget proposal.

## Capital Gains Taxes Hurt Business Investment

Neither the Department of Finance nor the IMF produced estimates of the impact of the capital gains tax increase on the economy; specifically investment, employment and GDP. So why did they claim it had no impact on business competitiveness?

There are two possible reasons. First, it's typical to assume Canada is a small open economy in capital markets. Under this assumption, businesses borrow freely in international markets at a world interest rate, and Canadian saving has no discernible impact on the cost of capital in international markets. Even if capital gains taxes discourage Canadian investors from buying corporate equities and bonds, they will have no impact on business investment since companies still incur the same cost of capital on international markets.

Second, the typical investment modelling by Finance Canada (the marginal effective tax rate) includes the corporate income tax and provisions, sales tax on capital inputs and asset-related taxes. However, corporate capital gains taxes are not included in the modelling; only the personal capital gains tax is included. So, obviously, an increase in the corporate capital gains tax rate will have no impact on investment in the model.

Neither of these assumptions holds up. While the Canadian capital market is only 2.5 percent of world stock markets, Canadian companies, even the largest ones, depend very much on equity capital provided by domestic households. Studies have generally shown that investors, even in advanced countries, have a home-country bias – a propensity to invest a disproportionate portion of their equity portfolio in their domestic market (Gaar, Scherer and Schiereck 2022). Canadians invest 52 percent of their equity portfolio in Canadian markets even though a properly diversified portfolio would suggest only a small portion of assets should be invested at home (Saldanha 2024).

There are many reasons for “home bias” in equity shares. Smaller companies do not have easy access to international markets. Companies that are Canadian-controlled need a significant share of Canadian ownership beyond 2.5 percent to qualify for the tax benefits of being a Canadian-controlled private corporation. Also, Canadians have more information about domestic opportunities and risks than they have with respect to international assets. While Canada does not have capital controls (except Investment Canada limitations on foreign direct investment), the dividend tax credit and certain other tax preferences apply only to investments in Canadian resident companies, not foreign ones.<sup>2</sup> Therefore, when home bias is accounted for, capital gains taxes have been shown to suppress equity values and raise the cost of equity-financed investment of Canadian companies (Mintz, Wilson and Milligan 1999).

Based on Statistics Canada data, I estimate that Canadian households own more than one-third (35.5 percent) of company shares listed in Canada.<sup>3</sup> If there were no home bias, Canadian household ownership of Canadian companies would obviously be much smaller and have little impact on the cost of investment for large companies.

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2 A more complicated story is the following. If foreign investors are more highly taxed than Canadian investors (for example, due to Canadian withholding taxes that are not fully credited against foreign taxes), home bias would result as foreign investors are squeezed out of the market. However, if foreign investors are less heavily taxed (for example, due to lower personal, corporate and capital gains tax rates or international tax planning opportunities), Canadian investors would be squeezed out of the market, reducing home bias. These complications are not measurable empirically, but they suggest that a higher capital gains tax rate might result in less home bias as foreign equity inflows substitute for domestic equity investment.

3 Calculations based on Statistics Canada, Table 36-10-0580-01.

As for corporate capital gains taxes, they are paid by companies that operate in Canada, regardless of ownership. Corporate capital gains are realized when physical and financial assets are sold. In some cases, corporate capital gains taxes are also paid when corporate reorganizations take place, such as in the case of mergers and acquisitions. Since the corporate tax applies to nominal capital gains, the capital gains tax increases the cost of investment, even if there are no real capital gains (i.e., when gains are purely inflationary). Also, the use of capital losses is highly restricted.

From 2011 to 2021, taxable corporate capital gains were roughly 7 percent of corporate taxable income of non-financial corporations.<sup>4</sup> Based on merger and acquisition data and the market value of the stock market, I estimate a fairly long holding period for corporate shares (35 years), not dissimilar to the lives for buildings. Taking into account short holding periods for trading financial assets, I estimate that the annualized tax rate on nominal capital gains in the non-financial sector (taking into account the value of deferring capital gains until disposal) will rise from 6.4 percent to 8.5 percent<sup>5</sup> due to the budget's capital gains tax hike. (See the Appendix for details on methodology.)

