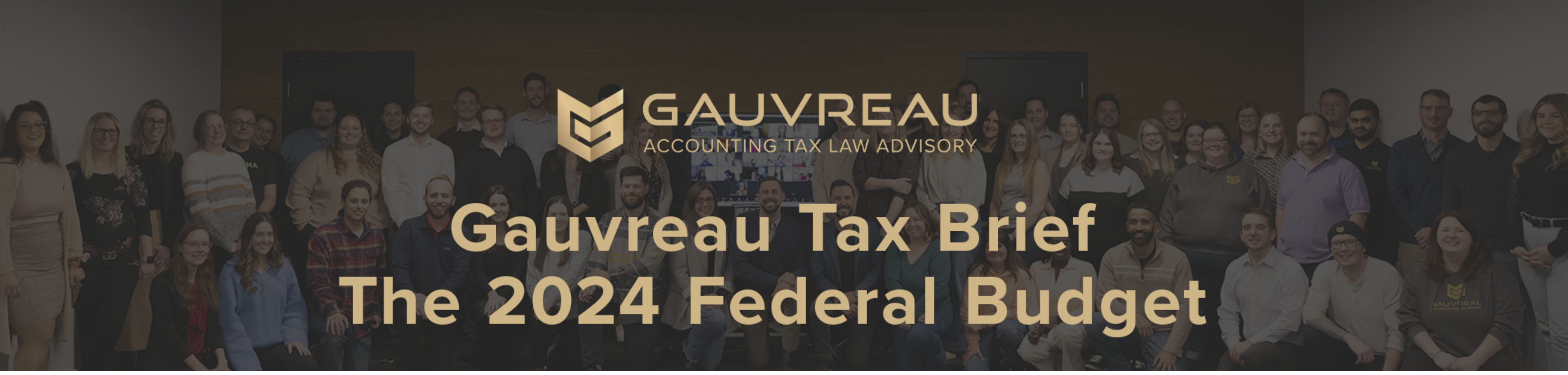

Gauvreau Tax Brief
The 2024 Federal Budget

On April 16, 2024, the Honourable Chrystia Freeland, Canada's Deputy Prime Minister and Minister of Finance, tabled the 2024 Federal Budget.

Here are just a few of the highlights:

- The government projects a budget deficit of $39.8 billion for the 2024-2025 fiscal year.
- There were no changes proposed to personal or corporate income tax rates.
- Effective June 25, 2024, the capital gain inclusion rate will be increased from 1/2 to 2/3 for certain capital gains realized by individuals in excess of $250,000 and for all capital gains realized by corporations and trusts. This proposal comes after years of speculation on whether the government will increase the capital gain inclusion rate.
- The lifetime capital gains exemption will be increased to $1.25 million for dispositions on or after June 25, 2024, and will continue to be indexed to inflation beginning in 2026.
- A newly introduced Canadian Entrepreneurs' Incentive will reduce the capital gain inclusion rate to 1/3 for dispositions of shares of certain small business corporations.
- The tax measures announced in the 2024 Federal Budget are expected to generate $21.9 billion in total revenue over five years.
- The government reiterated its commitment to "invest in building more homes, faster, creating good-paying jobs, and incentivizing economic growth that delivers fairness for every generation."

Our tax team has combed through the 500+ pages of budget documents, and our commentary below focuses only on the proposed tax changes that are most likely to be of interest or concern to our clients who are business owners or have a high net worth. If you're interested in how the Federal government plans to spend taxpayer dollars for the coming year, including on measures such as healthcare, housing, student loans, and other priorities, or in reading on some of the more niche tax proposals, you can access the budget documents at **this link.**

Note that these measures are proposed and not yet law until draft legislation passes all required readings in the House of Commons and Senate and receives royal assent.

PERSONAL INCOME TAX MEASURES

Capital Gains Inclusion Rate

The 2024 Federal Budget proposes to increase the inclusion rate from 1/2 to 2/3 for all capital gains realized by corporations and trusts, as well as certain capital gains in excess of $250,000 realized in a year by individuals, effective for dispositions occurring on or after June 25, 2024.

