Our Review of the 2024 Federal Budget: An In-Depth Analysis

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On April 16, 2024, the government of Canada released its **Budget 2024**. Overall, this budget can be characterized as a very heavy spending budget with continued large deficits, no fiscal anchor, increasing public debt charges (now estimated to be a whopping $54.1 billion for the upcoming year…yes, that's more than $1 billion per week) and a capital gains inclusion rate increase despite the fact that the Bank of Canada recently warned that it was time to **break the glass on Canada's productivity problem**. The capital gains inclusion rate will certainly not help deal with that productivity problem and in fact, as we say in more detail below, it will likely drive investment capital out of Canada and continue the departure of successful Canadians out of Canada.

With respect to Budget 2024 **taxation changes** most applicable to our audience, below is an executive summary for those that do not want to read the lengthy comments that follow.

EXECUTIVE SUMMARY

What is not in Budget 2024:

- There are no direct personal or corporate tax rate increases.

- There are no “windfall taxes” in the budget. There were rumours that energy companies and grocers might be targeted for “excess profits” but no such tax proposals are contained in the budget;
- There is not an introduction of a wealth tax…not a surprise.

What is included in Budget 2024:

A. The capital gains inclusion rate will increase from 1/2 to 2/3 for capital gains realized in the year that exceed $250K for capital gains realized on or after June 25, 2024 for individuals. For corporations and trusts, there is no such threshold, and instead, the inclusion rate will simply increase to 2/3. This is going to throw the foundational principle of integration into disarray. The choice of legal vehicle to realize income – such as capital gains – should be neutral from a tax perspective as to where investment dollars are placed. In other words, people will be more motivated to realize capital gains at the individual level as opposed to corporations or trusts.

The delayed implementation date of June 25, 2024, provides an opportunity for taxpayers to voluntarily ‘crystallize’ pregnant capital gains accrued prior to June 25, 2024, so that such historical capital gain will not be subject to the 2/3 inclusion rate after June 25, 2024, at the cost of tax acceleration. The pros and cons of accelerating gains realization will need to be weighed, and the math will need to be run.

B. There is an increase to the lifetime capital gains exemption amount to $1.25M, with indexation to commence again in 2026. Combined with the effect of the inclusion rate increasing to 2/3, this increases the cash tax saving of a full lifetime capital gain exemption claim from approximately $250,000 to more than $400,000.

C. The introduction of a new “Canadian Entrepreneur’s Incentive,” which would reduce the capital gains inclusion rate from 2/3 to 1/3 for a ‘founding investor’ on “qualifying shares” (which comes with a list of very specific required conditions some of which could be very difficult for the average entrepreneur to meet) to a lifetime cumulative limit of $2M (phased in over a ten-year period). This is interesting, but it needs much more analysis to determine how “sweet” this initiative really is.

D. The conditions to exempt $10M of capital gains realized on the transfer of shares of a corporation to an Employee Ownership Trust were released. Such conditions appear very restrictive and place significant risk on the seller claiming the exemption.

E. Amendments to the alternative minimum tax to soften the blow when charitable donations are made with some minor other AMT amendments. This is welcome.

F. There is a proposal to increase the CCA rate from 4% to 10% for new eligible purpose-built rental projects and immediate 100% expensing for certain productivity-enhancing assets.

G. CRA will have increased audit powers and new penalties that can be imposed for non-cooperation during an audit.

H. Expansion of the carbon tax rebate to certain small and medium-sized corporations.

I. Proposed changes will enable Canadian payers to apply to CRA to waive withholding requirements under Regulation 105 for payments made to non-resident service providers for services performed in Canada, but will not be subject to Canadian tax liabilities due to a tax treaty.

J. The withdrawal limit for the RRSP Home Buyers Plan increases from $35,000 to $60,000, and a temporary increase to the repayment grace period to 5 years.

K. Interest deductibility (EIFEL) relief for certain “purpose-built” rental housing.

L. Introduction of a new crypto asset reporting framework requirement to Canadian crypto-asset exchanges and other crypto-asset service providers.

M. The criminal penalty is removed for non-compliance with reportable and notifiable transaction reporting requirements.

N. Disqualification of closely-held mutual fund corporations.

O. Extension of the Canada Child Benefit in the event of the death of the qualified dependent

P. The list of expenses qualifying for disability supports deduction is expanded.

Q. Certain modernization measures relating to charities.

R. Addition of a supplementary rule to prevent the use of intermediaries to avoid joint and several liability on unpaid tax debts.

S. A new consultation on a future new federal vacant residential land tax.

T. Another extension of the Mineral Exploration Tax Credit.

U. Increasing the Volunteer Firefights and Search and Rescue Volunteers Tax Credits.

Similar to prior years' budget blogs, we have intentionally omitted the clean energy tax incentive measures as those are generally not accessible for our client base of private businesses and families.

A). Increase in Capital Gains Inclusion Rate to 2/3 (For Corporations and Trusts, and Over $250K for Individuals)

People have been predicting an increase to capital gains inclusion rates for years, and it's finally here. Since October 17, 2000, only 1/2 of a taxpayer's capital gains

are included in computing income, and correspondingly only 1/2 of a taxpayer's capital losses is allowable as a deduction against taxable capital gains. This generally left a capital gain with an effective tax rate of 24-27.5% in the various provinces (when earned individually). The 1/2 inclusion of capital gain applied to all taxpayers (be it a corporation or an individual) and in all circumstances with very limited exceptions (an example of such exception is when a partnership interest is sold to a non-resident person, or a tax-exempt entity, the inclusion rate of capital gain becomes 100%). There are ample policy reasons for the favourable treatment of capital gains, such as to prevent taxation on increased valuations due solely to inflation since inflationary increases do not represent an increase in real purchasing power and therefore should not be taxed and to incentivize investments into capital assets which can have significant societal benefits.

Since investment in capital assets requires capital, most Canadians will not earn large capital gains in their lifetime outside of gains realized on their residences. For example, Finance's Backgrounder document cites this statistic: "… *only about 5 per cent of Canadians under 30 had any capital gains at all.*" As such, increasing taxation on capital gains is a targeted way to raise taxes on the so-called "wealthy". We note that a capital gain is only applicable when an investment is sold, and not when there is an "unrealized gain".

To that end, Budget 2024 proposes the following effective for capital gains realized on or after June 25, 2024 (this date selection appears wholly arbitrary with no specific reason for its uniqueness):

- For corporations and trusts, increase the capital gains inclusion rate from 1/2 to 2/3 for all capital gains; and
- For individuals, increase the capital gains inclusion rate from 1/2 to 2/3 on capital gains realized in the year that exceeds a $250,000 threshold.

Importantly, the principal residence exemption will remain unchanged so that taxpayers disposing of properties that qualify for the "principal residence" designation should continue to be exempt from tax on such gains.

According to the proposed amendment, an individual (other than a trust) will still be subject to a 1/2 capital gains inclusion rate for the first $250,000 of capital gain. This $250,000 threshold will be computed as follows:

- Total of all capital gains realized by the individual, including those allocated from a partnership or distributed by a trust to the individual, less

- Current-year capital losses;
- Capital losses of other years applied to reduce current-year capital gains; and
- Capital gains in respect of which the lifetime capital gain exemption ("**LCGE**"), the proposed Employee Ownership Trust ("**EOT**") Exemption or the proposed Canadian Entrepreneurs Incentive ("**CEI**") are claimed. The proposed EOT exemption and CEI regime are discussed further in this blog.

For individuals, capital gains realized on or after June 25, 2024, beyond this $250,000 threshold will be subject to a 2/3 inclusion rate. We assume that for spouses, each spouse has their own $250,000 threshold.

For capital gains realized by corporations and capital gains realized and retained in trusts, all such capital gains will be subject to the 2/3 inclusion rate. The $250,000 bracket is irrelevant for corporations and trusts. Generally, for income tax purposes, trusts are treated like individuals, but Finance likely decided against granting trusts a $250,000 capital gain bracket because that would make it too easy for taxpayers to 'multiply' access to this $250,000 capital gain bracket.