Therefore, the effect of the tax change is twofold: an increase in the equity Canadian investor's capital gains tax rate and an increase in the corporate capital gains tax rate. According to financial theory, the supply cost of equity increases as the personal tax on capital gains (and dividends) rises with income: marginal investors providing equity finance to companies are often higher-taxed investors such as those with gains of more than \$250,000. Furthermore, the corporate capital gains tax changes increased the required rate of return on new investment for large, medium and small non-financial companies.<sup>6</sup>

## Impact on the Economy

Overall, the capital gains tax hike would have a significant impact on both the incentive to hold capital in Canada and on employment. (See Appendix for details regarding my methodology.)

The effect of the capital gains tax hike is to raise the effective tax on new investment for all industries, as shown in Table 2. The aggregate effective tax rate (measured as a percentage of the net-of-tax profitability of investment) rises by 5.4 percentage points (or 25.6 percent) from 21.1 percent pre-June 2024 to 26.6 percent post-June. The impact is similar across industries as our estimates of the effective tax rate on nominal capital gains at both the personal and corporate levels do not differ by industry. The smallest increase (5.0 percent) is faced by the least-taxed forestry companies, where depreciation and investment tax credits are prominent (lessening the impact on corporate capital gains taxes on the cost of investment). The smallest impact is the case for wholesale trade and construction (5.7 percent) where inventories are a greater share of capital.

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4 Calculations based on Statistics Canada, Table 33-10-0500-01.

5 This estimate is based on a nominal discount rate of 6.06 percent, which is the weighted average of the cost debt and equity finance.

6 As discussed in the Appendix, in the absence of real capital gains, the term  $c\pi$  is added to the numerator in the user-cost-of-capital formula with  $c$  denoting the accrual-equivalent corporate capital gains tax rate and  $\pi$  the rate of inflation. Furthermore, research is being undertaken to include real corporate capital gains by sector. Note that capital gains taxes might also be deferred when companies are restructured, potentially lengthening the holding period. No data are available to measure this impact.



**Table 2: Effective Tax Rate on New Investment by Industry, 2024, and the Effect of the Capital Gains Tax Increase in June 2024\* (percent)**

	Pre-June 2024	Post-June 2024	Increase in ETR
Agriculture	22.8	28.5	5.7
Forestry	9.9	14.9	5.0
Electric Power	23.0	28.4	5.4
Construction	19.4	25.1	5.7
Manufacturing	9.0	14.3	5.3
Wholesale Trade	19.4	25.1	5.7
Retail Trade	26.6	32.2	5.6
Transportation	22.7	27.8	5.1
Communications	25.4	30.7	5.3
Other Services	30.7	36.1	5.4
Aggregate	21.2	26.6	5.4

\*Measured as the gross-of-tax rate of return minus the net-of tax rate of return divided by the net-of-tax rate of return on capital.

Source: Calculations by Philip Bazel based on the marginal effective tax rate model at the School of Public Policy University of Calgary.

As proposed, the capital gains tax hike increases the tax-inclusive cost of capital for large companies by 4.4 percent (according to estimates by Philip Bazel, an associate at the University of Calgary's School of Public Policy, using our marginal effective tax rate model).<sup>7</sup> Two-thirds of the impact is due to the increase in the corporate capital gains tax rate and one-third due to the increase in the personal capital gains tax rate.

Based on a conservative assumption that an increase in the tax-inclusive cost of capital by 10 percent causes the capital stock to fall by 7 percent,<sup>8</sup> I estimate that Canada's capital stock would fall by \$127 billion in the long run with most of the adjustment in five years. Employment would permanently decline by 414,000 over the same period.<sup>9</sup> To put this in terms of its impact on unemployment, the capital gains tax hike would increase

7 The aggregate gross-of-tax marginal rate of return on capital (net of risk) is 4.06 percent before the capital gains tax increase. The net-of-tax rate of return on capital is 3.35 percent. Therefore, the effective tax rate is calculated as  $(4.06 - 3.35)/3.35$ , which equals 21.2 percent as reported in Table 2. After the capital gains tax increase, the gross-of-tax rate of return on capital would be 4.24 percent. Note that a five-year average of inflation rates is used (3.0 percent) consistent with our international model for 95 countries.

