Summary of Budget 2024 Proposals of Greatest Relevance to Clients of McLeod Law

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McLeod Law LLP's tax lawyers have prepared this summary of Budget 2024 based on the needs and interests of our clients and their advisors; consequently, certain proposals included in Budget 2024 have been excluded intentionally from this summary.

This summary is based on the contents of the budget speech delivered in Parliament on April 16, 2024 by the Deputy Prime Minister and Minister of Finance and a document released by the Government of Canada entitled "Federal Budget 2024 Tax Measures: Supplementary Information", which stated that "additional design details will be released in the coming months".

Increase in Capital Gains Inclusion Rate

The Government of Canada is proposing an increase in the taxable portion of capital gains realized by individuals, up from the current 50 per cent to 66-2/3% for annual capital gains in excess of $250,000 that are realized after June 24, 2024.

Presumably each spouse will have access to the 50% gains inclusion rate on capital gains realized by him or her.

This change was proposed with no grandfathering whatever for gains accrued up to April 16, 2024 ("**Budget Day**"). When a tax on capital gains was first introduced in Canada in 1972, a "valuation day" provided grandfathering for all gains that had accrued prior to the end of 1971. Only gains that accrued after that valuation day were subjected to the new capital gains tax. Under Budget 2024, on the other hand, gains that had accrued long before Budget Day (on property which the owner had thought would be subject to a 50% inclusion rate with no limitation) instead will be subject to a 66-2/3% inclusion in income to the extent they are realized by an individual after June 24, 2024 and exceed $250,000 for the year of sale.

In the following example provided by the Department of Finance, an individual has a $400,000 salary with capital gains of $300,000. Here is how this proposed tax change will affect capital gains for that individual. At present, 50% of the $300,000 capital gain (i.e. $150,000) constitutes a "taxable capital gain" and is required to be included in computing the individual's income for the year in which the gain is realized. Under the proposed change in Budget 2024, this individual's taxable capital gain will increase to 66-2/3% on the $50,000 portion of the capital gain that exceeds $250,000 for the year (creating a required income inclusion totalling $158,333). Specifically, 66-2/3% of $50,000 of this taxpayer's $300,000 capital gain ($33,333.33) will be required to be included in income, and 50% of the remaining $250,000 will be included in income ($125,000) - for a total taxable capital gain of $158,333.

Capital property that is owned by an individual at the time of his or her death is deemed, for income tax purposes, to be disposed of by that individual for proceeds equal to its then fair market value. This can create a substantial capital gain - and tax liability - for an individual upon death. No relief is provided in Budget 2024 to alleviate the fact that the deceased individual will be required to include in income 66-2/3% of the entire deemed capital gain in excess of $250,000 for the year of death.

Budget 2024 stated as follows in relation to gains realized by an individual indirectly through owning an interest in a partnership or trust, and in relation to the application of capital losses from various years:

> The $250,000 threshold would effectively apply to capital gains realized by an individual, either directly or indirectly via a partnership or trust, net of any:
>
> - 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 Gains Exemption, the proposed Employee Ownership Trust Exemption or the proposed Canadian Entrepreneurs' Incentive (all of which are discussed below) is claimed.

Budget 2024 also stated as follows in relation to individuals who have been granted employee stock options:

> Claimants of the employee stock option deduction would be provided a one-third deduction of the taxable benefit to reflect the new capital gains inclusion rate, but would be entitled to a deduction of one-half the taxable benefit up to a combined limit of $250,000 for both employee stock options and capital gains.

PLANNING POINTS:

Although we will need to await the tabling of draft legislation implementing many of the Budget 2024 provisions in order to achieve a greater degree of certainty, we have set forth in this Summary what we consider to be sensible tax planning responses to certain of the Budget proposals.

(a) Because the increased gains inclusion rate of 66-2/3% will apply only to dispositions that take place <u>after</u> June 24, 2024, it would appear that gains realized by an individual before June 25, 2024 are <u>not intended to reduce the $250,000 limit</u> to that same individual in respect of gains realized between June 25 and December 31, 2024. In other words, an individual would appear to be required to include in income only 50% of any capital gain (regardless of its magnitude) realized before June 25, 2024, and also to include in income only 50% of the first $250,000 of capital gains realized after June 24 and up to midnight on December 31, 2024.

(b) Also, since the 66-2/3% gains inclusion rate will apply only to dispositions made following June 24, 2024, it is likely that in some circumstances individuals will seek to complete a sale of property (such as marketable securities, shares of a private corporation or real estate) <u>on or before June 24, 2024</u> in order to obtain the benefit of the 50% inclusion rate <u>irrespective of the amount of the capital gain</u>. While it is not productive to <u>prepay</u> income tax, it could well make sense to utilize this approach for property that an individual intends to sell in any event <u>over the near term</u> (for example, in 2024 or early 2025). It will be important in such cases to <u>actually close</u> the sale transaction not later than June 24, 2024.