No detailed legislation on this proposed amendment has been released with Budget 2024, but we want to include some numeric illustrations of how we think the new capital gains inclusion rate regime will likely apply.

Example 1: Mr. A acquired a rental property for $500,000 in 2020, and he sells the property for $1,400,000 on July 1, 2024, which is after the effective date of this rule change. Since Mr. A sold the property after a 365-day hold period (in fact, he held the property for four years), the new "flipping tax," which would have denied capital gains treatment and fully taxed the profits, does not apply. Accordingly, Mr. A has a capital gain of $900,000 on this disposition. Assuming that Mr. A has no other capital gains or losses throughout 2024 and no capital loss carry-overs to deduct in 2024, Mr. A will include the following in computation of his income for tax purposes:

- 1/2 x $250,000 = $125,000
- 2/3 x $650,000 = $433,333.

Therefore, Mr. A will have to include in his 2024 personal tax return $558,333 of taxable capital gain, whereas under the existing rule, he would have included only $450,000. If Mr. A is in the top income rate bracket in Ontario, this represents an

increase in personal income tax from $240,700 to $298,700. This is assuming the proposed AMT rules do not further increase Mr. A's tax payable.

Obviously, the bigger the capital gain realized by an individual, the bigger the impact this rule change will have to the effective tax rate on the capital gain since there will be a bigger portion of the capital gain in excess of the $250,000 threshold and therefore subject to the 2/3 rather than 1/2 inclusion rate.

There is no pro-ration of the $250,000 threshold even though the June 25, 2024 effective date of the amendment will be partway through the year 2024, and the quantum of Mr. A's other income does not impact the computation of the $250,000 threshold.

Example 2: Canco is a Canadian-controlled private corporation ("**CCPC**") resident. On August 1, 2024, it realizes a capital gain of $1,000,000.

The table below shows the integration of personal and corporate tax, assuming that the after-tax capital gain is fully distributed to the individual shareholders in Alberta, B.C., and Ontario at top marginal tax bracket rates. The table then compares this fully distributed effective tax rate to the tax rate if the capital gain has been earned
personally.

Corporation earning capital gain and distributing proceeds as dividends	**Alberta**		**B.C.**		**Ontario**	
	Existing rule	**Proposed rule**	**Existing rule**	**Proposed rule**	**Existing rule**	**Proposed rule**
Corporate income tax						
Capital gain	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000
Inclusion rate	50%	66.67%	50%	66.67%	50%	66.67%
Taxable capital gain	$ 500,000	$ 666,667	$ 500,000	$ 666,667	$ 500,000	$ 666,667
Corporate tax rate	46.67%	46.67%	50.67%	50.67%	50.17%	50.17%
Corporate income tax	$ 233,333	$ 311,111	$ 253,333	$ 337,777	$ 250,833	$ 334,444
Assume full refund of "NERDTOH" at 30.67%	$ (153,333)	$ (204,444)	$ (153,333)	$ (204,444)	$ (153,333)	$ (204,444)
Net corporate income tax after dividend refund	$ 80,000	$ 106,667	$ 100,000	$ 133,333	$ 97,500	$ 130,000
Amount available for distribution to shareholders	*$ 920,000*	*$ 893,333*	*$ 900,000*	*$ 866,667*	*$ 902,500*	*$ 870,000*
Personal income tax						
Tax-free captial dividend	500,000	333,333	500,000	333,333	500,000	333,333
Non-eligible taxable dividend	420,000	560,000	400,000	533,334	402,500	536,667
Effective top marginal tax rate on taxable dividend	42.30%	42.30%	48.89%	48.89%	47.74%	47.74%
Personal income tax	177,660	236,880	195,560	260,747	192,153	256,205
Total Personal and Corporate income tax	**257,660**	**343,547**	**295,560**	**394,080**	**289,654**	**386,205**
Fully distributed effective tax rate	**25.8%**	**34.4%**	**29.6%**	**39.4%**	**29.0%**	**38.6%**
Compare to capital gain earned individually:						
First $250,000 of capital gain earned personally	*24.00%*	*24.00%*	*26.75%*	*26.75%*	*26.77%*	*26.77%*
Capital gain exceeding $250,000 earned personally	*24.00%*	*32.00%*	*26.75%*	*35.67%*	*26.77%*	*35.69%*

The capital gain inclusion change will increase the effective tax rate on capital gain earned corporately. For example, in Alberta, the fully distributed tax rate for earning capital gain corporately increases from 25.8% to 34.4%. However, there is

going to be a jarring lack of integration for capital gains below $250,000. In B.C., an individual earning capital gain of less than $250,000 a year (or $500,000 between two spouses if each realizes $250,000 capital gain) is subject to 26.75% at top marginal rates, but if the same gain is realized inside a corporation that effective tax rate increases to 39.4%. This represents a 47% increase in tax for the sole reason that the taxpayer did not earn the first $250,000 of capital gain personally.

A much better solution would have been to allow individuals to allocate their $250,000 amongst an associated group of corporations (perhaps based on the same definition used for the sharing of the small business limit). We think this would achieve the Government's objective and would maintain proper tax integration. Without such a fix, the capital gain inclusion rate increases to 2/3 and applies to all corporations, regardless of revenue, size, and amount of capital gain. This may impact not just the extremely "wealthy," as the government seems to indicate.

Also, the two different inclusion rates will complicate deducting capital loss carryover from other years. The proposed rules are expected to adjust these capital loss carryovers from other years to reflect the inclusion rate of the capital gains being offset. This means that a capital loss realized prior to the rate change should fully offset an equivalent capital gain realized after the rate change.

The taxation of employee stock options (except for certain employees of very large corporations) generally mirrors the taxation of capital gains – under current rules, taxable benefits from qualifying employee stock options are entitled to a 50% deduction. The proposed rule will decrease this 50% deduction to a 1/3 deduction (which yields a result equivalent to a 2/3 inclusion rate on the taxable benefit) to the extent the employee exceeds a combined limit of $250,000 for both employee stock options and capital gains.

While some of us have anticipated the Government will introduce a measure to increase taxation on capital gains beyond a threshold of $x, we are surprised that this threshold has been set so low at $250,000.

It needs to be emphasized that there is no grandfathering of unrealized capital gains accrued before June 25, 2024 – if such historical capital gains are realized after June 25, 2024, the entire amount will be subject to the new inclusion rate regime. Therefore, we should expect individuals and businesses across Canada to attempt to close planned dispositions before June 25, 2024, so as to avoid the new 2/3 inclusion rate on capital gains, unless they can benefit from (and can achieve a better tax result from) the proposed expansion of LCGE, or the newly proposed CEI or EOT regime to be discussed below. Where there is no sale in the near horizon, it

might be worthwhile for some taxpayers with unrealized capital gains to choose to realize such gains before June 25, 2024, with crystallization transactions (transactions that realize the capital gain, which can be implemented without an actual sale to a third party): this will accelerate tax but preserve the 1/2 inclusion rate for historical accrued gains and step-up tax cost base to the fair market value on the crystallization date. Also, based on the Budget document, it appears that capital gains realized by an individual before June 25, 2024, will not count towards the $250,000 threshold for dispositions after June 25, 2024, i.e. the individual still has the full $250,000 bracket in respect of which the 1/2 inclusion rate applies for dispositions after June 25, 2024, even if the individual had other capital gains realized before June 25, 2024.

There are pros and cons to crystallization transactions, and it is important to properly review such planning prior to June 25th. This voluntary acceleration of tax that taxpayers need to trigger with these kinds of self-help transactions to preserve 1/2 inclusion rate on historical accrued capital gain is certain to result in a huge additional revenue inflow for the Government for 2024.

Of course, with any type of crystallization planning, the new AMT rules will need to be carefully considered to avoid nasty surprises. It appears Finance has expected this to happen since their projections show a very large amount of projected revenue in 2024 for the new capital gain inclusion rate as it applies to corporations (approximately $4.7 billion in new revenue).