Here are our some of our observations and initial thoughts on how this change may affect individuals, with our comments for corporations and trusts following in another section:

- Those who realize $250,000 or less in capital gains in 2024 and future years would continue to only include 1/2 of the amount in their income as the taxable capital gain. These individuals are unaffected by this proposal.

- The $250,000 threshold is a net amount – the 2/3 inclusion rate applies only if the total capital gains realized in a year exceed the sum of capital losses in that year, capital losses of other years applied to the that year, and the amount of capital gains in respect of which the Lifetime Capital Gains Exemption, the Employee Ownership Trust Exemption or the Canadian Entrepreneurs' Incentive is claimed.

- All capital gains realized prior to June 25, 2024, will continue to benefit from the lower 1/2 inclusion rate. There may be an incentive for some individuals to crystallize a portion of their capital gains before that date, but this benefit needs to be weighed against the cost, which is giving up any tax deferral you might otherwise have by selling in a future year. Keep in mind that the date a capital gain is realized on a sale of securities traded on a stock exchange is the settlement date, not the trade date.

- On and after June 25, 2024, only the amount in excess of $250,000 is subject to the higher inclusion rate. For example, an individual realizing $350,000 of net capital gains as described above would include $191,667 in their income as a taxable capital gain, calculated as ($250,000 x 1/2) + ([$350,000 - $250,000] x 2/3).

- Planning becomes very important in the years leading up to an event that triggers a larger than usual capital gain, such as a sale of a business, rental property, or cottage. Consideration should be given to strategies that may allow realizing or crystallizing capital gains before June 25, 2024, or over the course of several years to avoid the higher 2/3 inclusion rate, if applicable.

- Capital gains that result from deemed dispositions are also affected, such as those realized upon an individual's death or upon ceasing to be a resident of Canada. Assuming an individual is subject to tax in a high combined Federal and provincial tax bracket of 54 per cent, which is common in the year of death or emigration, this increase in the inclusion rate from 1/2 to 2/3 causes an additional 9 per cent tax on capital gains. Providing gradual advances on inheritances while alive may become a more common planning technique.

- It's unclear whether the increased inclusion rate may be avoided by claiming a capital gains reserve. For example, instead of realizing a $1 million capital gain with $750,000 being subject to the 2/3 inclusion rate, could an individual who sells a business or property and who does not receive all proceeds on closing claim a reserve to defer the gain and circumvent the $250,000 threshold by spreading the total capital gain over multiple years? The budget does not include draft legislation on this measure, and so time will tell whether this planning is possible.

- Parallel changes are proposed for the taxation of employee stock option benefits, which will have a similar effective inclusion rate, and which will need to be considered in combination with an individual's capital gains when determining whether the $250,000 threshold is exceeded.

Keep in mind that the government has not provided any draft legislation for this new measure, and so these rules, and our interpretation of them, may change once that legislation becomes available.

Lifetime Capital Gains Exemption (LCGE)

The 2024 Federal Budget proposes to increase the LCGE from the current lifetime limit of $1,016,836 to $1.25 million for dispositions that occur on or after June 25, 2024. The exemption would continue to apply only to capital gains realized on the disposition of qualified small business corporation shares and qualified farm or fishing property. The LCGE's indexation to inflation would be temporarily paused and would resume in 2026.

As a planning point, those with a pending sale of shares or property that qualifies for the LCGE and which closes prior to June 25, 2024, may want to consider whether deferring the sale is possible to access the increased exemption, while considering any associated risks of doing so.

Canadian Entrepreneurs' Incentive (CEI)

The CEI introduces a new way for small business owners to reduce the effective tax rate on a capital gain realized on a sale of certain qualifying shares by reducing the inclusion rate by one half of the prevailing inclusion rate. This new measure would be effective for dispositions that occur on or after January 1, 2025. The reduced capital gains inclusion rate would apply up to a lifetime limit of $2 million in capital gains; however, this lifetime limit will not be available immediately in 2025 – it would be incrementally phased in at a rate of $200,000 per year, beginning in 2025, before reaching its maximum of $2 million by 2034.

Eligibility for the CEI would be dependent on many criteria, including:

- The shares must be shares of a small business corporation – this generally requires that 90 per cent or more of the fair market value of the corporation's assets are attributable to assets that are used principally in an active business carried on primarily in Canada.