(c) It should also be possible for an individual to sell capital property after June 24, 2024 and take back a promissory note, mortgage or other debt obligation that is payable in annual instalments over up to a five-year period, and to structure that debt obligation in a manner that will maximize the individual's access to the 50% inclusion rate on the principal instalments received. The reason is that paragraph 40(1)(a) of the *Income Tax Act* ("ITA") provides that a <u>taxpayer's gain</u> for a taxation year from selling his capital property on an instalment basis can be included in his income over the period - not to exceed five years – during which he <u>receives instalments of principal on such debt obligation</u>. In the best-case scenario, for example, if an individual's only sale of capital property in a given year were to be completed on an instalment basis, and $250,000 of the sale proceeds were receivable under a promissory note or mortgage in the year of sale and in each of the four subsequent years, each instalment of principal would be included in the individual vendor's income to the extent of 50% (rather than 66-2/3%). To the extent that a particular instalment of principal received in a particular year were to <u>exceed</u> $250,000, then 66-2/3% of such excess portion of that instalment would be required to be included in computing the individual vendor's income for tax purposes for that year.

(d) The same treatment as is described in the preceding item (c) should also apply to gains that had been realized by an individual vendor in taxation years preceding 2024 where that individual had taken back a debt obligation payable in annual instalments, including instalments that continued to be payable in 2024, 2025 and later years (not exceeding five years after the year of sale). Specifically, the individual should be required to include those principal repayments received in the $250,000 limit that will attract the 50% gains inclusion rate for each such year.

(e) We anticipate that the increase in the capital gains inclusion rate will serve as an increased incentive for individuals to undertake "freeze" transactions pursuant to which individual common shareholders of a corporation exchange all or a portion of their common shares for fixed value preferred shares, following which other younger family members - or a family trust of which those younger family members are beneficiaries - subscribe for new common shares that will participate in the future growth in value of the corporation. Freeze transactions generally have the benefit of limiting the amount of capital gain that will be realized upon the death of the parent shareholders - and hence the amount of capital gain that will be required to be included in the parents' income to the extent of 66-2/3% - at the time of their passing.

Corporations and trusts (to the extent that a trust does not make a designation of its taxable capital gains in favour of one or more of its individual beneficiaries) will be required to include in income 66-2/3% of the full amount of their capital gains (i.e. without the benefit of having only 50% of the first $250,000 per year thereof included in income).

Consequently, Budget 2024 will create a sizable difference in the gains inclusion rate that depends on whether a capital gain is realized by an individual as distinct from a corporation or trust - irrespective of whether the same individual owns all the shares of such corporation or is a beneficiary of such trust.

COMMENT: This represents a historic departure from the longstanding concept of "full integration" under which it made no material difference whether investment income or a capital gain was earned by an individual or a private corporation. Under the principle of full integration, once such income or capital gain had been distributed by a private reparation to its individual shareholders, it attracted income tax to substantially the same extent as if that same investment income or capital gain had been earned directly by the individual. Under Budget 2024, however, that all changes. Going forward, assuming that Budget 2024 is enacted in its current form, the first $250,000 per year of capital gains realized by an individual taxpayer is to be included in computing income to the extent of 50% but - if the same gain is realized by a corporation - 66-2/3 of the gain must be included in that entity's income. We are disappointed that the 50% gains inclusion rate on the first $250,000 per year of capital gain was not made available to individuals and Canadian-controlled private corporations alike (particularly in light of the extent to which the latter contribute to the Canadian economy, including by providing significant employment, innovation and entrepreneurial opportunity). This increase in the gains inclusion rate risks reducing the incentive to invest one's capital by undertaking a new or expanded business venture.

PLANNING POINT: As a general proposition, this should create an incentive for trustees of a Canadian-resident trust to make "designations" (under ITA subsection 104(21) of the *Income Tax Act*) of capital gains realized by the trust in favour of individual beneficiaries of the trust, so that those capital gains can have the benefit of the 50% inclusion rate in computing the income of the individual beneficiary - to the extent that the amount of all capital gains of such beneficiary for the year does not exceed $250,000.

Where a trustee considers that it is not in the best interest of a particular beneficiary to distribute significant amounts of cash, marketable securities or other trust property to that beneficiary, consideration should be given to amending the trust indenture (if necessary) to enable a reliable person to act as a "bare trustee" to receive the distribution from the trust on behalf of such beneficiary. In order to constitute a "bare trust", the bare trustee is required to transfer the property held to the beneficiary at such time as the beneficiary may require; however, in many cases the beneficiary is not aware that he or she is a beneficiary of a trust. The individual beneficiary of the bare trust will be required to include the taxable capital gain so distributed to the bare trustee in computing such beneficiary's income for the year in which the designation is made by the trust in favour of that individual beneficiary.