Unless there is going to be a specific exclusion for capital gains that arise on a deemed disposition of assets on death, the 2/3 inclusion rate will also increase tax on death. Many individuals who are not considered “wealthy” will have accumulated, on their death, over $250,000 of unrealized capital gains across their total assets, not including their principal residence, e.g. investment accounts outside of registered plans, cottages for which the principal residence designation is unavailable, farmland that exceeds/doesn’t qualify for the LCGE or the farmland rollover on death, etc. Also, will graduated rate estate (GRE) get a $250,000 bracket each year? We hope so.

We expect to see a renewed rush of entrepreneurs and high net-worth individuals leaving Canada. Individuals departing Canada are subject to Canadian income tax on a notional capital gain based on the fair market value of their assets on their departure date. If the departure date is after June 25, 2024, this entire notional capital gain will be subject to the new inclusion rate regime. Therefore, there will be individuals who will accelerate their exit from Canada prior to June 25, 2024. This is

in addition to the AMT amounts we discussed in last year's federal budget that may apply to individuals departing Canada.

The new $250,000 capital gain bracket for individuals will likely usher in a renewed interest in capital gain splitting amongst family members, which could be done with tools like prescribed rate loans. But given the high prescribed rate environment right now (and anti-avoidance rules like the tax on split income (TOSI) regime), planners should carefully model out any such planning before undertaking them.

It will be interesting to see whether non-residents of Canada disposing of Canadian taxable Canadian property (i.e. Canadian real estate) will also be entitled to the ½ inclusion rate on their first $250,000 of capital gain realized on such property. We presume the legislation, when it comes out, will also be increasing the section 116 withholding rate for non-residents disposing of taxable Canadian property – otherwise, the current 25% withholding is not sufficient to cover the income tax on the capital gain with the increased inclusion rate.

We also should not be surprised that investors and businesses will be reluctant to invest in assets that generate capital gains. For example, this may make it less attractive for investors to build new rental housing, which appears counterproductive to the Government's current effort to encourage the creation of more housing in Canada. On the other hand, the increased inclusion rate for capital gains takes away most of the favourable tax treatment that capital gains traditionally have had over dividends, at least for capital gains over the $250,000 threshold, and this in itself may have interesting implications on high net-worth families' investment decisions.

It remains to be seen how Finance will deal with the coming-into-force issues. For example, if a property was sold in 2023 and the taxpayer claims the capital gain reserve, will the reserved capital gain be subject to the new inclusion rate when it is reported in 2024 and subsequent years, even though the actual realization event occurred in 2023? And what about capital gain realized by a trust prior to June 25, 2024, but the capital gain is distributed to beneficiaries after June 25, 2024 – what inclusion rate will apply to the beneficiaries reporting the distributed gain? The detailed legislation, when they are released, should address these.

While the 2024 Budget increases taxation on capital gains in general, it also introduces changes to expand favourable tax treatment to certain capital gains that the Government deems to be 'good' capital gains. We will now discuss these.

B). Increase of the Lifetime Capital Gains Exemption on QSBC and QFFP To $1.25M

Under existing rules, an individual may claim a Lifetime Capital Gains Exemption (“**LCGE**”) of up to $1,016,836 in 2024 for capital gains realized on the disposition of qualified small business corporation (“**QSBC**”) shares and qualified farm or fishing property (“**QFFP**”). Currently, the cash tax saving from an individual claiming their full LCGE is approximately $250,000, with each province varying slightly.

Budget 2024 proposes to increase the LCGE amount to $1.25 million, effective for dispositions that occur on or after June 25, 2024. This $1.25 million will be indexed to inflation after 2025. The tax savings of an individual claiming $1.25 million of LCGE in a capital gain regime that includes 2/3 of a capital gain into income (ignoring the $250,000 capital gain bracket for 1/2 inclusion rate) is approximately $416,000, being $1,250,000 x 2/3 x approximate 50% top marginal combined federal plus provincial tax rate. That is a major increase in tax savings from $250,000 per LCGE (mostly due to the change in inclusion rate being subject to tax).

No legislative details of this change have been released with the 2024 Budget, but we anticipate no material change to the QSBC and QFFP rules and that this amendment to just be a revision of the LCGE amount as announced. We applaud this amendment, as it is a simple way to increase the economic incentive for entrepreneurs to grow their business. Since QSBC capital gains are not subject to the TOSI regime, entrepreneurs are generally permitted to ‘multiply’ the LCGE entitlement if they have properly employed family trust planning in their ownership structure. Therefore, the increase of the LCGE limit to $1.25 million could add up to a very material tax saving for entrepreneurs who are able to sell qualifying shares of their business in their family trusts.

For Canadian entrepreneurs and farmers/fishers who were planning to sell their QSBC shares or QFFP during 2024 and have the flexibility to close the sale either before or after June 25, 2024, they should carefully model and compare the tax impact of the two alternatives:

- *Sale closing before June 25, 2024*: entitlement to the current LCGE amount of $1,016,836 only, and all capital gains beyond the LCGE amount subject to the 1/2 inclusion rate, versus
- *Sale closing after June 25, 2024*: entitlement to the proposed LCGE amount of $1,250,000, but capital gain that exceeds the expanded LCGE amount plus the $250,000 capital gains bracket will be subject to the proposed 2/3 inclusion rate.

In both of the above scenarios, the new AMT rules would, once again, need to be carefully calculated and considered.

Note that the new Canadian Entrepreneurs Incentive (CEI) discussed below will generally have a nominal impact on the above decision as it relates to imminent dispositions occurring during 2024. This is because the proposed CEI regime begins *after* 2024.

C). New Canadian Entrepreneurs' Incentive ("CEI")

Budget 2024 is proposing to introduce a new "Canadian Entrepreneurs' Incentive" that will reduce, by half, the inclusion rate on capital gains on the disposition of qualifying shares by an eligible individual for dispositions on or after January 1, 2025. Capital gains otherwise subject to the proposed 2/3 capital gain inclusion rate will, if the gain qualifies for CEI treatment, become subject to a 1/3 inclusion rate instead of 2/3. Note that a disposition after 2024 can benefit from all three of the LCGE, the CEI and the 1/2 inclusion rate on the first $250,000 of capital gain that exceeds the LCGE and CEI amounts.

Each eligible individual will have a lifetime limit on capital gains that can qualify for the CEI. This lifetime limit would be phased in by increments of $200,000 per year, beginning on January 1, 2025, before ultimately reaching a maximum value of $2 million by January 1, 2034. This is a <u>very slow</u> phase-in period.

To put this into perspective, if an entrepreneur sells his business in 2025 and his capital gain qualifies for CEI treatment, even in the top income bracket, this results in a maximum tax savings of between $32,000 and $36,000, depending on the province. While this is still a tax savings, we doubt it will sway the near-term timing of a sale by someone who is already a business owner.

However, once this CEI maximum limit becomes more materially phased in, the benefit should become much more interesting. For instance, the tax saving for someone in Ontario selling their business in the year 2034 and qualifying for the maximum $2 million CEI lifetime limit at that time can mean a reduction in their tax bill by $356,000 ($2,000,000 x 1/3 reduced inclusion rate for CEI x 53.5% top marginal rate in Ontario). This is <u>in addition to</u> the tax savings that the seller can realize by claiming the LCGE. Therefore, the CEI will provide meaningful incentives for entrepreneurs who qualify, albeit only if the horizon for the sale of shares is several years away.

Here is a further illustration of the 'stacking' effect of the various proposed capital gains rules. Ms. B sells shares of her corporation on January 31, 2025, realizing a capital gain of $1,800,000, and the sale qualifies for both LCGE and CEI treatment. Here is how this capital gain of $1,800,000 will be treated for her 2025 year if the proposals are enacted:

- The first $1,250,000 of capital gain is exempt from tax;
- The next $200,000 of capital gain will be under the CEI rules so that it is included in her income at a 1/3 inclusion rate;
- The subsequent $250,000 of capital gain will be included in her income at a 1/2 inclusion rate; and
- The remaining $100,000 of capital gain will be included in her income at a 2/3 inclusion rate.

