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Federal Budget 2024: How It Impacts You and Your Business

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The Honourable Chrystia Freeland, Deputy Prime Minister of Canada and Minister of Finance, delivered the Liberal Party's federal budget (Budget 2024) on April 16, 2024. Budget 2024 included a number of proposed changes to the *Income Tax Act* (ITA) and other tax legislation.

The most significant tax change in Budget 2024 is an increase in the capital gains inclusion rate from 50% to 66.6%, effective as of June 25, 2024. The budget does include relieving measures for certain individuals that realize capital gains, including enhancements to the lifetime capital gains exemption. As expected, the budget expands on the government's recent announcements related to the Canadian housing shortage by providing incentives for new purpose-built rental housing. Additional incentives are available for productivity-enhancing assets and clean-energy investments. Lastly, the budget contains significant administrative and procedural changes.

General Tax Measures

Increase in the Capital Gains Inclusion Rate and Related Changes

Budget 2024 proposes to increase the capital gains inclusion rate from 50% to 66.6%, effective for capital gains realized on or after June 25, 2024. This change accounts for the vast majority of the projected increased revenue resulting from the Budget 2024 tax changes, with the government projecting an increase of \$19.3 billion of taxes through the 2024–2029 period.

The increased inclusion rate would apply for corporations, individuals and trusts, except that individuals would continue to benefit from a 50% inclusion rate for up to \$250,000 of capital gains realized each year (including capital gains earned through a partnership or trust). The \$250,000 amount would apply to the individual's net capital gains after applying capital loss carryforwards, the lifetime capital gains exemption and the gains sheltered under the new preferential capital gains rules discussed below. The \$250,000 amount would not be prorated for the portion of the taxation year in which the increased inclusion rate applies. Changes would be made to the stock option rules so that qualifying stock option benefits would also be 66.6% included in income. The changes do not appear to provide a \$250,000 exemption for Canadian-controlled private corporations, which represents a shift in the principle that taxpayers should generally be indifferent to realizing capital gains personally or through a Canadian-controlled private corporation they control, and may represent incremental cost to investing through corporations.

Adjustments will be made to carried forward allowable capital losses to reflect the relative inclusion rates in the years in which the losses arose and are applied, so that, in effect, one dollar of capital loss will always offset one dollar of capital gain.

Budget 2024 appears to have viewed tax on capital gains (in particular, tax on capital gains exceeding \$250,000 per year) as a proxy for tax on Canada's wealthiest taxpayers, and explains at length that the changes will impact only a small percentage of Canadian taxpayers – apparently 0.13% of taxpayers and only 0.01% of taxpayers below the age of 30. When the capital gains inclusion rate was last changed in 2000, the purpose of the change was to encourage risk taking and provide greater access to financing. By increasing the capital gains inclusion rate, the budget may reduce further business investment and counteract the incentives discussed below to increase investment in purpose-built rental housing and enhanced productivity equipment.

Budget 2024 does not include draft legislation for the changes described above relating to the capital gains inclusion rate or capital gains exclusions. The increase in the capital gains inclusion rate will require complicated consequential changes throughout the ITA. For example, it is unclear how these rules will apply to taxpayers that realize capital gains prior to June 25, 2024 through a partnership or trust

that allocates the gain to the partner or beneficiary later in the year. Budget 2024 indicates that “additional design details” regarding the required changes will be released in the coming months.

Given that the increase in the capital gains inclusion rate will not be effective until June 25, 2024, taxpayers may wish to consider transactions to trigger unrealized accrued gains before that date while they can still benefit from the lower inclusion rate. In addition, taxpayers who would otherwise be claiming capital loss carryforwards on their 2023 tax returns may consider whether it would be beneficial to defer claiming such carryforwards to capital gains realized after June 25, 2024.

Business Tax Measures

Rental Housing Incentive

As expected, Budget 2024 includes a series of tax measures aimed at incentivizing the development of purpose-built rental housing in Canada.

Budget 2024 increases the available deduction for capital cost allowance (CCA) from 4% to 10% for all eligible purpose-built rental projects that begin construction on or after Budget Day and before January 1, 2031, and are available for use before January 1, 2036. Consistent with the temporary enhancement to the GST New Residential Rental Property Rebate, eligible projects are new purpose-built rental housing projects that are residential complexes with at least four private apartment units or 10 private rooms or suites and in which at least 90% of residential units are held for long-term rental.