Although the trustee of a bare trust will have a reporting obligation in respect of the 2024 taxation year, the cost of complying with that obligation will often pale in comparison with the amount of tax that can be saved through making this type of designation. The entitlement of a Canadian-resident individual beneficiary to access the 50% gains inclusion rate (rather than the 66-2/3% inclusion rate), on $250,000 of capital gain amounts to a $41,667 lesser income inclusion for that individual beneficiary.

For the past several years, there has been a lifetime capital gains exemption which allows Canadian-resident individuals to realize up to $1,016,836 in capital gains tax-free on the sale of "qualified small business shares" and farming and fishing property. Effective on June 25, 2024, Budget 2024 proposes to increase this tax-free capital gains limit to $1.25 million for dispositions that occur after June 24, 2024, and to continue to index that $1,250,000 amount of that tax-free limit to inflation after 2024.

No change will be made to the principal residence exemption.

For individuals, the $250,000 threshold will not be prorated for 2024; rather, the 66-2/3% inclusion rate should apply only to the extent that the capital gains realized by the individual after June 24, 2024 up to and including December 31, 2024 exceed $250,000.

Canadian Entrepreneurial Incentive

In addition to the proposed increased capital gains exemption limit of $1,250,000 after 2024 and the entitlement to include in income 50% (rather than 66-2/3%) of capital gains up to $250,000 per year, Budget 2024 proposes to support Canadian entrepreneurs through a new "Canadian Entrepreneurs' Incentive" for qualifying individuals. It will provide tax savings for individual entrepreneurs who dispose of shares in the capital of certain Canadian-controlled private corporations ("**CCPCs**") that meet numerous criteria required by the Government of Canada.

Under the proposed Canadian Entrepreneurs' Incentive, an eligible individual would be entitled to include in income - instead of 66-2/3% of capital gains - only 1/2 of that rate (ie. 33-1/3%). The Supplementary Information provided by Finance Canada with Budget 2024 states, however, that the Canadian Entrepreneurs' Incentive "would provide for a capital gains inclusion rate that is one half the prevailing inclusion rate, on up to $2 million in capital gains per individual over their lifetime [underlining added by us]." It would be consistent with that comment that the 50% inclusion rate applicable to the first $250,000 of capital gains realized by an individual in a particular year be reduced to a 25% inclusion rate; however, we will have to await the release of the draft legislation implementing Budget 2024 to ascertain whether that is the case. There will be a lifetime limit on the amount of capital gains eligible for the reduced inclusion rate - that limit is up to $2 million of capital gains from the disposition after 2024 of qualifying shares. This $2 million lifetime limit is, however, proposed to be phased in over a protracted period of 10 years, commencing with $200,000 beginning on January 1, 2025, and ending with $2 million on January 1, 2034.

Once the proposed Canadian Entrepreneurs' Incentive has been fully phased in, however, it should afford eligible entrepreneurs with a significant incentive to risk their capital.

> **COMMENT: Budget 2024 provides no clarity on how, if at all, capital gains eligible for the Canadian Entrepreneurs' Incentive will impact adjusted taxable income for AMT purposes. It is hoped that any such impact does not negate the potential benefit of the Canadian Entrepreneurs' Incentive.**

In order for a share owned by an individual to qualify for the Canadian Entrepreneurs' Incentive, the following numerous conditions must be met during various time periods (which we have underlined below):

- At the time of sale, the share must be a share of a "small business corporation", as defined in the ITA, and must be owned directly by the disposing individual.

  > **COMMENT: This is the same requirement as is found in paragraph (a) of the "qualified small business corporation share" (QSBC share") definition in ITA subsection 110.6(1); accordingly, any share that qualifies for the capital gains deduction as a QSBC share should satisfy this requirement.**

- Throughout the 24-month period preceding the time of sale, the issuer corporation must be a CCPC, and more than 50% of the fair market value of the assets of the corporation must be
  - attributable to assets used principally in an active business carried on primarily in Canada by the CCPC or by a related corporation,

- shares and debts of "connected" corporations (within the meaning in ITA subsection 186(4)), or
- some combination thereof.

COMMENT: The above three requirement are the same as those found in paragraph (c) of the QSBC share definition, so any share that qualifies for the capital gains deduction as a QSBC share should satisfy these three requirements.

- The individual must be a "founding investor" of the CCPC "at the time the corporation was initially capitalized."

COMMENT: It is unclear how the term "founding investor" will be defined or when a corporation will be considered to have been "initially capitalized," as Budget 2024 does not elaborate on those requirements. Presumably they will be clarified in the forthcoming draft legislation.

- The individual must hold the share for a minimum of five years prior to the time of sale.

COMMENT: It is unclear whether this five-year holding period will include times during which the share was held by a person or partnership related to the individual.

- At all times since the initial share subscription, the claimant must directly have owned shares representing more than 10% of the votes and value of all of the outstanding shares of the CCPC.