According to the Budget documents, a capital gain realized after January 1, 2025, can qualify for CEI treatment if all of the following conditions are met:

- At the time of sale, the shares sold were QSBC shares owned directly (personally) by the seller;
- Throughout the immediately preceding 24-month period, it was a share of a CCPC and more than 50% of the fair market value of the assets of the corporation were either assets used principally in an active business or certain shares/debts of connected corporations;
- The claimant was a "founding investor" at the time the corporation was initially capitalized and held the share for a minimum of 5 years prior to disposition;
- At all times since the initial share subscription, the claimant directly owned shares amounting to more than 10% of votes and more than 10% of the value of the corporation;
- Throughout the immediately preceding 5-year period, the claimant must have been actively engaged on a regular, continuous, and substantial basis in the activities of the business;
- The share does not represent a direct or indirect interest in a professional corporation, a corporation whose principal asset is the reputation or skill of one or more employees, or a corporation that carries on the business in the

financial, insurance, real estate, food and accommodation, arts, recreation, or entertainment sector, consulting or personal care services sector;

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

That is quite a long list of requirements a founding investor must meet to qualify for the new CEI treatment, and quite stringent relative to the low CEI lifetime limit amount will be in the initial years of the introduction of the program. In addition, the industry restrictions carve out a lot of otherwise potential claimants.

It will be interesting to see how the legislation, when it comes out, will define what it means to be a "founding investor at the time the corporation was initially capitalized". For example, are you still a "founding investor" if you purchase or subscribed for shares of the corporation a month after initial incorporation? What about a year?

There is also an inherent problem with these conditions, which requires the founding investor to be active on a regular, continuous and substantial basis in the activities in the business (if TOSI rules apply, that generally means >20 hours per week) AND to have obtained the shares for fair market value consideration. In our experience, shareholders who are active in the business typically subscribe for shares at nominal value, or a value significantly below fair market value, because they are putting in 'sweat equity'. We wonder how many taxpayers will actually be able to qualify for this CEI treatment if the rules are enacted as proposed in Budget 2024.

The CEI conditions carving out consulting businesses, professional corporations, and real estate businesses is not unexpected given the tax regime's unfavourable treatment of such businesses in other areas (e.g. the personal service business rules, the TOSI rules, and rules recharacterizing certain real estate businesses as passive activities), but we find it curious why the Government chose to explicitly exclude businesses in the financial, insurance, food and accommodation, arts, recreation, entertainment, and personal care services sector from qualifying for CEI. These kinds of industry-specific carve-outs are certain to attract criticisms from stakeholders in such industries.

We, of course, welcome any new incentive provided to entrepreneurs, including this new CEI regime. However, we are disappointed that the Government did not use Budget 2024 as an opportunity to address a major inequity that arises in the sale of business. To qualify for the LCGE, an entrepreneur must sell the shares of a corporation that operates the business. However, this is often not possible because, as a rule, buyers often want to buy assets for legal and tax reasons. Sellers

in weaker negotiation positions may be forced into selling assets, and they will not be entitled to LCGE treatment. Compared to sellers who manage to sell shares of their business and are able to 'multiply' the LCGE with family members, these disadvantaged sellers of assets are comparatively being subject to a lot more tax (as discussed earlier, generally speaking, each LCGE is worth approximately $250,000 of cash tax savings which is increasing to approximately $416,000 after the amendment to increase the LCGE amount; with multiplication, this can result in tax savings of millions of dollars for sellers who are able to sell their business in the form of a share sale).

In our view, there should be no economic difference between an entrepreneur selling shares of their active business corporation versus their corporation selling all or substantially all of its active business assets, and so tax policy should be neutral between these two options. It is unfortunate that the proposed expansion to the LCGE and the introduction of the CEI will not rectify this but will exacerbate this inequity instead.

Detailed legislation on the CEI has not been released with Budget 2024, and we look forward to reviewing it when released.

D). Employee Ownership Trust ("EOT") $10M Capital Gain Exemption

Unlike countries in Europe and certain other countries in the world, there are relatively few businesses in Canada whose ownership is widely dispersed in the hands of employees. The Government clearly wants to change this and is introducing a potentially very significant tax incentive to business owners to convert their businesses into a rigid employee ownership model.

As part of Budget 2023, the Government proposed tax rules to facilitate the creation of EOTs, and these proposals are currently before Parliament as part of Bill C-59. Under the Budget 2023 proposed rules, certain benefits are available if a business owner sells their business under a "qualifying business transfer" to a trust that qualifies as an "employee ownership trust" (EOT).

For a sale to be considered a "qualifying business transfer" for the seller, all the following conditions must be met:

- The seller sells shares of a corporation (the "Subject Corporation") either to the EOT or a CCPC ("PurchaseCo") controlled and wholly owned by an EOT and transfers control of the subject corporation to it as part of the sale;

- All of substantially all of the fair market value of the Subject Corporation's assets is attributable to assets used principally in an active business;
- At the time of the sale, the seller deals at arm's length with the EOT and PurchaseCo; and
- At all times after the sale, the seller deals at arm's length with the EOT, PurchaseCo and Subject Corporation, and the seller does not retain any legal or factual control over any of them.

The trust also needs to qualify as an EOT for the tax benefits to apply, and this EOT status requires all of the following conditions be satisfied:

- The trust must be resident in Canada;
- The trust must exclusively be for the benefit of employees, and generally speaking, all employees of the business must be beneficiaries (other than the significant owners described below)
- The beneficiaries must not include any significant owners so of the business (generally defined to be someone who owns greater than 10% of corporations controlled by the trust or someone who alone or as part of a group owned more than 50% of such corporations currently or immediately prior to the qualifying business transfer);
- Each of the beneficiaries' entitlement in the trust is based solely on any combination of hours of employment service provided, the amount of T4 income to the employee (but up to an indexed amount of approximately $500,000), and the total period of employment service provided by the employee;
- The trustees are prohibited from acting in the interest of one beneficiary to the prejudice of another;
- At least 1/3 of the trustees must be current employees of the business;
- Each trustee has an equal vote;
- Each trustee must either be a natural person or a professional trustee company;
- Unless the trustee was voted in by the employee-beneficiaries within the last five years, at least 60% of all trustees must deal at arm's length with each vendor who sold the corporation to the trust;

- Any fundamental changes to the businesses must be approved by the majority of the beneficiaries; and
- All or substantially all of the property of the trust must be attributable to shares of CCPCs that the trust controls, and the majority of directors of these CCPCs are not, and are not related to, persons who sold the corporation to the trust.

In summary, these criteria are meant to ensure that the business is sold to a trust that is collectively owned by all employees, the seller would have to give up legal and factual control over the business sold, and that it would be the employees who control the destiny of the business going forward (rather than the seller). To encourage such a sale, Budget 2023 introduced the following tax incentives:

- The selling individual can claim a 10-year capital gain reserve to potentially spread out the recognition of capital gains over 10 years rather than the usual 5 years;
- The trust can borrow funds from the business itself (i.e. borrowing from the corporation it purchased) to pay the purchase price without having to repay such funds within the usual one-year period under the normal shareholder loan rules. Instead, an EOT is allowed 15 years to make full repayment to the corporation; and
- The trust will not be subject to the usual 21-year deemed disposition rule.

As expected, the response from the business community to the Budget 2023 proposal was deafeningly mute. Budget 2023 did not provide nearly enough of an incentive for business owners to turn over their lifework to a collective formed by all employees of the business, particularly where the business owner will be paid out over a period of up to 15 years from the future profits of the business (the viability of which depend on the ability for the employee-chosen trustees to properly manage the business over the pay-out period).

As a result of feedback from the consultation period, the Government announced in its 2023 Fall Economic Statement to introduce a $10 million exemption for capital gains realized on the sale of a business to an EOT. A $10 million capital gain exemption certainly peaked the attention of tax planners, but anecdotally, many were still reluctant to earnestly present this as an exit option to business owners, primarily due to the difficult requirements that the EOT rules require and the business reality issues we mentioned above.