8 Based on a mid-point range of elasticity estimates discussed in de Mooij and Ederveen (2008) of -0.5 and -1.0.

9 This estimated change in employment is based on a fixed capital-labour ratio and labour and capital income shares of GDP. Non-residential capital stock (2022 prices) is taken from Statistics Canada, Table 36-10-0097-3. Private employment (seasonally-adjusted) is taken from Statistics Canada, Table 14-10-0355-02. The finance, insurance and real estate sector is excluded. It is assumed in these calculations that the wage rate is fixed, resulting in job losses. If wages fall, job losses will be less although the loss in the total wage income is the same.

unemployment from 1.5 million to 1.9 million Canadian workers (based on employment data for November 2024). GDP will fall by almost \$90 billion and real per capita GDP by 3 percent.<sup>10</sup>

Clearly, the impact of the capital gains tax hike is substantial and another hit on Canada's productivity and economic growth on top of other tax increases and, more important, regulatory obstacles to investment.

## What about Neutrality?

It is not just tax rates that affect economic growth and productivity. Tax distortions that result in the misallocation of resources also undermine productivity. With capital gains taxation, however, the impact is rather complex.

The strongest argument made for increasing the capital gains tax from one-half to two-thirds of the ordinary personal income tax is neutrality in financial structures. As the federal-provincial corporate income tax rates have fallen from 43 percent in 1999 to 26 percent today, the dividend tax credit has been reduced. This resulted in dividend tax rates rising since 2000, while the capital gains tax rate remained unchanged at one-half of the personal income tax rate.<sup>11</sup> When dividends are taxed more heavily than capital gains, it encourages companies to pass out income to investors in the form of capital gains rather than dividends, often through structures that are challenged by the Canada Revenue Agency as inappropriate "surplus stripping." This is one distortion addressed by the budget, although only limited to capital gains in excess of \$250,000.

With the corporate capital gains tax, however, a different distortion arises in that corporate capital gains are taxed more heavily than inter-corporate dividends (the latter are exempt from taxation to avoid double taxation on profits distributed from one corporation to another). When corporate capital gains are more heavily taxed than dividends, companies are encouraged to structure inter-corporate payments as dividends rather than capital gains, a practice that can be limited by legislation.

Therefore, increasing the corporate capital gains tax rate widens the distortion at the corporate level between dividend payments and reinvested earnings. As shown in a recent European study, the corporate capital gains tax distorts the market for corporate control by discouraging acquisitions and mergers, resulting in a forgone deal loss of \$1.1 billion in 2013 for Canada as estimated by the authors (Todtenhaupt et al. 2020).

Furthermore, the budget introduces a new distortion in the tax system. In the past, the capital gains tax rate at the corporate level was the same as that paid by individuals. The reason for this policy was to minimize the incentive to hold assets at the corporate or personal level to reduce capital gains taxes. For example, if there were no corporate capital gains tax, an investor could avoid capital gains taxes by selling real estate assets through a corporation rather than selling them as an individual.

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10 An alternative simplified approach is to assume a Cobb-Douglas production function whereby the substitutability between capital and labour is unity and shares of GDP are constant. Assuming that labour income is two-thirds of GDP, the elasticity of capital demand with respect to changes in the cost of capital is 0.75 (I used a slightly lower value of 0.7). The elasticity of an increase in the cost of capital on labour demand is the same, given that labour and capital income shares are constant.

11 Since 2007, two dividend tax credits have applied to eligible dividends (profits subject to the large corporate income tax rate) and ineligible dividends (profits eligible for the small business deduction available to private corporations). The capital gains inclusion rate applies to capital gains earned on shares regardless of whether the company is subject to the large or small corporate tax rates.