COMMENT: The rationale for this minimum shareholding threshold is not explained in Budget 2024.

- Throughout the five-year period preceding the disposition, the individual must be engaged in the CCPC's business on a regular, continuous, and substantial basis.

COMMENT: The wording of these requirements in Budget 2024 appears to adopt the language in the definitions of "excluded business" and "excluded shares" in the "tax on split income" (TOSI) provisions of ITA subsection 120.4(1); however, there is no indication of whether the clarifying rules in ITA subsection 120.4(1.1) will also apply for this purpose.

- The share cannot be a direct or indirect investment in a professional corporation, a corporation whose principal asset is the "reputation or skill of an employee", or a corporation carrying on a business in the financial, insurance, real estate, food, accommodation, arts, recreation, entertainment, consulting or personal care sectors.

COMMENT: It is unclear how ascertaining whether a CCPC's principal asset is (or is not) the reputation or skill of an employee is to be measured. It is also unclear why those specific businesses were excluded from this incentive. This type of limitation does not apply to the (more generous) capital gains deduction for QSBC shares, and consequently some shares that qualify for that capital gains deduction will not qualify for the Canadian Entrepreneurs' Incentive.

- At the time of acquisition of the share, the individual entrepreneur must have given consideration for it equal to its then fair market value.

COMMENT: Undoubtedly there will be substantial uncertainty regarding whether this test has been met, since at the inception of a new enterprise, substantial skill, labour and innovation likely will have been provided by a founder, the value of which is extremely difficult measure in monetary terms.

> **Further, if the parent of an individual entrepreneur had completed a share freeze, following which the individual entrepreneur had subscribed a nominal sum for new common shares, will such subscription have satisfied this "fair market value" requirement? In our view it should - provided that the freeze was implemented correctly. Another issue is whether the individual entrepreneur could be a "founding investor" if, for example, at the time of the subscription for new common shares, that individual caused the corporation to commence a new business. Moreover, in such circumstances could that corporation be considered to have been "initially capitalized" as a result of the entrepreneur subscribing for the new common shares?" Budget 2024 refers to "the time the corporation was initially capitalized" which presumably occurred shortly after it was incorporated. Consequently, in this fact situation, the prudent course of action would be for the individual entrepreneur to form an entirely new corporation.**

No draft legislation was released for this measure.

Tax Exemption for up to $10,000,000 of Qualifying Gains on Sale of Shares to an Employee Ownership Trust

Three years ago, the Government of Canada's Budget 2021 had expressed support for employee ownership trusts as being a means of encouraging employee ownership of a business and facilitating the transition of privately owned businesses to employees, similar to vehicles that are utilized for the same purpose in the United States and the United Kingdom. The following year, Budget 2022 proposed to introduce an employee ownership trust - but no details were provided in relation to them. The next chapter in this saga was that the Notice of Ways and Means Motion that was tabled on March 28, 2023 (which subsequently became Bill C-59), provided a selling shareholder with a 10-year capital gains reserve (meaning that the vendor could include in income the resulting taxable capital gain over the 10 years following the year of sale). Many observers considered this to be an inadequate incentive. Finance Canada then responded by proposing in the 2023 Fall Economic Statement that the first $10 million of capital gains realized by an individual who sells shares to an employee ownership trust would be tax-exempt.

Budget 2024 proposes that a capital gain realized by an individual (other than a trust) as a result of a disposition to an employee ownership trust would qualify for the exemption where the following conditions are met:

- The individual, a trust of which the individual is a beneficiary, or a partnership of which the individual is a member, has disposed of shares of a corporation other than a professional corporation;
- The transaction is a "qualifying business transfer," as that term is proposed to be defined in ITA subsection 248(1);
- The acquiring trust is not already an employee ownership trust or a similar trust (the meaning of a similar trust is not set out in Budget 2024);
- Throughout the preceding 24 months:
    - The transferred shares were not owned by any person other than the individual, a related person or a partnership of which the individual was a member. In our view, the transferred shares should be able to be owned by a trust of which the individual is a beneficiary, since a disposition by such a trust satisfies the first condition above;
    - Over 50% of the fair market value of the assets of the corporation was attributable to assets used principally in an active business;
    - At any time prior to the qualifying business transfer, the individual (or the spouse or common-law partner of the individual) was actively engaged in the "qualifying business" on a regular and continuous basis for a minimum of 48 months; and
    - Immediately after the qualifying business transfer, at least 90% of the beneficiaries of the employee ownership trust are resident in Canada.

The proposed $10,000,000 exemption must be shared between all of the vendors who qualify for an exemption in relation to a disposition forming part of a particular qualifying business transfer, on whatever basis the vendors agree. This requirement to share the $10,000,000 exemption applies whether or not the vendors deal with one another at arm's length.