In Budget 2024, the Government has now provided further details on the EOT regime and the new capital gain exemption (but no detailed legislation has been released with Budget 2024). After reviewing these details do we now think this is a preferred exit option for a typical business owner we see in our practice? Unfortunately, not really.

Budget 2024 proposes that, for qualifying dispositions of shares that occur between January 1, 2024, and December 31, 2026, an individual would be able to claim an exemption for up to $10 million in capital gains realized. If multiple individual sellers are involved, the total exemption in respect of the sale will not exceed $10 million, so the sellers will have to agree amongst themselves on how to allocate this $10 million exemption amount. Also, for AMT purposes, any exempt capital gain would be subject to an inclusion rate of 30% only, similar to the treatment for LCGE gains.

In order to claim the $10 million capital gain exemption, Budget 2024 set out additional conditions that must be met:

- The claimant individual, a personal trust of which the individual is a beneficiary, or a partnership in which the individual is a member, disposes of shares of a corporation that is not a professional corporation; [*in other words, the seller can be trusts or partnerships, as long as the gain is distributed/allocated to an individual claiming the capital gain exemption*]
- The transaction is a "qualifying business transfer", as described above.
- The trust acquiring the shares is not already an EOT or a similar trust with employee beneficiaries;*[meaning, the qualifying business transfer cannot occur in multiple tranches – subsequent tranches will not qualify for the exemption]*
- Throughout the 24 months immediately prior to the sale:
  - the transferred shares were exclusively owned by the individual claiming the exemption, a related person, or a partnership in which the individual is a member; [*in general terms, this is analogous to the 24-month related person holding period test for claiming LCGE],* and
  - over 50% of the fair market value of the corporation's assets was used principally in an active business.
- At any time prior to the qualifying business transfer, the individual (or their spouse or common-law partner) has been actively engaged in the business

on a regular and continuous basis for a minimum period of 24 months;*[Interesting that Finance is adding an 'actively engaged' requirement for a seller to qualify for favourable treatment on capital gain, we see this as well in the new CEI rules discussed earlier.]*

- Immediately after the qualifying business transfer, at least 90% of the beneficiaries of the EOT must be resident in Canada.

If a disqualifying event occurs within 36 months of the sale, the exemption would not be available and the exemption would be retroactively denied. A disqualifying event would occur if an EOT loses its status as an EOT at any moment in time or if the composition of the active business assets falls under 50% for two consecutive taxation years. The EOT (and any corporation owned by the EOT that acquired the transferred shares) and the individual would need to elect to be jointly and severally liable for any tax payable by the individual as a result of the exemption being denied due to a disqualifying event within the first 36 months. The normal reassessment period of an individual for a taxation year in respect of this exemption is proposed to be extended by three years.

If the disqualifying event occurs more than 36 months after a qualifying business transfer, the EOT would be deemed to realize a capital gain equal to the total amount of exempt capital gains. In that case, the EOT would be solely liable for this tax.

Budget 2024 also proposes to extend the same tax benefits to a qualifying sale to a Worker Cooperative that meets the definition set out under the Canada Cooperatives Act.

Any business owners wanting to take advantage of this new $10 million capital gain exemption will still have to get over the significant hurdle of handing over their legacy and the security of whether they can ultimately collect the sale proceeds over to an employee collective. Given the myriad of conditions that must be met, the implementation of such a transaction will certainly be complex, and the seller claiming the EOT exemption will be at risk for 36 months of retroactively losing the exemption if a disqualifying event happens, which could arise with no fault of the seller. Given the many restrictions that an EOT must continue to meet to qualify as an EOT (e.g. making sure beneficiaries' entitlement are governed by a formula based on the permissible criteria), there is very real risk that an EOT could lose EOT status for a moment in time within 36 months of the qualifying business transfer and the seller's exemption gets revoked, even if that seller is not a trustee of the EOT and played no part in the disqualification event.

Despite the proposed rules making the EOT jointly liable with the seller if the disqualifying event occurs within 36 months of the qualifying business transfer, this is likely still not an acceptable risk for the seller since the CRA collections will most likely go after the seller as the primary taxpayer who lost the exemption before they would go after the EOT under the joint and several liabilities.

The new EOT regime might be a viable option for some, but probably very few, private business owners in Canada. In any case, we look forward to reviewing the detailed legislation when it is released.

E). Changes To Alternative Minimum Tax To Be Less Onerous

Budget 2024 introduced some tweaks to the alternative minimum tax ("**AMT**") changes previously announced in Budget 2023. As a recap, Budget 2023 proposed a three-prong approach to adjust the federal AMT, which included:

- Broadening the AMT Base by modifying the "adjusted taxable income" ("**ATI**") calculation for AMT purposes;
- Raising the AMT exemption amount from $40,000 to the start of the 4th federal tax bracket ($173,205 for 2024) (so that the AMT is not levied on the "middle class"); and
- Increasing the AMT rate from 15% to 20.5%

As a part of the "Broadening the AMT Base" initiative, many tax credits would only be included at 50% for the purposes of calculating the "basic minimum tax credit" for the ATI calculation. One of the major concerns was limiting the donation credit to 50% for AMT purposes, which was met with much disdain from the tax and charity communities. Our firm posted an **extensive blog** on this particular topic. This feedback was apparently taken into consideration and Budget 2024 has proposed to amend the draft legislation to allow 80% (rather than the originally proposed 50%) of donation credits for AMT purposes. This is a positive change for taxpayers, with the caveat that fully allowing donation credits for AMT purposes would have been ideal. The effect of this change, in isolation, greatly improves the ability of high-income taxpayers to donate to charity where their income is composed of primarily income other than capital gain (e.g., salary and dividends). However, taxpayers with substantial realized capital gains making large donations will likely continue to be subject to increased AMT even with this proposed change.

The example below illustrates the effect of the proposed AMT changes compared to the AMT regime that applies to years ending before 2024 and the proposed AMT changes in the 2023 Budget for an individual with a $5 million capital gain (not eligible for the lifetime capital gains exemption) and makes the maximum donations allowable. The calculations below assume no other forms of income and only contemplate federal AMT.

	Capital Gain			
Capital Gain	5,000,000	5,000,000	5,000,000	
Amount of Donation	1,875,000	1,875,000	2,468,750	**Note 1**
"Regular" Tax Calculation				
Capital Gain	5,000,000	5,000,000	5,000,000	
Inclusion Rate	50.00%	50.00%	65.83%	**Note 2**
Taxable Capital Gain (Income)	2,500,000	2,500,000	3,291,667	
Tax Rate (Fedeal Only)	33.00%	33.00%	33.00%	
Federal Part I Tax owing prior to credits	(825,000)	(825,000)	(1,086,250)	
Federal donation credit	618,750	618,750	814,687	
Net Tax - Prior to AMT	(206,250)	(206,250)	(271,562)	

	Old AMT - Pre 2024	AMT - Per 2023 Budget	AMT - Per 2024 Budget
Income from above	$ 2,500,000	$ 2,500,000	$ 3,291,667
Add: Non-Taxable Portion of CG	$ 2,500,000	$ 2,500,000	$ 1,645,833
Less: 1/5 of Capital Gain	$ (1,000,000)	$ -	$ -
Less: AMT Exemption	$ (40,000)	$ (173,205)	$ (173,205)
Net Adjusted Taxable Income ("ATI")	$ 3,960,000	$ 4,826,795	$ 4,764,295
AMT Rate	15.00%	20.50%	20.50%
Net ATI x AMT Rate	$ 594,000	$ 989,493	$ 976,680
Less AMT Credits	$ (618,750)	$ (309,375)	$ (651,750)
Minimum Tax Amount under AMT	**$ -**	**$ 680,118**	**$ 324,930**
Less: Part I Tax otherwise payable	$ (206,250)	$ (206,250)	$ (206,250)
AMT Carry Forward	**$ -**	**$ 473,868**	**$ 118,680**
Federal Tax including AMT	**$ 206,250**	**$ 680,118**	**$ 324,930**
Increase in Tax Burden (Compared to 2023 AMT)		**$ 473,868**	**$ 118,680**
After Tax Cash In Hand	**$ 2,918,750**	**$ 2,444,882**	**$ 2,206,320**
Effective Tax Rate (on non-donated income)	**6.60%**	**21.76%**	**12.84%**

Note 1: Maximum donation is 75% of income pursuant to the definition of "total gifts" in subsection 118.1(1) of the Act

Note 2: Inclusion blended to account for the 1/2 inclusion on the first $250,000 of capital gain

While the proposed modifications reduce the AMT burden compared to Budget 2023, there may still be tax costs to donating to charity, especially for individuals with large capital gains.