Furthermore, Budget 2024 provides for a new broad carve-out from the proposed excessive interest and financing expenses limitation (EIFEL) rules for eligible purpose-built rental housing projects. Prior to Budget 2024, the EIFEL rules contained a narrow carve-out in respect of arm’s-length financing for certain public-private partnership infrastructure projects. Budget 2024 proposes to expand this carveout to apply to eligible purpose-built rental housing projects retroactive to tax years beginning after October 1, 2023. Notably, this includes arm’s-length financing expenses incurred to develop, as well as to acquire, eligible purpose-built rental housing. These EIFEL changes will apply for tax years beginning after October 1, 2023 (i.e., from when EIFEL first came into effect).

Budget 2024 also includes amendments to the *Excise Tax Act* (ETA) to ensure that universities, public colleges and school authorities can claim the enhanced GST Rental Rebate on eligible purpose-built rental housing, announced on September 14, 2023.

Finally, the government proposes in Budget 2024 to launch a consultation on a potential new tax on residentially zoned vacant land.

Productivity Enhancing Assets

Budget 2024 also provides for accelerated CCA on certain “productivity enhancing” depreciable assets, namely, patents, data network infrastructure and related software, general-purpose electronic data-processing equipment and systems software. Currently, taxpayers may take CCA in respect of such assets at a rate of 25%, 30% and 55%, respectively. Budget 2024 proposes to provide immediate expensing for new additions of property in respect of these three classes, provided such property is acquired on or after Budget Day and becomes available for use before January 1, 2027.

Clean Electricity and Manufacturing Tax Credits

Budget 2024 includes proposed legislation in respect of the Clean Electricity Investment Tax Credit, a 15% refundable investment tax credit initially announced in the 2023 Fall Economic Statement in respect of capital expenditures for eligible clean electricity capital expenditures, including expenditures in respect of solar, wind, hydro and nuclear energy projects, or natural gas with carbon capture and storage. Budget 2024 provides that this refundable tax credit is only available to provincial and territorial Crown corporations, corporations owned by municipalities and by indigenous communities, pension investment corporations and taxable Canadian corporations, whereas previously it was understood this could be claimed by trusts. Notably, to avail themselves of this tax credit, provincial and territorial Crown corporations must publicly commit to working towards a net-zero electricity grid by 2035 and to passing on the value of the tax credit to electricity ratepayers in their province or territory to reduce ratepayers’ bills, and must further publicly

report, on an annual basis, on how the tax credit has improved ratepayers' bills, failing which they will be subject to a penalty. To qualify for the full 15% credit, certain labour requirements would need to be met. If the requirements are not met, the credit is reduced to 5%.

Budget 2024 also updates the Clean Technology Manufacturing tax credit, the 30% refundable tax credit for eligible expenditures in respect of clean technology manufacturing announced in Budget 2023, to accommodate projects producing several types of metals. It also includes a safe harbour to limit the recapture under these rules in the event that a taxpayer obtains a tax credit in respect of a property whose use would no longer qualify for the tax credit within a 10-year period following its acquisition.

Budget 2024 introduces a new 10% tax credit (in addition to the 30% Clean Technology Manufacturing tax credit) on the cost of buildings used in electric vehicle assembly, electric vehicle battery production and cathode active material production.

Finally, Budget 2024 includes certain technical rules relating to the integration of the Clean Electricity Investment Tax Credit with other federal tax credits (including the 30% Clean Technology Manufacturing tax credit), as well as rules governing the availability of the tax credit in respect of expenditures made by project partnerships, including clarifications that each partner of a partnership may claim either the Clean Electricity Investment Tax Credit and the Clean Technology Investment Credit based on its reasonable share of either credit for which they are qualified.

Canada Carbon Rebate for Small Businesses

Budget 2024 expands the Canada Carbon Rebate to provide a new automatic refundable tax credit based on provincial fuel charge proceeds that will be available to Canadian-controlled private corporations with no more than 499 employees in the calendar year in which the fuel charge year begins. The credit will be determined based on the number of persons employed by the corporation in a province and the rate specified by the Minister of Finance for the province for the corresponding fuel charge year. There is no need for small businesses to apply for the tax credit; the Canada Revenue Agency (CRA) will automatically determine eligibility and apply the tax credit.