Budget 2024 also introduced the concept of a "disqualifying event," which means:

- the purchaser trust ceases to be an employee ownership trust because the interests of its beneficiaries are determined in an impermissible manner; or
- at the beginning of two consecutive taxation years of the subject corporation, less than 50% of the fair market value of the shares of the subject corporation is attributable to assets used principally in an active business.

If a disqualifying event occurs within 36 months of the qualifying business transfer, an exemption claimed by a vendor would be retroactively denied. If a disqualifying event occurs more than 36 months after the qualifying business transfer, the employee ownership trust will be deemed to realize a capital gain equal to the total of the exempt capital gains realized by the vendors of the shares.

To qualify for the exemption, the individual, the employee ownership trust and, if applicable, any corporation controlled by the employee ownership trust that acquires shares from the individual is required to elect to be jointly and severally liable for any tax payable by the individual if the exemption is denied because of a disqualifying event that occurs within 36 months of the qualifying business transfer. Where an election is made, the normal reassessment period will be extended for three years in respect of the exemption.

In calculating an individual vendor's adjusted taxable income for alternative minimum tax (AMT) purposes under ITA section 127.52, an exempt capital gain will be included at a rate of 30%.

Mutual Fund Corporation Changes

A mutual fund corporation by definition in the ITA must be a "public corporation." Despite that, a mutual fund corporation is subject to the refundable Part IV tax levied on portfolio dividend income earned by a private corporation. A mutual fund corporation (as well as a mutual fund trust) is not treated as a "trader or dealer" in securities for the purpose of the election under ITA subsection 39(4) - with the result that it is entitled to capital gains treatment (rather than a full income inclusion requirement) with respect to its dispositions of Canadian securities. In addition, a mutual fund corporation is entitled to deduct in computing its taxable income dividends received from taxable Canadian corporations.

A mutual fund corporation is essentially an incorporated mutual fund the shares of which are redeemable at the option of its shareholders.

Although a mutual fund corporation incurs income tax at normal corporate rates on its taxable capital gains, this tax is refunded to it to the extent that it distributes its capital gains to its shareholders by way of a "capital gains dividend" or by redeeming its shares.

One of the requirements for a corporation to be a mutual fund corporation is that it be a Canadian corporation that is a "public corporation." Generally, public corporation status can be obtained by:

a. causing a class (or series) of the mutual fund corporation's outstanding shares to be listed on a "designated stock exchange" in Canada; and

b. causing the mutual fund corporation to (i) meet certain prescribed conditions relating to the number of its shareholders, the dispersal of ownership of its outstanding shares and the public trading of those shares and (ii) having the mutual fund corporation elect under the ITA to be a public corporation.

It is not necessary that all of the outstanding classes of shares of a mutual fund corporation be listed on a designated stock exchange or that the listed shares have material value. Once a corporation qualifies as a public corporation, it will continue to be a public corporation until it meets certain conditions and either elects not to be a public corporation or the Minister of National Revenue designates it not to be a public corporation.

Budget 2024 states:

> A corporation can qualify as a mutual fund corporation under the [Tax Act] if a class of its shares is listed on a designated stock exchange in Canada, even if all other shares of the corporation are held by a corporate group and those shares represent all or substantially all of the fair market value of the issued shares of the corporation. This could allow a corporate group to use a mutual fund corporation to benefit from the special rules available to these corporations in an unintended manner.

While the Government asserts that using a mutual fund corporation to defer or avoid taxes can be challenged (presumably under the general anti-avoidance rule - GAAR), Budget 2024 proposes to add a specific rule to deny "mutual fund corporation" status to such a corporation for taxation years beginning after 2024.

The proposed rule will provide that a corporation (other than a prescribed labour-sponsored venture capital corporation) is deemed not to be a mutual fund corporation after a particular time if, at the particular time,

- a person or partnership, or any combination of persons or partnerships that do not deal with each other at arm's length (in either case referred to as "specified persons") own shares of the corporation having an aggregate fair market value (FMV) greater than 10% of the aggregate FMV of all shares of the corporation; and
- the corporation is controlled by or for the benefit of one or more specified persons.

Often a public mutual fund corporations has several classes of shares, only one of which is entitled to vote. This class of shares may be owned by the manager or by a trust for the benefit of the holders of the other shares - so that it will not be necessary for the corporation to have annual meetings of all its shareholders. If the manager (or one or more persons not dealing at arm's length with the manager) owns shares of the corporation having an aggregate fair market value greater than 10% of the aggregate value of all shares of the corporation, the corporation would be deemed not to qualify as a mutual fund corporation. Given that a manager normally establishes new share classes to invest in a particular manner, this could occur readily.

Accordingly, an exception to the proposed rule will provide that the above-described new rule denying mutual fund corporation status will not apply if:

- the corporation was incorporated not more than two years before the particular time; and
- specified persons do not own shares of the corporation with an aggregate fair market value of more than $5 million.