Other legislative amendments to the AMT in Budget 2024 include:

- Full deductions for the Guaranteed Income Supplement, social assistance, and workers' compensation payments;
- Full claim for the federal logging tax credit;
- Exempting Employee Ownership Trusts from the AMT; and
- Allowing certain disallowed credits under the AMT to be eligible for the AMT carry-forward (the federal political contribution tax credit, investment tax credits, and labour-sponsored funds tax credit).

All of the above amendments function as a "thinning" of the previously broadened AMT base, which are welcome.

It is also appropriate to mention that with the proposed increase to the capital gains rate, the effective federal tax rate on capital gains is now 22% which, absent any donation credit, is greater than the proposed AMT tax rate of 20.5%. This essentially means that capital gains not eligible for preferred tax treatment (i.e., the first $250,000 capital gain of an individual, QSBC or QFFP gains entitled to the LCGE, or gains entitled to CEI treatment or the EOT exemption) should no longer result in AMT on their own. This is a return to how things were prior to the Budget 2023 AMT changes. Unfortunately, this just furthers the point of how impactful the increase of the inclusion rate for capital gains will be on taxpayers with more than $250,000 capital gain in a year.

Going forward, it will be prudent for taxpayers and their advisors to review substantial transactions in a given tax year and carefully assess the impact that the AMT may have to help guide charitable giving.

This change is expected to be applicable on or after January 1, 2024 (i.e., the day as the previously announced AMT changes).

F). Accelerated Capital Cost Allowance

Budget 2024 proposes accelerated Capital Cost Allowance ("**CCA**") deductions for (1) certain technology assets and (2) purpose-built rental housing. These measures build upon the recently enacted:

1. Accelerated Investment Incentive, announced in the 2018 Fall Economic Statement, which very generally provided,

    - increasing available CCA on new additions by 50 percent, suspending the half-year rule on many CCA classes until 2023 with a phase-out until 2027, and
    - immediate expensing of certain manufacturing and processing machinery and equipment and clean energy equipment, and

2. Immediate Expensing Incentive, announced in Budget 2021, allowed a CCPC to claim CCA of up to $1.5M per year on eligible property (generally excluding long-lived assets, but in addition to the immediate expensing in the Accelerated Investment Incentive) available for use by the end of 2023. This incentive was expanded in 2022 to include certain proprietorships and partnerships for depreciable property available for use by the end of 2024 (or 2023, if not all members of a partnership are individuals).

Productivity-Enhancing Assets

Immediate (100%) expensing will be available for CCA assets in Class 44 (patents or the rights to use patented information for a limited or unlimited period), Class 46 (data network infrastructure equipment and related systems software), and Class 50 (general-purpose electronic data-processing equipment and systems software), instead of the typical CCA rates for those classes of 25%, 30%, and 55%, respectively.

In order to qualify, the property must be acquired on or after April 16, 2024, and available for use by the end of 2026. Similar to other recent accelerated CCA rules, there is also a restriction on used property acquired from a non-arm's-length person that has been transferred on a tax-deferred basis.

For short taxation years, the accelerated CCA will be prorated (as per typical proration rules), but the remainder will not be able to be accelerated in a subsequent taxation year.

Purpose-Built Rental Housing

Budget 2024 proposes to increase the CCA available on Class 1 buildings from the current 4% to 10% for new eligible purpose-built rental projects that begin construction on or after April 16, 2024, and before the end of 2030 and are available for use before the end of 2035. Similar to the recent GST rebate for new purpose-built rental housing, an eligible property will be a residential complex 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. Renovations to existing buildings will not qualify, however new additions may qualify. This new measure

will also interact with the Accelerated Investment Incentive, to potentially provide elimination of the half-year rule until the end of 2027.

We welcome measures to spur investment and economic growth. An extension of the Immediate Expensing Incentive (or at least the inclusion of more types of depreciable property) would have been preferable and simpler to implement rather than limiting ongoing immediate expensing to three specific (technology-related) CCA classes. The timing of acquisition of eligible property should be considered if the taxpayer is expected to be subject to a short taxation year.

Combined with other incentives, we are hopeful the Purpose-Built Rental Housing measure will encourage building more housing. However, on its own, accelerated CCA may not have much impact, if deductions for high financing costs prevent actual use of accelerated CCA for many years.

G). Non-Compliance Penalties with Information Requests

Budget 2024 includes provisions that would increase the CRA's information-gathering abilities, in large part, by imposing monetary penalties on individuals who fail to comply with the CRA's requests for information.

The proposals would allow the CRA to issue notices of non-compliance to individuals who have failed to comply with a requirement or notice to provide assistance or information to the CRA. The proposals could further impose a penalty on a person who has been issued a notice of non-compliance, amounting to $50 per day that the notice is outstanding, up to a $25,000 maximum. Notice of non-compliance would be reviewable by the CRA upon the request of the person to whom it was issued and (along with any penalties) could be vacated if found to be unreasonable.

The proposals would also impose a new monetary penalty on individuals for failing to comply with compliance orders that have been issued by a court. The CRA can seek a compliance order from a court in circumstances where a taxpayer has failed to comply with the CRA's information requests. Historically, no monetary penalty has been imposed on an individual when they fail to comply with such an order. The proposals in Budget 2024 would impose a monetary penalty amounting to 10% of the aggregate tax payable by the taxpayer for the years to which the compliance order relates. As proposed, such penalties could only be proposed in circumstances where the tax owing for the tax years in question exceeds $50,000.

Budget 2024 also includes proposals that:

- Require information or documents provided pursuant to the Income Tax Act to be provided under oath or affirmation; and
- Extending stop-the-clock rules for reassessments in circumstances where a taxpayer seeks judicial review of a requirement or notice issued in respect of an audit or enforcement process or during a period for which a notice of non-compliance is outstanding.

These proposals are a heavy-handed way to enforce compliance. The Act already contains numerous penalties that can apply in various situations and this proposal simply adds to the pile. Going forward, it will be paramount to respond to the CRA on a timely basis. These proposals are expected to come into force upon receiving royal assent.

H). Carbon Rebate To Small and Medium Sized Corporations

Budget 2024 proposes to grant a Carbon Tax rebate to small and medium-sized corporations. Until now, rebates in the provinces in which the federal Carbon Tax applies (i.e. excluding B.C. and Quebec) have been limited to individuals (and farmers under a separate tax credit for the use of natural gas and propane). The government states that 90% of the federal Carbon Tax collected is returned to individuals through those existing rebates.

This measure is intended to rebate (presumably) that remaining 10% of Carbon Tax collected to CCPCs (and Indigenous governments) based on the number of employees. A CCPC with more than 499 employees will not qualify, and presumably, a CCPC must have a minimum of one employee to qualify. No application is necessary, although a tax return must be filed for the relevant year. The rebate will be retroactive from 2019, resulting in an expected $2.5B expenditure in the government's 2024-2025 year.

It is not clear why the government felt this rebate was necessary, especially while other taxes on corporations are being increased. Presumably, and consistent with the government's commitment to a Carbon Tax, the government believes a fully revenue-neutral Carbon Tax is more effective than financing public transportation or other carbon reduction initiatives.

I). Reg 105 Withholding Waiver Process For Canadian Payers Paying Non-Resident Service Providers

Budget 2024 includes a proposal to provide the CRA with the authority to waive the withholding requirement of Canadian residents to withhold 15% for payments to non-resident service providers (providing services in Canada) if the non-resident service provider would not be subject to Canadian tax due to a tax treaty between its country of residence and Canada.