The 2024 budget introduces a lower tax rate on capital gains at the individual level (due to the \$250,000 exemption) compared to the corporate level. This will encourage investors to hold equities directly rather than at the corporate level.<sup>12</sup> While this might seem innocent, it can create distortions in the allocation of capital. For example, corporate assets are subject to limited liability and can be jointly held by many investors. By pushing assets to be held at the individual level, some of the benefits of incorporation can be lost.<sup>13</sup>

Furthermore, an increase in the capital gains tax rate encourages investors to hold on to assets longer rather than replace them with assets that provide superior returns to equity. This lock-in effect impedes the efficient allocation of resources. Capital gains taxes also discourage risk-taking since the government taxes nominal capital gains but does not provide a refund or even symmetrical treatment for capital losses.

Taking into account all these considerations, the 2024 budget measures would reduce some but increase other tax distortions. Productivity is likely reduced simply by raising taxes on capital investment.

## Key Takeaways

Overall, the proposed increase in the capital gains tax rate at both the corporate and personal level can be expected to discourage business investment and employment, despite claims to the contrary in April's federal budget and by the IMF. I find that the increase in the capital gains tax rate would reduce Canada's GDP by \$90 billion, real per capita GDP by 3 percent, its capital stock by \$127 billion and employment by 414,000, with most occurring within five years. This is a substantial loss to the Canadian economy at a time when growth in per capita GDP is falling and unemployment is increasing. If the proposed law does not proceed, it would be worthwhile for a government to review capital gains taxation as part of general tax review that would improve opportunities for economic growth rather than hurt it.

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12 A countervailing consideration, however, is the recent broadening of the personal AMT.

13 The differential treatment of capital gains at the personal, as opposed to corporate level, undermines a longstanding policy of neutrality. As noted by Larry Chapman and Jack Mintz (2012, p. 4:19): "The Department of Finance has been concerned when tax rates on dividends and capital gains are different. Whenever there is a difference, an arbitrage opportunity arises and taxpayers have an incentive to convert dividends into capital gains or capital gains into dividends to achieve lower taxation."



## Technical Appendix: Methodology

This technical appendix provides an explanation of the methodology used to estimate the impact of corporate and personal capital gains taxes on investment. The theoretical section will be of interest to those familiar with the “user cost of capital,” the workhorse used by economists to analyze the impact of taxes on investment (see Mintz 1995 for a survey that is the basis for the underlying model). Since the inclusion of corporate capital gains taxes in the user cost of capital is a new innovation in our modelling (Bazel and Mintz 2021), I present it here.

When investors and corporations earn capital gains by disposing of their investments, the income is subject to tax. To incorporate the effect of corporate capital gains taxes on investment, I model a company’s decision whereby it invests until the point in which the return on investment per dollar of capital is equal to the user cost of capital. The user cost of capital is comprised of two parts: the replacement cost of depreciation net of real capital gains and the inflation-adjusted cost of finance, with all items adjusted for taxes.

In symbolic terms, the user cost of capital derived in the absence of the corporate capital gains tax is as follows:

$$VMP/q = \frac{(D - \frac{\Delta q}{q} + r)}{(1-u)} (1 - A) \quad (1)$$

*VMP* denotes the value of marginal product per dollar of capital, which is income paid to owners of capital to cover economic depreciation, financing and tax costs. Economic depreciation is conventionally defined as replacement cost of physical wear and tear of capital net of real capital gains earned by holding the asset. *VMP* is net revenues from the marginal investment subject to the corporate income tax levied at the rate  $u$  (hence the user cost is divided by the factor  $(1 - u)$ ), by dividing the left and righthand sides of the above equation by  $(1 - u)$ .