The exception is likely to apply very seldom.

> **PLANNING POINT: ITA subparagraph 131(1)(b)(ii) deems an amount received by a taxpayer on account of a capital gains dividend received from a mutual fund corporation to be "deemed to be a capital gain of the taxpayer from the disposition of capital property in the year." Consequently, to the extent that an individual shareholder of a mutual fund corporation receives a capital gains dividend, such individuals should be entitled to include such dividend in computing his capital gains for the year in respect of which the individual can access the 50% gains inclusion rate (on up to $250,000 for the year in which such dividend is received - combined with any unrelated capital gains that such individual may realize in the same year).**

CRA is Authorized to Waive Withholding Tax for Non-resident Service Providers

Budget 2024 proposes to provide the Canada Revenue Agency (the "**CRA**") with statutory authority to waive the requirement to withhold under Regulation 105, and to increase the circumstances in which such a waiver may be available.

ITA paragraph 153(1)(g) and Regulation 105 impose a 15% withholding tax on payments made by a resident of Canada to a non-resident person for services performed in Canada by the non-resident. Regulation 105 withholding tax is not a proxy for the actual amount of Canadian income tax for which the non-resident may be liable but, rather, is a remittance on account of the non-resident person's potential liability for same. At present, where a non-resident person is ultimately not liable for Canadian income tax (e.g., because of a tax treaty), the non-resident person is required to file a Canadian income tax return in order to seek a refund of the withheld amount. The CRA currently provides waivers of withholding in certain circumstances on an administrative basis. These waivers must generally be applied for on a transaction-by-transaction basis.

Proposed subsection 153(8) will allow the CRA to waive Regulation 105 withholding from payments made by a Canadian resident to a non-resident during a specified period of time (including in respect of many occasions on which the non-resident rendered services) in respect of:

- a business carried on by the non-resident, the income from which is exempt from tax under Part I because of a tax treaty; or
- income from providing services related to international shipping or the operation of an aircraft in international traffic that is exempt under ITA paragraph 81(1)(c).

The provision of a waiver will be subject to any conditions established by the CRA "necessary to reduce compliance risks" (including, for example, an undertaking by the non-resident to file a Canadian income tax return). If any such conditions cease to be satisfied, the CRA could revoke the waiver.

These amendments are proposed to come into force on Royal Assent.

Qualified Investments for Registered Plans

Budget 2024 announces the launch of a consultation process on the modernization of the qualified investment rules, aiming to improve clarity and consistency as they apply to different registered plans. The specific issues upon which stakeholders are invited to provide comments are the following:

- the harmonization of the qualified investment rules concerned with investments in small businesses as they apply to all different registered savings plans;
- the qualified investment status of annuities that are qualified investments only for purposes of registered retirement savings plans (RRSP), registered retirement income funds (RRIFs) and registered disability savings plans (RDSPs);
- the aptness of certain conditions applicable to certain pooled investment products to meet the definition of qualified investments, including the formal registration process for registered investments; and
- the opportunity to use the qualified investment rules to promote Canadian-based investment.

Incenting Pension Funds to Invest within Canada

The Government of Canada seeks to encourage Canadian pension funds to invest more funds within Canada. To that and, Budget 2024 announced:

- The Government will create a working group with Canadian pension plans. The group will be led by former Governor of the Bank of Canada Stephen Poloz and supported by the Deputy Prime Minister and Minister of Finance. It will concentrate on such areas of investment as digital infrastructure and artificial intelligence ("**AI**"), physical infrastructure, airport facilities, venture capital and home building (including on public lands). In addition, it will explore the removal of the so-called "30% rule" for domestic investments.
- The Government will amend the federal pension regulations to require that large federally-regulated pension plans disclose the distribution of plan investments by jurisdiction and, within each jurisdiction, by asset class. Further, the Office of the Superintendent of Financial Institutions will release publicly this information. The Government will continue to engage with the provinces and territories to discuss setting up similar disclosure regimes for large provincial and regional pension plans.

Alternative Minimum Tax

In August, 2023, the Government of Canada released draft legislation for significant changes to the AMT which had been first proposed in Budget 2023. Budget 2024 has proposed further changes to the AMT regime. The AMT is a separate regime for calculating income tax which allows for fewer deductions, tax credits, and exemptions than are provided for under the standard income tax rules. Effectively, the AMT regime is used to produce a second income tax calculation for individuals under the AMT rules. For most individuals, the normal calculation will result in a higher amount of tax owing. However, where the separate AMT calculation produces a higher amount of tax owing by an individual, the individual must pay that higher amount. Most Canadians will not be subject to AMT; however, individuals who utilize numerous deductions or credits should be prepared for the AMT's potential application.