Finance has identified a specific issue that has plagued Canadian businesses for quite some time. The issue is that Canadian entities, currently, are required to withhold 15% of gross payments made to non-residents providing services in Canada, unless a waiver has been provided. Currently the ability to obtain a waiver from this withholding lies solely with the non-resident service provider (i.e., a regulation 105 waiver).

As an example, Canco (a Canadian resident corporation) purchased a specialized machine that requires US Contractor (non-resident of Canada) to travel to Canada to properly install the machine. Under the current rules, any payments made to the non-resident must have 15% withheld and remitted to the CRA. In many cases, the US Contractor would not be subject to Canadian tax due to not having a permanent establishment in Canada. The current rules allow for the US Contractor to apply to the CRA to waive the withholding requirement for Canco. The problem that Finance has correctly identified is that the US Contractor now has to apply to a foreign (to them) taxing authority and go through the CRA to obtain said waiver, which can be a painstaking process. In our experience, the US Contractor, in this example, would often opt not to engage in this waiver process and simply increase their prices to the detriment of Canco.

Budget 2024 proposes to allow Canco to apply for the waiver directly, taking the burden off the US Contractor (provided the CRA is satisfied that US Contractor would not be subject to Canadian tax). Presumably the idea is that non-resident service providers will not charge inflated prices to compensate for their administrative burden of dealing with the Canadian tax authority.

Frankly, this is a good proposal by Finance and should be welcomed by many Canadian businesses. We cannot ignore the fact that this does introduce a new (optional) administrative burden on Canadian businesses, which is a valid concern. However, the current system requiring Canadians to withhold and remit tax on payments to non-resident service providers is an equal, if not more arduous, burden that Canadian businesses face.

This proposal is expected to be applicable upon receiving royal assent.

J). Sweetening The RRSP Home Buyers Plan

The budget proposes an increase to the maximum eligible amount that can be withdrawn from an individual's RRSP and applied against the purchase price of a first home from $35,000 to $60,000 for withdrawals occurring after Budget Day.

The Home Buyers Plan ("**HBP**") enables first-time home buyers to subsidize the cost of a downpayment using their prior contributions to RRSPs. Contributions to an RRSP are generally made on a tax-deferred basis. The HBP allows for funds withdrawn from an RRSP under certain circumstances to retain their tax-deferred attributes, which ultimately means more cash available to the individual for the purpose of making a downpayment. With the proposed increase to $60,000, first-time homebuyers will be able to access even more tax-deferred cash for the purpose of acquiring a home, assuming they have already made sufficient contributions to an RRSP.

Normally, RRSP funds withdrawn under the HBP must be repaid within fifteen years, beginning two years after the funds are first withdrawn. The Budget proposes a temporary increase to this repayment grace period from two years to five, which would only be available with respect to eligible withdrawals made between January 1, 2022, and December 31, 2025.

If an individual utilized the entire $60,000 maximum eligible withdrawal amount, they would have to repay 1/15 of that amount or $4,000 per year. This could be a fairly onerous obligation given that a first-time home buyer may also have a sizeable mortgage to pay down after making their downpayment. In this sense, the extended grace period may be especially important as it gives buyers the opportunity to better manage that repayment obligation (whether through savings, pre-emptively reducing the RRSP repayment obligation or other payment obligations like their mortgage, or by improving their income-earning capacity).

An individual may also be able to reduce their mandatory RRSP repayment obligation by using the HBP in conjunction with the First Home Savings Account ("**FHSA**"). The RRSP, HBP and FHSA provisions, as presently drafted, allow for an individual to withdraw funds from an RRSP under the HBP and then contribute those funds to an FHSA before finally applying them toward the purchase price of a home. In addition to any prior deduction they may have claimed for having contributed to an RRSP, using the HBP and FHSA sequentially in this manner can create a deduction when the funds are re-invested in the FHSA. That funds have been withdrawn from an RRSP under the HBP has no impact on eligibility for the FHSA deduction (though a direct transfer from an RRSP to an FHSA would).

To illustrate, if an individual were to open an FHSA in 2024, they would have $8,000 of available contribution room for that account. By first contributing the funds to an RRSP, they would be able to claim a deduction of $8,000 from their income. They could then withdraw the $8,000 under the HBP on a tax-deferred basis before then contributing that same $8,000 to their FHSA, entitling them to another deduction of $8,000 from their income. In this example, the taxpayer would be able to contribute $8,000 towards the purchase of their first home and claim $16,000 worth of deductions in the process. Depending on the marginal tax rate for that individual, this deduction could mean anywhere between $4,000 and $8,000 in tax savings, which could then be used to immediately repay a portion (or all) of the RRSP withdrawals.

This option allows first-time homebuyers to leverage both the HBP and FHSA tax incentives to reduce their out-of-pocket cost in acquiring a first home while also generating considerable tax savings through deductions from income that can help reduce the burden of repaying amounts withdrawn from their RRSP. First-time home buyers must be careful in how they time these transactions, as there are specific timing criteria that must be met for withdrawals under the HBP and from an FHSA.

K). Interest Deductibility Limits – Purpose-Built Rental Housing Elective Exemption

The proposed excessive interest and financing expenses limitation ("**EIFEL**") regime was announced in the 2021 budget on April 19, 2021 is now before parliament in Bill C-59. Generally, EIFEL will limit interest and financing expenses to 30% (40% for taxation years beginning on or after October 1, 2023, and before January 1, 2024) of "tax EBITDA". The EIFEL rules are intended to address BEPS Action 4: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments.

Budget 2024 proposes to include an elective exemption to the EIFEL rules 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. This change is expected to be applicable for taxation years that begin on or after October 1, 2023, consistent with the current EIFEL amendments.

According to the Budget 2024 documents, "eligible purpose-built rental housing" would be a residential complex:

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

This measure is on-brand and will attempt to promote the building of housing in Canada to alleviate the Government's housing concerns, however, with no draft legislation released with the Budget, it remains to be seen how this proposal will be implemented. That said, this is undoubtedly a positive for taxpayers and Canadians at large.

We also hope that this elective exemption will apply not just to newly built or acquired eligible purpose-built rental housing but also to properties that were built or acquired prior to October 1, 2023, or construction projects that were already underway on that date. The high-interest rate environment has caused many housing providers to inadvertently fall within the EIFEL (e.g. because of a foreign affiliate in their corporate structure or having a specified shareholder who is a non-resident of Canada), which takes away from the after-tax cashflow they have to reinvest in their tenants and to build new housing projects.

L). Crypto-Asset Reporting Framework

Budget 2024 proposes to implement the OECD-developed Crypto-Asset Reporting Framework ("**CARF**") in Canada. Broadly, Canada's implementation of CARF will require Canadian resident individuals and entities (or carry on business in Canada) that provide business services effectuating exchange transactions in Crypto-Assets to report to the CRA certain Crypto-Asset transactions. This would include crypto exchanges, crypto-asset brokers and dealers, and operators of crypto-asset automated teller machines. The reporting requirements would not only require reporting of the transactions themselves but would require Crypto-Asset service providers to obtain and report information on each of their customers, including:

- name;
- address;
- date of birth;
- jurisdiction(s) of residence;
- taxpayer identification numbers for each jurisdiction of residence; and

- in the case of non-natural persons, the same information listed above is for the persons who exercise control over such entities.

Long story short, in the near future Crypto-Assets will be subject to the same reporting standards that financial accounts are currently subject to. No draft legislation has been released in the Budget, but this change is expected to be applicable for 2026 and later calendar years.

We think transparency is a good thing in general (as long as the data is forever kept private and secured), but this will likely further encourage privacy-minded crypto-asset holders to shift their assets to offshore exchanges or cold wallets that the Canadian authorities will have a very hard time finding.

M). Removal Of Criminal Penalties For Reportable and Notifiable Transaction Reporting

Since June 22, 2023, transactions that meet the broadly worded definition of a "reportable transaction" or a "notifiable transaction" are required to be disclosed to the CRA on Form RC312. The obligation to make the disclosure falls not only on the taxpayer but also on the counter-party to the transaction, every advisor or promoter in respect of the transaction, and persons who do not deal at arm's length with an advisor or promoter and who are entitled to a fee in respect of the transaction. The penalty for non-compliance is set out in the specific reportable transaction and notifiable transaction provisions and they are extremely onerous.

