

# Expropriations and the Proposed Increased Capital Gains Inclusion Rate

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By Michael Ding

Federal Budget 2024 announced an increase of the capital gains inclusion rate from one-half (1/2) to two-thirds (2/3) on capital gains realized on or after June 25, 2024. The first \$250,000 of capital gains realized per year by an individual would remain subject to the 50% inclusion rate.

In light of these proposed changes coming into effect on June 25, the timing of when capital gains arise has taken on new importance and some urgency where parties are in the midst of disposing of capital assets such as real property, including in the context of expropriations. As discussed below, in the context of an expropriation, the higher inclusion rate may apply even where the transfer of the property has already occurred.

In a non-expropriation/voluntary disposition context, the general rules of disposition pursuant to the *Income Tax Act* (Canada) apply when the proceeds are received and taxable. That is, capital gains are generally realized on closing (subject to a capital gains reserve where a portion of the proceeds are not receivable in the year of disposition).

However, special rules of disposition apply in an involuntary disposition context (e.g. expropriation). These rules apply to proceeds of disposition that are:

(a) compensation for property unlawfully taken;

(b) compensation for property destroyed, or any amount payable under a policy of insurance in respect of loss or destruction of property; and,

(c) compensation for property taken under statutory authority or the sale price of property sold to a person by whom notice of an intention to take it under statutory authority was given.

In an expropriation context, "C" will generally be satisfied where the expropriated party:

(i) has received written indication of an intent to expropriate, including a Notice of Application for Approval to Expropriate Land from the authority; or

(ii) has the property expropriated (i.e. a plan of expropriation has been registered on title).

Where the proceeds of disposition from the expropriated property satisfies the above, then the disposition of the property is deemed to generally occur and the proceeds of disposition to be receivable at the earlier of:

(a) the day the taxpayer has agreed to an amount as full compensation to the taxpayer for the property lost, destroyed, taken or sold,

(b) where a claim, suit, appeal or other proceeding has been taken before one or more tribunals or courts of competent jurisdiction, the day on which the taxpayer's compensation for the property is finally determined by those tribunals or courts,

(c) where a claim, suit, appeal or other proceeding referred to in paragraph (b) has not been taken before a tribunal or court of competent jurisdiction within two years of the loss, destruction or taking of the property, the day that is two years following the day of the loss, destruction or taking,

(d) the time at which the taxpayer is deemed to have disposed of the property because of the death or emigration from Canada of the taxpayer, and

(e) where the taxpayer is a corporation, the time immediately before the winding-up of the corporation (other than a tax-deferred wind-up of a subsidiary corporation).

The expropriated party is deemed to have owned the property continuously until the time is determined as per the above. Capital gains on the disposition of the property would be determined on the date in which the proceeds of disposition are receivable (based on (a) to (e) above).

Some payments that an expropriating authority makes to an owner will not trigger a disposition. Where there has been an expropriation, an expropriating authority may be required to offer an advance payment of the authority's estimate of the market value compensation and injurious affection on a without prejudice basis before taking possession of lands it has expropriated. If the owner accepts such a without prejudice payment, it would not generally trigger a disposition of the expropriated property. Similarly, an agreement between an expropriating authority and an owner providing for a without prejudice payment of the compensation, in which the owner reserves the right to claim additional compensation under the relevant expropriation statutes would not on its own trigger a disposition of the expropriated property. Simply put, interim payments would not by itself trigger a disposition of the expropriated property provided that the parties have not otherwise reached a final settlement in respect of the total proceeds.

Where an expropriated party elects and obtains a replacement property in accordance with the *Income Tax Act* (Canada), the capital gains from the disposition of the expropriated property ("former property") can be deferred. The time and amounts deferred depend on the facts. If the replacement property rules apply, then the ultimate disposition of the replacement property would include some gains from the disposition of the former property that were not otherwise realized due to the rollover. These factors may affect the total amount of taxes paid in light of the capital gains inclusion rate increase under Federal Budget 2024. For example, a deferred amount may, in whole in part, be subject to a higher capital gains inclusion rate when realized on the eventual disposition of the replacement property.

If the intention of an owner of an expropriated property or a property identified to be expropriated in a written notice is to take advantage of the lower capital gains inclusion rate before June 25, they may wish to look into whether the special rules of disposition can be triggered (e.g., agreement to full compensation under (a) above) so that capital gains on the property can be crystallized prior to June 25. However, where an owner is in a legal proceeding against the expropriating authority, it may be more beneficial (e.g., from a time value of money perspective) to take advantage of the special rules of disposition and defer the capital gains. Given the ongoing delays affecting Canadian courts, these special rules could provide owners with an avenue to defer the capital gains and accordingly from paying tax on the disposition of their expropriated property for years to come.

***The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.***

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