In particular, the proposed AMT changes to the treatment of tax credits received for charitable donations are significantly helpful. Previously, the Government of Canada proposed to include only 50% of the tax credits received by individuals for charitable donations when calculating their AMT; however, Budget 2024 proposes to change this charitable donation tax credit inclusion rate to 80%, thereby reducing the tax calculated under the AMT. It appears this change comes as a result of concerns having been expressed over the AMT's negative impact on the quantum of charitable donations being made by Canadians.

Other changes to the AMT proposed by Budget 2024 include:

- Allowing for the full deduction of the Guaranteed Income Supplement, social assistance, and workers' compensation payments;
- Allowing individuals to fully claim the logging tax credit; and
- Allowing certain disallowed tax credits (i.e. investment tax credits, federal political contribution tax credits and labour-sponsored funds tax credits) to be eligible for the AMT-carryforward. Budget 2024 also proposed a number of changes to the AMT which seek to provide relief for certain trusts under the exclusion provision in ITA paragraph 127.55(f). These trusts are generally exempt from Part I income tax under ITA paragraph 81(1)(a) or subsection 149(1). Adding such trusts to the AMT calculation would defeat the purpose of excluding these trusts from Part I income tax. The Government of Canada has, therefore, proposed to exempt the following trusts from the AMT:
- An employee ownership trust (as discussed above);
- A trust established under a law of Canada or a province for the benefit of an Indigenous group, community, or people holding rights under section 35 of the Constitution Act, 1982, or under a treaty or settlement agreement between the Crown and an Indigenous group, community, or people, provided that all or substantially all of the contributions to the trust were made under the relevant, law, treaty, or settlement, or can be traced to those amounts; and
- A trust, all of the beneficiaries of which are a combination of (i) all of the members of an Indigenous group, community, or people that hold rights under section 35 of the Constitution Act, 1982; (ii) an Indigenous government described under ITA paragraph 149(1)(c; (iii) a non-profit organization organized and operated primarily for health, education, social welfare or community improvement of an Indigenous group, community, or people that holds rights under section 35 of the Constitution Act, 1982; (iv) a corporation, all of the shares or capital of which are held by any combination of persons or entities described in (ii) or (iii), or by a trust otherwise exempt from AMT because it was created pursuant to a law, treaty, or settlement agreement; or (iv) a Settlement Trust.

Home Buyer's Plan

The Home Buyer's Plan ("**HBP**") is a program from the Government of Canada which allows individuals to withdraw money from their RRSP for the purpose of purchasing their first home, without having to pay tax on the amount withdrawn from that RRSP. Normally, an individual is taxed at their standard income tax rate for withdrawals from their RRSP. This happens because taxpayers are also granted a corresponding tax deduction for any amounts they contribute to their RRSP in a taxation year. In turn, taxpayers are required to include in income amounts that are eventually withdrawn from their RRSP. The HBP is an exception to this income inclusion requirement.

Under the current HBP, taxpayers are limited to an RRSP withdrawal limit of $35,000. Budget 2024 proposes to increase this limit to $60,000 for any withdrawals made after Budget Day. In order to access this income exclusion benefit, the RRSP withdrawal must be used as a down payment to purchase or build the taxpayer's first home or a home for a specified disabled individual. Home buyers who are jointly acquiring a house may each make withdrawals from their RRSP up to the proposed limit, which would allow joint homeowners to access $120,000 from their combined RRSP's in order to fund the purchase of their first home.

Under the current HBP, taxpayers who make withdrawals for the purposes of utilizing the HBP are required to reimburse their RRSP over 15 years; however, Budget 2024 proposes to delay the start of the required RRSP reimbursement until the 5th year following the year in which the withdrawal was made. This deferred reimbursement requirement would apply to any withdrawal made between January 1, 2022 and December 31, 2024. For example, if a taxpayer withdrew funds from their RRSP to purchase a home in April, 2024, they will need to begin reimbursing their RRSP in 2029. The full amount will still need to be reimbursed to the individual's RRSP over 15 years, despite the proposed deferral.

Non-Compliance with Information Requests

The Government of Canada has sought to enhance the auditing powers of the CRA through a number of measures in Budget 2024. This comes as no surprise following the recent string of investments into the CRA's audit and enforcement activities which were also accompanied by the expansion of the CRA's general audit powers under ITA section 231.1. Budget 2024 expands on the Government of Canada's plan to enhance CRA's auditing powers through the imposition of additional consequences for taxpayers who fail to comply with information requests.

Compliance Order Penalty

Budget 2024 proposes an additional penalty to taxpayers against whom the CRA is successful in obtaining a "compliance order" under ITA subsection 231.7(6). In such circumstances, the proposed penalty would be 10% of the "aggregate amount of tax payable by the taxpayer under the Act for each taxation year of the taxpayer in respect of which the order relates". This would be applicable only in cases where there is more than $50,000 of tax owing in any relevant taxation year. Budget 2024 states that the purpose of this new compliance order penalty is to "create an incentive for taxpayers to comply with the original request for information or assistance".