Given the onerous penalties that can already be levied, the Government did not think it was necessary to *also* apply a potential criminal penalty of $25,000 and imprisonment of up to a year to the non-compliant taxpayer, counter-party, advisor, promoter, and persons not dealing at arm's length with such advisor or promoter, so Budget 2024 removed reportable and notifiable reporting from the scope of this penalty provision. That is great, but it does not begin to address the bigger problem of the definition of reportable and notifiable transactions being so broadly worded that they are causing issues with everyday commercial transactions that are not remotely tax-motivated. Also, it appears removing reportable and notifiable transaction reporting the scope of the criminal penalty may be the Government's strategy to render moot the challenge currently being made at the British Colombia Supreme Court regarding whether the mandatory disclosure rules should apply to lawyers.

N). Disqualification Of Closely-Held Mutual Fund Corporations

A mutual fund corporation ("**MFC**") is a special type of corporation that allows for flow-through tax treatment to the shareholder. MFCs are similar to mutual fund trusts, but offer certain advantages when held in unregistered accounts.

The government has identified use of MFCs in unintended ways, where a class of the MFC is listed on a designated stock exchange (in order to qualify as a MFC), however all or substantially all of the value of the MFC is held by a small group of investors owning a different class of (unlisted) shares.

Budget 2024 proposes amendments to the Act to preclude a corporation from qualifying as an MFC, where a group that does not deal with each other at arm's length owns more than 10% of the value of the MFC, and it is controlled by or for the benefit of one or more members of that group. Exceptions are provided for a relatively new MFC that may not yet be widely held (less than two years old and less than $5M in value) and for prescribed labour-sponsored venture capital corporations. This measure is proposed to apply taxation years that begin after 2024.

This is a fairly specific tweak that is likely to impact only a handful of MFCs and existing rules would likely have been sufficient to deal with any abuse of the MFC rules. Therefore, this change is to ease CRA's enforcement burden for offending MFCs.

O). Canada Child Benefit – Death Of Child

Budget 2024 proposes to extend eligibility for the Canada Child Benefit in the event of the death of the qualified dependent (i.e., the child). The Canada Child Benefit provides monthly financial assistance for parents who are responsible for the care and upbringing of qualified dependents and whose annual income falls below certain specified thresholds. Normally, an individual would lose their entitlement to the Canada Child Benefit in respect of a particular child if that child were to die. The parent would be required to report their change of status to the CRA before the end of the month following the month in which the child had died, and failure to do so could mean an obligation to repay any overpayments.

Budget 2024 proposes a set of rules deeming a deceased child to still be a qualified dependent and the parent to be eligible for the Canada Child Benefit for a period of six months following the death of the child. These proposed rules do not relieve the parent of the obligation to report their change of status before the end of the

month following the month of the child's death, but it does provide for continued financial support to a family for a period immediately following the death of the child. The proposed rules would apply the extended benefit period in respect of deaths occurring after 2024 and would also apply to deductions available under the Child Disability Benefit.

This is a compassionate proposal from Finance, the loss of a child is a traumatic event and the last thing grieving parents need is the CRA hounding them to repay benefits received post the death of their child.

P). Expansion Of Disability Supports Deduction

Budget 2024 will expand the list of expenses for disability supports that are eligible for deduction on account of impairment in an individual's physical or mental functions. The list now includes the cost of various supports, including ergonomic work chairs and bed positioning devices (as well as the cost paid for an ergonomic assessment for those supports), mobile computer carts, alternative input and digital pen devices for use of computers, navigation devices for low vision and memory or organization aids for eligible individuals. A medical practitioner must have either prescribed these supports or certified that they were required for the individual for them to be able to claim the deduction.

The proposals will also allow for individuals to claim expenses with respect to service animals to be claimed either as deductions under the Disability Supports Deduction or as a credit under the Medical Expense Tax Credit (as they had been previously).

This measure is expected to apply to the 2024 taxation year and beyond.

Q). Charities and Qualified Donees

Budget 2024 includes a number of proposals regarding registration and reporting obligations of charities and qualified donees. Of note, foreign charities will now be able to register as qualified donees in Canada on a temporary basis for an extended period of 36 months rather than 24. As qualified donees, foreign charities are obliged to submit annual information returns disclosing the total amount of receipts issued to Canadian donors, the total amount of gifts received from qualified donees and information regarding the use of such gifts, which disclosures would be publicly available.

The Budget also includes proposals that intend to modernize services and communications provided by the CRA. These proposals would:

- allow the CRA to communicate official notices digitally with charities, provided they have opted to receive such information electronically;
- Publish official notices of revocation on government webpages; and
- Remove requirement for objections to be addressed directly to the Assistant Commissioner of the CRA's Appeals Branch.

The proposals would also modernize and simplify receipting obligations for registered charities and qualified donees. Of note, the proposals would allow charities to issue receipts electronically and alleviate some information previously required to be included on official receipts.

The measures addressing foreign charities are expected to be effective on Budget Day, and all remaining measures are expected to be effective upon receiving royal assent.

R). Supplementary Rule To Prevent Use Of Intermediaries To Avoid Tax Debts

The tax debt avoidance rule under the Income Tax Act imposes joint and several, or solidary, liability with respect to a tax obligation in circumstances where a taxpayer has transferred assets to non-arms-length persons as a means of avoiding tax liability. Budget 2024 introduces a supplementary deeming rule that would strengthen the ambit of the tax debt avoidance rule to cover certain types of transactions that are aimed at avoiding the tax debt avoidance rule itself.

The supplementary rule would deem property transferred in arrangements involving a person other than the tax debtor and transferee (that person referred to in the proposed legislation as the "planner") to have been transferred by a tax debtor to a transferee for the purposes of the tax debt avoidance rule, thus imposing liability for the tax debt, jointly and severally, on the debtor and transferee.

The criteria for the proposed supplementary rule to apply include:

- There has been a transfer of property from a tax debtor to another person;

- As part of the same transaction or series of transactions, there has been a separate transfer of property from a person other than the tax debtor to a transferee that does not deal at arm's length with the tax debtor; and
- One of the purposes of the transaction or series of transactions is to avoid joint and several liability.

The proposals would expand the scope of the tax debt liability to include any portion of the tax debt that has been retained by a planner as a fee (previously, such fees have been excluded from the tax liability imposed under the tax debt avoidance rules). The proposals would also expand the use of penalties imposed under the tax debt avoidance rule to apply in circumstances contemplated under the proposed supplementary rule.

S). Consultation On Potential New Tax on Residentially Zoned Vacant Land

To encourage more housing development, it is announced that the Government will start a new consultation process on potentially creating a new tax on residentially zoned vacant land. We generally do not think taxes aimed at specific industries is good tax policy. We caution that any such tax regime must take local circumstances into account.

T). Extension Of Mineral Exploration Tax Credit

Budget 2024 proposes to extend eligibility for the Mineral Exploration Tax Credit ("**METC**") by one year. The METC provides a 15% tax credit for mining exploration expenditures that have been renounced by mining companies to shareholders under flow-through share agreements. Previously, the incentive was slated to expire at the end of 2024 and would not be available for flow-through share agreements entered into after March 2024. As proposed in the Budget, the METC will now be available with respect to expenditures that have been incurred before the end of 2025 and that have been renounced under flow-through share agreements entered into before March 31, 2025.

U). Increase To Volunteer Firefighters and Search and Rescue Volunteers Tax Credits

Budget 2024 proposes to increase the Volunteer Firefighters and Search and Rescue Volunteers Tax Credits. The credits are available to volunteer firefighters

and search and rescue volunteers who perform at least 200 hours of eligible service in the year. Previously, the credit was calculated by multiplying $3,000 by the prescribed percentage rate of 15%, which equalled $450 in tax credits. Budget 2024 proposes to double the credit to $6,000 multiplied by 15%, or $900 total.