- Throughout the 24-month period immediately before the disposition of the shares, they were shares of a Canadian-Controlled Private Corporation and more than 50 per cent of the fair market value of the assets of the corporation were used principally in an active business carried on primarily in Canada, certain shares or debts of connected corporations, or a combination of these two types of assets.

- The individual must be a “founding investor”, have held the shares for a minimum of five years, and have held shares that entitle them to more than 10 per cent of the voting rights and value of the corporation from the initial share subscription until the sale.

- The individual must be actively engaged on a regular, continuous, and substantial basis in the activities of the business throughout the five-year period immediately before the disposition.

- The shares must have been obtained for fair market value consideration.

- One last requirement, which will undoubtedly be quite disappointing to many, is that certain types of businesses carried on by a corporation may disentitle an individual to the CEI, including those carried on by many professionals and solopreneurs, those operating in the financial, insurance, real estate, food and accommodation, arts, recreation, or entertainment sectors, and those providing consulting or personal care services. More details will be provided by the government at a later date.

Employee Ownership Trust Tax Exemption

This measure, initially proposed in the 2023 budget, would allow a business owner to sell their business to a trust for the benefit of all employees of the business while gaining access to many tax benefits not normally available on such a sale, provided numerous and strict conditions are met. The 2024 Federal Budget provides further details on these arrangements and confirms that, if all conditions are satisfied, an individual may be able to claim an exemption for up to $10 million in capital gains from the sale. This measure is not expected to apply to many business owners and will involve high implementation costs. However, if you expect to be able to sell your business to a group consisting of all your employees for a large sum, contact us for more information on how this proposed measure may benefit you.

Alternative Minimum Tax (AMT)

Until recently, many people had never heard of the AMT. The AMT was designed to levy a special tax on individuals with high amounts of income subject to a low effective tax rate or who shelter their income with very large deductions or credits on a personal tax return. It works by comparing an individual’s actual income tax liability to the result obtained using an adjusted taxable income and, if the adjusted calculation produces a higher tax result, the difference is the AMT that is payable over and above the regular income tax liability.

In the 2023 Federal Budget, the government proposed to amend the AMT in such a way that it would affect more individuals. One of the previously proposed changes involved disallowing 50 per cent of various expenses and credits, including donations. Many advisors expressed concern that this change would cause an unexpected increase in tax and would cause high net worth individuals and philanthropists to change or reconsider their charitable gifting plans.

The 2024 Federal Budget proposes to back track on the proposed AMT changes, to a certain extent, by allowing individuals to claim 80 per cent of charitable donation credits (instead of the previously proposed 50 per cent) when calculating AMT.

Home Buyers' Plan

The 2024 Federal Budget proposes to increase the withdrawal limit under the RRSP Home Buyers' Plan from $35,000 to $60,000, effective for withdrawals made on or after April 17, 2024. This increase would also apply to withdrawals made for the benefit of a disabled individual. The budget also proposes to temporarily defer the start of the 15-year repayment period by three years for individuals making a first withdrawal under the Home Buyers' Plan between January 1, 2022, and December 31, 2025, meaning that the 15-year repayment period would start the fifth year following the year of the first withdrawal.

Volunteer Firefighters and Search and Rescue Volunteers Tax Credits

The Volunteer Firefighters Tax Credit and the Search and Rescue Volunteers Tax Credit is being doubled from $3,000 to $6,000. Based on a 15 per cent federal credit, this may result in an additional $450 in tax savings to individuals with at least 200 hours of combined volunteer firefighting or search and rescue service during the year.

Mineral Exploration Tax Credit

This tax credit, which was set to expire on March 31, 2024, provides support to junior mining companies engaged in certain mineral exploration by granting investors in flow-through shares a credit equal to 15 per cent of specified mineral exploration expenses incurred in Canada that are renounced. The 2024 Federal Budget proposes to extend eligibility to March 31, 2025.

Canada Child Benefit (CCB)

The 2024 Federal Budget proposes to extend an individual's eligibility for the CCB for six months after a child's death if the individual would have otherwise been eligible for the CCB in respect of that particular child. This measure would apply to deaths that occur after 2024.