> **PLANNING POINT: This new penalty creates substantial uncertainty for taxpayers under the current form proposed by Budget 2024. The CRA often takes many years to determine the final aggregate amount of tax payable by a taxpayer. In these cases, it is unclear how this penalty will be imposed. For example, will the 10% be applied to the current calculated tax debt or a final amount once the assessment is complete? Moreover, the penalty does not appear to be impacted by whether or not a taxpayer complies with a compliance order or if the information provided under a compliance order led to the reassessment of taxes payable. This could lead to a substantial increase in the burden on taxpayers for compliance. An immediate penalty could now be imposed on a taxpayer simply for objecting to providing certain information. A taxpayer will likely have to demonstrate the reasonableness of their actions or that the CRA's request was unreasonable. This could lead the CRA to use this penalty in order to make extremely broad and unreasonable requests for taxpayer information or assistance. This may also discourage taxpayers from making legitimate challenges to CRA demands for the reason that they fear they will be subjected to a compliance order and the accompanying penalty. If you are faced with requests for information and are unsure of your rights and responsibilities, please contact one of the tax lawyers at McLeod Law LLP for advice on how you should proceed.**

Notice of Non-Compliance

Budget 2024 also proposes giving the CRA an ability to issue a "notice of non-compliance" to any person who the CRA determines has not complied with an initial requirement or notice to provide information or assistance under ITA section 231.1 or subsections 231.2(1) and 231.6(2). The consequences proposed for taxpayers who receive a notice of non-compliance are substantial. They would include the normal reassessment period of a taxpayer (and each party not dealing at arm's length with the taxpayer) being suspended for any taxation year to which the notice of non-compliance relates. Not only will the reassessment period be indefinite, a penalty of $50 per day (up to a maximum of $25,000) is also proposed. This penalty could be assessed to a taxpayer at any time. The proposals under Budget 2024 do include the

ability for a taxpayer to have the CRA conduct a second review of a notice of non-compliance and, following this review, a statutory right to apply for a review by the Federal Court. The normal CRA objection process will be used to appeal the assessment of the penalty. Despite these mechanisms, it is clear that taxpayers will need to be compliant with CRA requests or risk the application of substantial penalties.

Miscellaneous other Proposed Changes

Budget 2024 also proposes a number of other changes to the CRA's auditing power. They include the ability of the CRA to request that documents be provided under oath, affirmation or by way of an affidavit. Reassessment periods could also be extended in all circumstances where a taxpayer is seeking judicial review of a requirement or notice issued by the CRA. Finally, Budget 2024 expands the circumstances where the CRA may seek a compliance order by allowing such orders to be made for foreign-based information requests (a change from the current policies which only allow compliance orders for general and domestic auditing powers).

Canada Carbon Rebate for Small Businesses

The federal fuel charge for carbon applies in a number of provinces, including Alberta, Saskatchewan, Manitoba, and Ontario. Budget 2024 announces the Government of Canada's intention to return a portion of the fuel charge collected from these "**Non-Agreeing Provinces**" to small and medium-sized businesses operating within them (i.e., a portion of the fuel charges collected from Alberta will be distributed to Alberta businesses). This will be known as the Canada Carbon Rebate for Small Businesses (the "**CCR Tax Credit**"). The CCR Tax Credit will be a refundable tax credit that is paid automatically to eligible corporations in the Non-Agreeing Provinces.

In order to be eligible for the CCR Tax Credit for corresponding fuel charges from the 2019-2020 fuel charge year until the 2023-2024 fuel charge year, corporations will need to be eligible CCPCs that file a tax return for the 2023 tax year by July 15, 2024. An eligible CCPC will need to have employed fewer than 500 employees throughout Canada in the calendar year in which the fuel charge year began (i.e., the 2023 calendar year for the 2023-2024 fuel charge year). Each corporation will receive a CCR Tax Credit equal to the number of employees the corporation had in a given Non-Agreeing Province multiplied by a payment rate set by the Government of Canada for each individual Non-Agreeing Province.

> **PLANNING POINT: Given Alberta's status as a "Non-Agreeing Province," a number of small and medium-sized businesses will be eligible to receive the CCR Tax Credit. If you believe your business qualifies for this refund and is not automatically being granted such credit, please reach out to McLeod Law LLP's tax lawyers for assistance.**

Mineral Exploration Tax Credit

As announced on March 28, 2024, Budget 2024 proposes extending for one year the mineral exploration tax credit in ITA section 127. This tax credit will be available for costs that arise out of flow-through share agreements entered into on or before March 21, 2025.

Taxing Vacant Land

Budget 2024 included a brief statement expressing the Government of Canada's intention to consider imposing a tax on vacant land that is zoned for residential use. Very few details were included in Budget 2024, and it was stated that a consultation process will be conducted later in 2024.