The cost of purchasing capital is reduced by the present value of tax savings from depreciation allowances and investment tax credits ( $A$ ).  $D$  is the physical wear and tear of an asset. The term  $\Delta q/q$  denotes the accrued real capital gains in holding assets. The real cost of finance ( $r$ ) is equal to the nominal financing costs ( $R$ ) net of inflation ( $\Pi$ ). The nominal financing cost is equal to the weighted average of the net of corporate tax cost of debt,  $i(1 - u)$ , and cost of equity,  $e$ , gross of personal taxes on equity returns denoted as  $t'$ :<sup>14</sup>

$$r = R - \Pi = B(i(1-u) + e/(1-t')) - \Pi = (2)$$

The personal income tax is the weighted tax rates on dividends and capital gains, based on the dividend payout ratio,  $a$ , consistent with the traditional model (see Mintz 1995):  $t' = atd + (1-a)tc$  ( $td$  is the personal tax on dividends, and  $tc$  is the effective personal tax rate on accrued capital gains.)

The effective personal capital gains tax rate is measured as if the investor paid taxes on nominal accrued capital gains each year. It is computed by equating the present value of accrual-equivalent capital gains taxes with the present value of capital gains taxes paid on a realization basis. Using the King-Fullerton (1984) method, the personal tax rate on nominal accrued capital gains is estimated using a declining balance formula:

14 Income risk is implicitly included in this formulation by treating the cost of equity finance in certainty-equivalent terms. To do this, it is assumed that any capital losses are fully deductible from gains.

$tc = tc^* a/(a+R)$  with  $tc^*$  = capital gains tax rate on nominal realizations;  $tc$  = accrual-equivalent capital gains tax rate;  $a$  = declining balance realizations propensity and  $R$  = nominal discount rate used by investors.

Now, I introduce the corporate capital gains tax on accrued nominal increases in capital good prices. The accrued gain is equal to real capital gains plus inflation:  $\Delta q/q + \pi$ . Since the corporate capital gains taxes is applied to nominal capital gain realizations, it can be converted to an accrual-equivalent capital gains tax using the same King-Fullerton formula mentioned above for the personal capital gains tax rate. Letting  $c$  denote the accrual-equivalent corporate capital gains tax rate, the tax on nominal accrued capital gains earned on an asset each year is  $c(\Delta q/q + \pi)$ . For simplicity, I shall assume real capital gains is zero.<sup>15</sup> Therefore, the capital gains tax is levied on inflationary gains in capital good prices:  $c\pi$ . With the assumption of zero real capital gains, the user cost of capital becomes:

$$VMP/q = \frac{(D+c\pi+r)}{(1-u)} (1 - A) \quad (3)$$

For each capital good (including inventories), the user cost of capital is increased by the tax on corporate capital gains, which is the basis of our estimates.

The empirical estimate is based on the model developed by Bazel and Mintz (2021) using data provided by Finance Canada. Instead of taking a GDP-weighted average of the G7 countries to measure personal taxes on dividends, capital gains and interest income to measure the cost of equity finance, “home bias” is incorporated by putting a larger weight (35 percent) on the Canadian share (which is otherwise quite small for a diversified world portfolio of equities) for the marginal investor (who is the most highly taxed investor).

The corporate capital gains tax estimate, however, is based only on Canadian corporate taxes paid by the firm. We estimate the realization propensity on a declining balance basis by taking twice times the market value of corporate mergers and acquisitions as a share of corporate equity stock.<sup>16</sup> The corporate income tax rate on realizations is the combined federal and provincial rate (26.1 percent) multiplied by the inclusion rate. Once we estimate the Canadian capital gains tax rates paid by investors and corporations, the user cost of capital is used to determine the effect of an increase in both personal and corporate capital gains taxes on investment, as explained in the text.

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15 Daria Crisan at the University of Calgary School of Public Policy is developing an industry and asset-based real capital gain series for future work.

16 The holding period for assets is measured as the inverse ratio of the value of mergers and acquisitions to the market value of the stock of listed company equity. Statistics on the value of mergers and acquisitions are taken from Institute for Mergers and Acquisitions for Canada averaged over six years. The stock of equity invested in listed Canadian corporations is based on Statistics Canada, Table 36-10-0580-01.

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This E-Brief is a publication of the C.D. Howe Institute.

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