Disability Supports Deduction

This deduction allows individuals who have an impairment in physical or mental functions to deduct certain expenses that enable them to earn business or employment income or to attend school. The

Federal Budget proposes to expand the types of expenses that are eligible for the deduction to include things such as ergonomic work chairs, a bed positioning device, a mobile computer card, certain input devices and digital pens, navigation devices for low vision, memory or organizational aids, and service animals, depending on an individual's condition and needs. This measure would apply to 2024 and future years.

Deduction for Tradespeople's Travel Expenses

Eligible tradespeople and apprentices in the construction industry may currently be entitled to deduct up to $4,000 in eligible travel and relocation expenses per year with the Labour Mobility Deduction for Tradespeople. The 2024 Federal Budget announces that the government intends to review this deduction, including the possibility of eliminating the $4,000 cap. Unfortunately, no other details have been provided at this time.

BUSINESS INCOME TAX MEASURES

Capital Gain Inclusion Rate for Corporations and Trusts

The increase to the capital gain inclusion rate discussed above applies to corporations and trusts, but without any $250,000 threshold. This means that every dollar of capital gains realized by a corporation or trust on or after June 25, 2024, will be subject to the 2/3 inclusion rate, without regard to the amount of capital gains that the corporation's shareholders have. This may have many consequences, including:

- increased taxes, including refundable taxes, on investment income earned by Canadian-controlled private corporations;
- access to the small business deduction may be more easily lost, since it begins to be phased out when a corporation's adjusted aggregate investment income, including taxable capital gains, exceeds $50,000;
- a lower addition to the capital dividend account (CDA) when capital gains are realized (CDA is a good corporate tax attribute and may be paid out to shareholders tax free with a special election); and
- as part of an overall asset location and tax optimization strategy, it may be better – from a tax perspective only – to prioritize realizing capital gains in personal investment accounts as opposed to in a corporate or trust account.

The increase in the inclusion rate may be of particular interest to those with corporations that are selling business assets or other properties on or after June 25, 2024. Consideration should be given to moving the date of a sale forward to a date before June 25, 2024, to take advantage of the 50 per cent inclusion rate in the corporation.

As mentioned, these measures are not yet accompanied by any draft legislation, and so we will need to wait and see how the final rules are worded before assessing the full impact on corporations and trusts.

Clean Electricity Investment Tax Credit

The 2024 Federal Budget provides the implementation details of the clean electricity investment tax credit that was outlined in the 2023 Federal Budget. This tax credit is equal to 15 per cent of the capital cost of eligible property that meets certain criteria. More detailed information is available in the budget documents.

Polymetallic Extraction and Processing

Budget 2023 proposed the Clean Technology Manufacturing investment tax credit, which would provide a refundable tax credit equal to 30 percent of the cost of investments in eligible property used all or substantially all for eligible manufacturing activities. Budget 2024 clarifies that the production of qualifying materials that occurs at polymetallic projects may qualify for this investment tax credit.

Accelerated Capital Cost Allowance (CCA) - Purpose-Built Rental Housing

Continuing the trend of providing incentives for building more housing, the 2024 Federal Budget provides for an accelerated CCA rate of 10 per cent (instead of 4 per cent) for new eligible purpose-built rental projects that begin construction on or after April 16, 2024, and before January 1, 2031, and that are available for use by January 1, 2036.

Eligible property would be new purpose-built rental housing that is a residential complex:

- with at least four private apartment units (i.e., a unit with a private kitchen, bathroom and living areas) or at least 10 private rooms or suites; and
- in which 90 per cent of residential units are held for long-term rental.

Projects that convert non-residential real estate to residential real estate may be eligible if these conditions are met. While renovations of an existing residential building would not qualify for the enhanced CCA, the cost of a new addition to an existing residential structure may qualify.

Immediate Expensing - Productivity-Enhancing Assets

Budget 2024 provides for immediate expensing (100 per cent CCA deduction) for property in the following classes of assets that is acquired on or after April 16, 2024, and becomes available for use before January 1, 2027:

- Class 44 (patents or rights to use patented information for a limited or unlimited period)

- Class 46 (data network infrastructure equipment and related systems software)
- Class 50 (general-purpose electronic data-processing equipment and systems software)

For the property to qualify for the accelerated CCA, both of the following conditions need to be met:

- neither the taxpayer nor a non-arm's-length person previously owned the property; and
- the property has not been transferred to the taxpayer on a tax-deferred "rollover" basis.