Synthetic Equity Arrangements

Subject to a growing list of exceptions, dividends paid between Canadian corporations are eligible for an offsetting "dividend received deduction" in order to avoid multiple layers of tax on the same income. A specific anti-avoidance rule in respect of "synthetic equity arrangements" denies the dividend received deduction where the corporate taxpayer has transferred all, or substantially all, of the risk of loss and opportunity for gain or profit to a counterparty. Budget 2024 proposes to expand these anti-avoidance rules by eliminating the exceptions that currently exist for arrangements that are traded on a derivatives exchange, or where the corporate taxpayer can establish that "tax-indifferent investors" do not have all of the economic exposure to the shares. This proposal represents a continuation of the trend of limiting the dividend received deduction as was seen last year with the restriction of the dividend received deduction for financial institutions. This proposal would apply to dividends received on or after January 1, 2025.

Mutual Fund Corporations

A mutual fund corporation is a pooling vehicle for investment subject to special rules to integrate corporate and shareholder level tax (such as the capital gain refund mechanism). Budget 2024 proposes to adjust the definition of a mutual fund corporation so that a corporation could not qualify if the corporation is controlled by or for the benefit of a person or partnership (or any combination of persons or partnerships that do not deal with each other at arm's length) that holds in aggregate more than 10% of the fair market value of all of the issued and outstanding shares of the corporation. The draft legislation provides a limited safe harbour during the first two years of incorporation and the aggregate fair market value of the shares held by the controlling person, partnership or group does not exceed \$5 million. Budget 2024 indicates that exceptions will be provided for widely held vehicles. This change would apply to taxation years that begin after 2024.

Bankrupt Corporations Subject to Debt Forgiveness Rules

The ITA contains debt forgiveness rules that reduce tax attributes of taxpayers that have settled indebtedness for an amount less than its principal amount. Generally, these rules do not apply to bankrupt taxpayers which are subject to specific loss restrictions. Budget 2024 includes a targeted change that would remove the exclusion of bankrupt corporations (but not individuals) from the debt forgiveness rules in the ITA. The exclusion from the debt forgiveness rules had been relied on by certain taxpayers to avoid the loss of tax attributes under the debt forgiveness rules while also not completing the bankruptcy – arrangements which are already targeted by requiring such arrangements to be reported under the notifiable transaction rules. This change would apply to bankruptcy proceedings that begin on or after Budget Day.

Non-Resident Service Providers

Budget 2024 proposes to broaden the CRA's authority to issue waivers of "regulation 105" withholding on payments to non-resident service providers. The expanded authority would apply to non-resident service providers that are exempt under a tax treaty or are engaged in certain types of transportation businesses that are not subject to tax in Canada, and would allow the CRA to waive withholding for all transactions over a period of time, but would apparently still require an application for the waiver to be filed with the CRA.

Scientific Research and Educational Development

One of the technical background documents accompanying Budget 2024 indicates that there will be a modernization of scientific research and experimental development tax incentives, but no further details are provided.

Encouraging Investment by Canadian Pension Plans

Budget 2024 proposes to launch a working group to find opportunities for Canada's largest pension plans to increase investment in Canada.

Digital Services Tax

The Canadian government previously proposed legislation to implement a digital services tax, which would impose a 3% tax on certain Canadian-source revenue of digital businesses, but it has been unclear when this new tax would come into effect. Budget 2024 confirms that the digital services tax is intended to come into effect in 2024, with the initial payments, due in 2025, covering digital revenue back to 2022.

Personal Tax Measures

Lifetime Capital Gains Exemption Changes

The lifetime capital gains exemption limit will be increased from the current approximate \$1 million to \$1.25 million for the remainder of 2024 and 2025, with indexation resuming in 2026.

Canadian Entrepreneurs' Incentive

Budget 2024 proposes a new Canadian Entrepreneurs' Incentive (CEI), which would function as an enhanced lifetime capital gains exemption for a narrower range of taxpayers, with a lifetime limit of up to \$2 million per taxpayer, and reduce the capital gains inclusion rate to 33.33% for the covered capital gains. The maximum gains covered by the CEI would start at \$200,000 in 2025, and thereafter increase by \$200,000 per year until 2034.

