

Capital Gain Inclusion Rate Draft Legislation Released

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To the chagrin of many tax professionals, today's release of draft legislation implementing the increase of the capital gains inclusion rate announced in Budget 2024 did not defer the effective date of the increase. It remains June 25, 2024.

The draft legislation addresses some uncertainties that advisors and their clients faced with the general Budget 2024 announcement. Below, we comment on select aspects of the draft legislation.

Graduated Rate Estates and Qualified Disability Trusts

The Budget 2024 announcement provided that the first \$250,000 of capital gains realized per year by an individual would be subject to a one-half inclusion rate. The draft legislation released today helpfully clarifies that graduated rate estates and qualified disability trusts will also benefit from this \$250,000 threshold in respect of capital gains that are not allocated to a beneficiary in the year. Graduated rate estates and qualified disability trusts are subject to the same progressive personal income tax rate structure as individuals.

Capital Gains Reserve

With respect to the capital gains reserve, it would have been equitable for pre-June 25 dispositions to be subject to the one-half inclusion rate regardless of the year that the gain is brought into income. Unfortunately, the draft legislation provides that the portion of the capital gains reserve brought into income in a taxation year will be subject to the capital gains inclusion rate applicable at the start of the year. Accordingly, taxpayers that were utilizing the capital gain reserve or were planning on utilizing the reserve for dispositions that occurred in a taxation year ending prior to June 25 will need to consider whether to utilize or continue to utilize the reserve – and pay capital gains at the two-thirds inclusion rate for the portion of the reserve brought into income in years starting on or after June 25– or to forego all or a portion of the reserve and pay capital gains at the one-half inclusion rate on the forgone reserve brought into income in the first taxation year ending on or after June 24. As the reserve is predicated on proceeds being receivable after a taxation year, cash flow considerations will be an important and potentially determinative consideration.

Net Capital Losses

Net capital losses can generally be carried back three years and carried forward indefinitely to offset capital gains in other years. To account for the changes in capital gains inclusions rate, an additional adjustment factor is to be applied to calculate the value of a net capital loss from another year in the year the loss is to be used. The applicable adjustment factor is set out as follows:

	Inclusion Rate of Offsetting Capital Gain in Year Loss is to be used	
Inclusion Rate at Time of Capital Loss	One-Half	Two-Thirds
One-Half	1	4/3

The adjustment factors are consistent with the indication in Budget 2024 that pre-June 25 capital losses will be able to fully offset post-June 24 capital losses. Where a taxpayer has net capital gains under two inclusion rates, net capital losses are applied first to offset capital gains subject to the higher inclusion rate. Taxpayers may wish to consider delaying the carry forward of capital losses, or not carrying back capital losses to offset pre-June 25 gains, in order to later utilize such losses against capital gains that are subject to the higher inclusion rate.

Allowable Business Investment Losses (ABILs)

ABILs can be carried back three years and carried forward 10 years to offset income from any source. The deductible portion of ABILs realized on or after June 25, 2024 will increase from one-half to two-thirds. Unlike net capital losses above, the amount of ABILs are not subject to an adjustment factor and will always be determined with reference to the two-thirds inclusion rate. Accordingly, there is no inherent disincentive to carry back an ABIL to a year to offset capital subject to the current one-half inclusion rate.

Disposition of Taxable Canadian Property by Non-Residents

The withholding rate applicable to acquisitions of “taxable Canadian property” (e.g., real estate, Canadian resource property, etc.) from non-residents is to increase from 25% to 35% applicable to acquisitions that occur on or after January 1, 2025.

Employee Stock Options

Employees claiming employee stock option deductions, when available, will have a basic one-third deduction of the taxable benefit for stock options exercised or disposed of, or for shares (generally of a CCPC) with a crystallized but deferred taxable benefit (under subsection 7(1.1) of the *Income Tax Act* (Canada)) are disposed of, on or after June 25, 2024. Consistent with the first \$250,000 of capital gains realized per year by an individual remaining subject to the one-half inclusion rate, the employee stock option deduction is increased to one-half of the benefit up to \$250,000 annually. One \$250,000 limit applies to the aggregate of an individual's employee stock option benefit and capital gains. When the total employee stock option benefits and capital gains exceed \$250,000, the technical backgrounder released with today's draft legislation indicates that the allocation of the preferential treatment will be at the taxpayer's discretion.

Allocations from Partnerships and Trusts

The draft legislation contains transitional rules designed to ensure that capital gains allocated to members of partnerships and trusts are subject to the inclusion rate that would have been applicable had the member realized the capital gain directly. An exception to this rule is that commercial trusts (e.g., mutual fund trusts) will have the option of electing the capital gains allocated to investors to have been realized by them proportionally within the two periods (the period in the trust's taxation year ending June 24, 2024, and the period in the trust's taxation year after June 24, 2024) based on the number of days in each period divided by the number of days in the trust's taxation year.

Conclusion

The draft legislation provides welcome clarity on how the capital gains inclusion rate increase will be implemented. However, the timing of the release – just 14 days before the effective date – is questionable. It is unclear why the effective date could not and should not have been pushed back to January 1, 2025. This would have provided taxpayers and their advisors time to comment on the draft legislation, potentially leading to changes or refinements that might have material consequences on taxpayers'

crystallization/realization choices, and would have avoided or simplified transitional rules (at least for taxpayers that have December 31 year ends).

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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