Of relevance to many business owners: Class 50 includes most types of computer equipment and peripherals used for general purposes, including desktops, laptops, monitors, printers, and other peripheral equipment. This measure provides an incentive to upgrade aging equipment.

Canada Carbon Rebate for Small Businesses

Budget 2024 proposed to return a portion of federal fuel charge (a.k.a. Carbon Tax) proceeds in select provinces via the new Canada Carbon Rebate for Small Businesses. Businesses in the following provinces may be eligible: Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland and Labrador. This will be an automatic refundable tax credit provided directly to eligible businesses (those with less than 500 employees), based on the number of persons they employ in the province. With respect to the 2019-20 to 2023-24 fuel charge years, the tax credit would be available to a Canadian-controlled private corporation that files a tax return for its 2023 taxation year by July 15, 2024. **It is very important that the 2023 T2 corporate tax return of an eligible business is completed by this date to receive the rebate!**

The tax credit will be equal to the number of persons employed by the eligible corporation in the province in that calendar year multiplied by a payment rate to be specified by the Minister of Finance for the province for the corresponding fuel charge year. The Minister of Finance will specify payment rates for the 2019-20 to 2023-24 fuel charge years once sufficient information is available for the 2023 taxation year.

Interested Deductibility Limits - Purpose-Built Rental Housing

The excessive interest and financing expenses (EIFEL) rules limit the amount of net interest and financing expenses that may be deducted by certain large Canadian organizations in computing net taxable income. The EIFEL rules provide an exemption for interest and financing expenses incurred in respect of arm's length financing for certain public-private partnership (P3) infrastructure projects. Budget 2024 proposes to expand this exemption for certain interest and financing expenses incurred before January 1, 2036, in respect of arm's length financing used to build or acquire eligible purpose-built rental housing in Canada.

INTERNATIONAL TAX MEASURES

Crypto-Asset Reporting Framework and the Common Reporting Standard

Budget 2024 proposes to implement the Crypto-Asset Reporting Framework (CARF), which is a framework developed by the Organisation for Economic Co-operation and Development for the automatic exchange of tax information relating to transactions in crypto-assets. The new reporting rules will apply to crypto-asset service providers that are resident or carrying on business in Canada, and that provide services effectuating exchanges in crypto-assets. This would include crypto exchanges, crypto-asset brokers and dealers, and operators of crypto-asset automated teller machines. These measures will apply to 2026 and subsequent calendar years.

OTHER TAX MEASURES

Many other tax measures were announced in the 2024 Federal Budget but have not been covered here to ensure this Tax Brief is timelier and more relevant to our corporate and high net worth clients, including:

- An exemption from the taxation of trusts established under the First Nations Child and Family Services, Jordan's Principle, and Trout Class Settlement Agreement
- An extension of the status of foreign charities
- A review of qualified investments for registered plans
- Powers granted to the CRA with respect to non-compliance with information requests and the avoidance of tax debts
- Penalties applicable to reportable and notifiable transactions
- Restrictions on obtaining mutual fund corporation status
- The tax treatment of synthetic equity arrangements
- The manipulation of bankrupt status for certain tax benefits
- Withholding taxes for non-resident service providers
- Extending GST relief to student residences
- Repealing the temporary GST/HST zero-rating on face masks and face shields that was implemented during COVID

- Increases to tobacco and vaping product taxation
- Amendments to fuel, alcohol, cannabis, and tobacco sales tax framework applicable to first nations

If any of these topics are of interest to you, please consult the budgets supplementary information on tax measures at this link or contact us for a consultation.

GAUVREAU'S FINAL THOUGHTS

The 2024 Federal Budget has announced some of the most significant tax changes applicable to individuals and small business owners in the last several years. Given the complexity of these proposals, we encourage our clients to reach out to us with any questions or concerns on how the 2024 Federal Budget may affect their overall tax plan. Our firm will provide an update on these measures once clarifications and draft legislation are made available by the government.

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