To qualify for the CEI, a selling shareholder must meet the requirements to claim the lifetime capital gains exemption and in addition: (i) the individual would need to be a "founding investor" in the business from the time it was initially capitalized that has always directly held shares accounting for at least 10% of the votes and value, (ii) the individual would need to be actively engaged in the business on a regular, continuous and substantial basis, and (iii) the corporation must not be a professional corporation and the business must not fall into certain prohibited categories including a business where the principal asset of which is the skill or reputation of an individual; a business in

the financial, insurance, real estate, food and accommodation, arts, recreation or entertainment sectors; or a business providing consulting or personal care services.

Employee Ownership Trusts

Budget 2024 also provides further details on a proposal from the 2023 Fall Economic Statement to exempt (EOT Exemption) up to \$10 million of capital gains resulting from the sale of shares to a employee ownership trust (EOT) pursuant to a "qualifying business transfer" (as defined in the previously proposed EOT rules). The \$10 million exemption would need to be split, by agreement, among all of the individuals transferring shares in the qualifying business transfer. In order for an individual to qualify for the EOT Exemption, the shares must have been owned by the individual (or certain related persons or partnerships) through the preceding 24 months; during that 24 month period more than 50% of the corporation's assets must have been used principally in an active business (though not necessarily an active business in Canada) (50% asset test); at some time prior to the transfer the individual (or a spouse) must have been actively engaged in the business on a regular and continuous basis for a period of at least 24 months; and immediately after the transfer to the EOT, at least 90% of the beneficiaries of the EOT must be Canadian residents. The EOT Exemption will also not apply to shares of a professional corporation.

The EOT Exemption is also contingent on a "disqualifying event" not occurring. A disqualifying event will occur if the trust loses its status as an EOT or if the corporation fails to meet the 50% asset test at the beginning of two consecutive taxation years. If a disqualifying event occurs within three years after the transfer, then the EOT Exemption would be retroactively denied, and the EOT would be jointly and severally liable for the transferring individual's resulting tax. If the disqualifying event occurs after the three-year mark then the EOT would be deemed to realize a capital gain equal to the capital gain sheltered under the EOT Exemption and would be solely liable for the tax on the deemed capital gain.

Budget 2024 also proposes to fully exempt EOTs from the alternative minimum tax and to extend the normal reassessment period of an individual for a taxation year in respect of which the EOT Exemption is utilized by three years.

Alternative Minimum Tax

A number of changes are proposed to amendments to the alternative minimum tax (AMT) first announced in Budget 2023. Budget 2024 proposes to revise the tax treatment of charitable donations to allow individuals to claim 80% of the charitable donation tax credit (rather than 50% as previously proposed) in the AMT calculation. Employee ownership trusts will be exempt from AMT, as will certain Indigenous settlement and community trusts. Other technical amendments would allow previously disallowed credits under the AMT to be eligible for carryforward. These amendments would apply to taxation years that begin on or after January 1, 2024. Budget 2024 further proposed that capital gains exempt under the new Canadian Entrepreneurs' Incentive described above will be subject to a 30% inclusion rate for AMT purposes.

Qualified Investments for Registered Plans

Budget 2024 invites stakeholder feedback on the qualified investment rules applicable to registered plans such as Registered Retirement Savings Plans and Tax-Free Savings Accounts by July 15, 2024. The range of assets that satisfy the qualified investments rules varies from one registered plan to another, for example as regards small business investments, pooled investment products and annuities. The government is seeking input on, among other considerations, whether the qualified investment rules should be harmonized, and whether and how the qualified investment rules could promote an increase in Canadian-based investments. Any changes may provide registered plans a wider range of investment products, including greater access to so-called alternative assets (such as private equity, infrastructure and private credit) that have been largely unavailable for these plans in the past.

Expanded Tax Administration and Enforcement Powers

Non-Compliance with Information Requests

Budget 2024 includes a number of measures which strengthen the CRA's audit powers, all of which come into force on royal assent of the enacting legislation. Similar rules will be enacted to the ETA, the *Excise Act* (EA), the *Select Luxury Items Tax Act* (SLITA), and the *Underused Housing Tax Act* (UHTA). These broadened powers follow on the heels of the December 15, 2022 enactments that expanded the CRA's audit powers to include, among others, the ability to compel oral interviews and require taxpayers to provide information in the form specified by the CRA (e.g. charts, spreadsheets, tables, etc.).

