What You Need to Know About the Capital Gains Inclusion Rate Increase

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On June 10, 2024, the Department of Finance Canada ("Finance") issued a Notice of Ways and Means Motion ("NWMM") that provided additional information and clarity on the measures proposed in the 2024 federal budget ("Budget 2024"). One of the most notable takeaways is Finance's confirmation of its intention for the increased capital gains inclusion rate to take effect for gains realized on or after June 25, 2024. We have summarized these takeaways below.

1. Capital gains inclusion rate

As summarized in our article **Federal Budget 2024: 4 Key Takeaways for Tax Planning**, Budget 2024 proposed an increase to the capital gains inclusion rate for corporations and trusts from 50% to 66.67% for dispositions that occur on or after June 25, 2024. Additionally, Budget 2024 proposed an increase from the 50% inclusion rate applicable to gains realized by individuals to 66.67% for the portion of gains that exceed $250,000 in a year.

In addition to confirming that the increased inclusion rates are still intended to come into effect, the NWMM provided the following additional details:

1. Individuals will continue to be entitled to a deduction of 50% of the taxable benefit for the combined limit of $250,000 for both employee stock options and capital gains, but any amounts in excess of $250,000 will have a 33% deduction of the taxable benefit due to the new capital gains inclusion rate.
2. Each individual will have access to their own $250,000 threshold where there is a property that is jointly owned by multiple individuals.
3. Graduated rate estates and qualified disability trusts will also qualify for the $250,000 threshold for capital gains that are not allocated to a beneficiary in the year. Taxpayers with capital gains and employee stock option benefits that exceed $250,000 will have the discretion to determine where they want to allocate their $250,000 threshold to access the 50% capital gains inclusion rate.
4. Currently, individuals can choose to have proceeds from the disposition of a capital property be payable over a maximum period of five years, with certain circumstances that allow a reserve to be claimed over the course of ten years. The NWMM states that if the payout of the reserves begins before June 25, 2024, and ends afterwards, the 50% inclusion rate rather than the increased rate will apply.

2. Capital dividend account ("CDA") calculation
For taxation years that start before June 25, 2024, and end after June 24, 2024, it is important to note that there will be a blended rate applied to all dispositions in the taxation year to determine the CDA balance. One may assume that the old rate would apply prior to June 25 and the new rate would apply afterwards, but absent any further amendments, that is not the case. A rate will be calculated based on the capital gains received before and after June 25 and that rate will be applied to the entire year. This could lead to a different CDA balance than one might anticipate; therefore, properly using the blended rate can save a taxpayer from negative tax consequences that may result from the corporation paying a capital dividend in excess of its CDA balance.

3. Allowable business investment losses
Finance clarifies that the deductible portion of an allowable business investment loss will also increase to 66.67% for losses realized on or after June 25, 2024. The 66.67% inclusion rate will still apply even if the losses are carried back and applied in any of the three previous years. Therefore, if possible, it would be more beneficial to realize an allowable business investment loss after June 25, 2024, if an individual plans to carry back the losses to any of the three previous years.

4. Capital gains from trusts, mutual funds and partnerships
Finance confirms that where trusts have a taxation year that begins before June 25, 2024, and ends after June 24, 2024, the amount designated in respect of its net taxable capital gains would be grossed up and deemed to be capital gains realized by the beneficiary at the time that the trust disposed of the relevant capital property, which would either be before June 25 or after June 24. As a result, gains realized before June 25 would be doubled and gains realized after June 24 would be increased by 1.5x. Trusts will also be required to disclose to their beneficiaries the portion of the capital gains related to dispositions of property that occurred before and after the June 25, 2024, changes. If they do not, the deemed capital gains would be deemed to have been realized after June 24, 2024.

Finance advises that any capital gains dividend received on or after June 25, 2024, by shareholders of mutual fund corporations would be taxed based on when the corporation realized the underlying capital gain. Again, the amount would depend on whether the gain was realized before June 25 or after June 24. Similarly, the corporation will be required to disclose to its shareholders the portion of the capital gains dividend that occurred before and after the changes, and if it does not, the capital gains would be deemed to have been realized after June 24, 2024.

Finance clarifies that when a partnership realizes a taxable capital gain, allowable capital loss or allowable business investment loss in a fiscal period that begins before June 25, 2024, and ends after June 24, 2024, it will be grossed up and deemed to be a capital gain, capital loss or business investment loss upon allocation from the partnership to each partner. As previously mentioned, if the amount is realized before June 25, 2024, it will be grossed up more than amounts realized after June 24, 2024.

5. Non-resident withholding rate

Finance states that it will be increasing the withholding rate applicable to non-resident dispositions of taxable Canadian property that occur on or after January 1, 2025, from 25% to 35%.

Finance also confirms that there will need to be additional consequential amendments to other tax rules due to the new inclusion rate for capital gains, one of which will be to the proposed changes to the alternative minimum tax rules. Draft legislation and implementation details on the Canadian Entrepreneurs' Incentive will be made available at the end of July 2024. Our tax group will provide an update on such details as they are made available.

6. Royal Assent of new bills

Lastly, it is worth noting that on June 20, 2024, the Budget Implementation Act, 2024, No. 1 ("Bill C-69") and the Fall Economic Statement Implementation Act, 2023 ("Bill C-59"), received Royal Assent and became enacted. Included within Bill C-59 are the general anti-avoidance rule ("GAAR") amendments, which strengthen the GAAR and generally apply to transactions that occurred after 2023.

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