Notice of Non-Compliance

First, Budget 2024 introduces a "notice of non-compliance," which can be issued by the CRA to a taxpayer that has not complied in part or in full with an existing audit request or demand. A person who is issued such a notice of non-compliance will be subject to a penalty of \$50 for each day that the notice is outstanding, to a maximum of \$25,000. In addition, while such notice of non-compliance remains outstanding, the limitation period within which the CRA may reassess a taxpayer will be suspended. A taxpayer served with such notice may request that the CRA review the decision to issue the notice, and may make representations in that regard. This review is itself reviewable by the Federal Court. If the notice of non-compliance is ultimately vacated by the CRA or the Court then the penalty would not apply, though the suspension of the limitation period is not reversed.

Compliance Order Penalty

In addition, Budget 2024 introduces additional penalties for non-compliance with an audit request. Currently, the CRA may make an application to the Federal Court for a compliance order in cases where taxpayers have not complied with audit requests (i.e. demands or requests for information). Budget 2024 proposes to further expand these compliance order powers by imposing a penalty on the taxpayer equal to 10% of the aggregate tax payable in respect of the taxation year or years to which the compliance order relates.

The penalty would only be applied if the tax owing in respect of one of the taxation years to which the compliance order relates exceeds \$50,000.

Questioning Under Oath or Affirmation

The enactments that provided the CRA with the ability to compel oral interviews came into force on December 15, 2022. Now, Budget 2024 proposes a further expansion of these powers by providing that a person may be required to provide answers to questions, information and documents either orally under oath or affirmation or by way of affidavit. This introduces the risk that statements made by taxpayers (oral or written) during their audit could be used in later proceedings, potentially to perjure the taxpayer or in connection with the application of penalties, fines, or even imprisonment.

Extension to Information Sought by Foreign Countries

The CRA's ability to request foreign-based information or documents was historically limited to the administration and enforcement of the ITA. Budget 2024 expands this ability by extending the meaning of "foreign-based information or document" to include any information or document located outside of Canada that may be relevant to a listed international agreement or a tax treaty with another country. Budget 2024 also provides that these powers extend to CRA collection actions.

Avoidance of Tax Debts

The ITA contains rules that are intended to ensure that a taxpayer cannot avoid payment of a tax debt by transferring assets to a non arm's-length person for inadequate consideration. According to Budget 2024, certain taxpayers have allegedly undertaken transactions that avoid the application of these rules by transferring property through intermediary persons. Budget 2024 includes a number of proposed changes that expand these rules, including by holding the intermediary persons jointly and severally liable for the full amount of the avoided tax debt, including any portion that has effectively been retained by the intermediaries. These rules will apply to transactions that occur on or after Budget Day. Similar rules will be enacted to the ETA, EA, the SLITA and the UHTA. These changes would apply to transactions that occur on or after Budget Day.

Reduced Penalties on Reportable and Notifiable Transactions

In a very minor relaxation of the recently enacted rules regarding reportable and notifiable transactions, Budget 2024 proposes that the ITA's general penalty for failure to file information returns would not apply to failures to file reports regarding reportable or notifiable transactions, with the rationale that failure to file such report is covered by specific penalties in the rules for reportable and notifiable transactions. This change would be retroactively effective from June 22, 2023 when reportable and notifiable rules came into effect.

Crypto Reporting

Budget 2024 proposes to implement the Organization for Economic Co-operation and Development's crypto asset reporting framework (CARF) in Canada. These changes would require additional reporting from entities and individuals that are resident or carry on business in Canada, and provide business services effectuating the exchanges of crypto assets. Such service providers would be required to obtain and report information about their customers, as well as information about transactions involving crypto assets, such as exchanges of crypto assets for other crypto assets or currency, and transfers of crypto assets by customers to merchants as payment for the provision of goods or services with a value exceeding \$50,000.

Common Reporting Standard

Further to the implementation of the CARF, Budget 2024 proposes to expand common reporting standard (CRS) reporting requirements to include specified electronic money products and central bank digital currencies not covered by the CARF. These changes will include amendments to implement proper coordination between the CRS and CARF and increase the information reporting requirements and enhance due diligence procedures required of financial institutions. Finally, specific amendments to modify the reporting requirements relating to non-registered accounts held in labour-sponsored venture capital corporations (such that they are more closely aligned with those applicable to registered accounts such as Registered Retirement Savings Plans) and to strengthen certain anti-avoidance provisions in the CRS are also proposed.

Measures relating to the CARF and CRS are proposed to apply to the 2026 and subsequent calendar years, with the first reporting under these rules due in 2027.

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