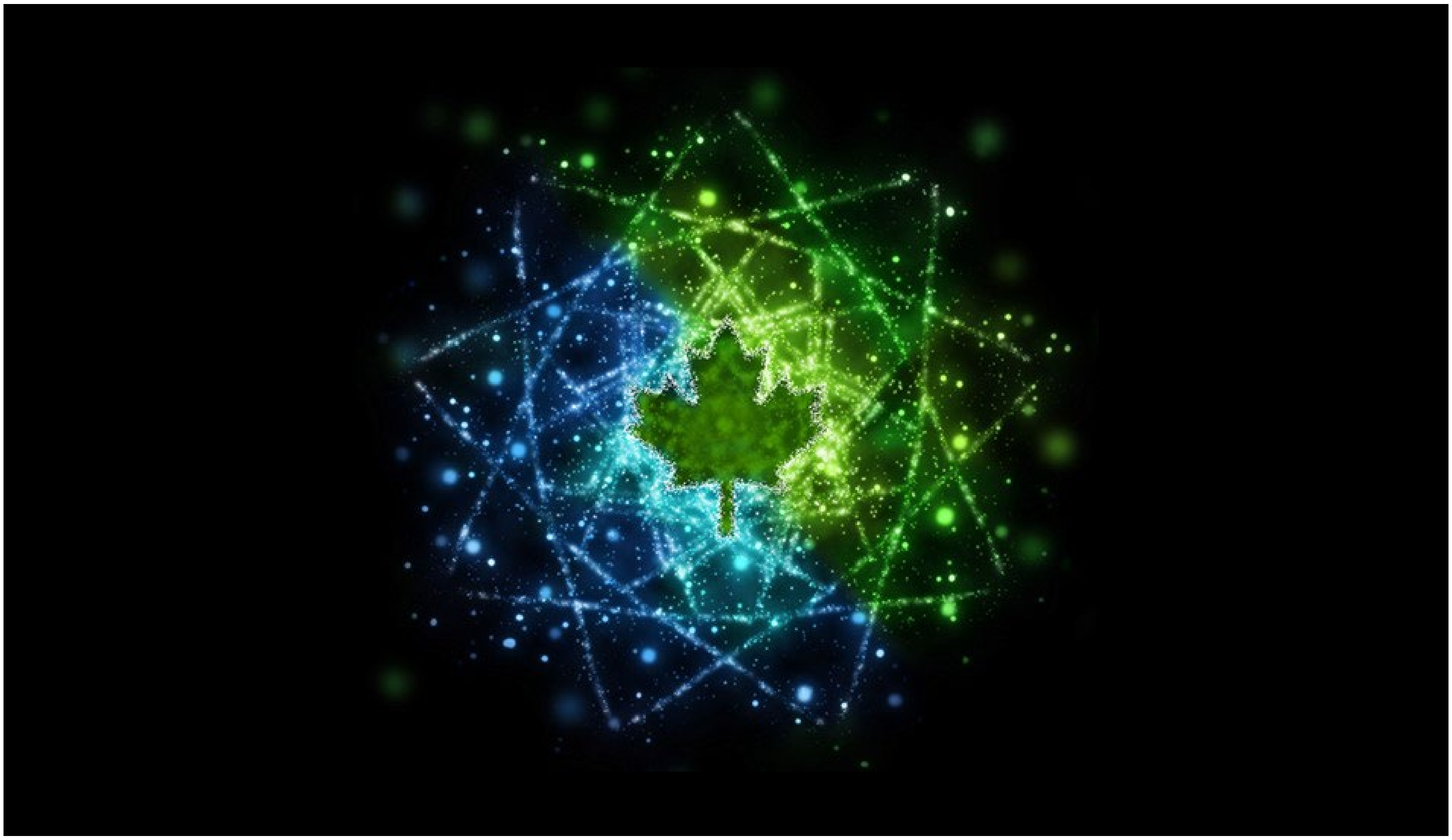

Canadian Tax & Legal Alert

2024 federal budget highlights

April 17, 2024

Deputy Prime Minister and Minister of Finance, the Honourable Chrystia Freeland, presented Budget 2024 entitled "Fairness for Every Generation" in the House of Commons on April 16, 2024.

A summary of the tax highlights contained in the budget is provided below.

Deloitte professionals can help you understand how these measures may impact your business. If you have any questions, please reach out to your Deloitte advisor or any of the individuals noted in this alert.

C-suite briefing notes

What wasn't there

- Contrary to widespread speculation leading up to Budget Day, the Budget did not contain any proposals in respect of excess profits taxes, wealth taxes, increases to the generally applicable personal or corporate tax rates or increases to the Goods and Services Tax (GST) rate.
- While the government confirmed its intention to soon introduce legislation in Parliament to enact the global minimum tax rules and other international tax measures designed to reallocate taxing rights among jurisdictions, no additional draft legislation was released, and there were no proposed changes to effective dates. Depending on when legislation is introduced, the measures could be substantively enacted as early as June 30, 2024.
- There were no new international tax proposals, including updates on the transfer pricing consultation or details on the second package of anti-hybrid proposals. There was no substantive draft legislation released, although the government reconfirmed its commitment to previously announced measures.

A $19.4 billion tax increase: Capital gains inclusion rate increases to 66.67% effective June 25, 2024

The annual speculation is over: the capital gains inclusion rate will increase to two-thirds effective June 25, 2024. The increase is expected to raise $19.4 billion of federal revenue over the next five years from individuals ($8.8 billion) and corporations ($10.6 billion). Given the government's commitment to their fiscal anchors and the magnitude of their investments announced pre-budget, the proposal is not unexpected. Individuals will continue to benefit from the existing 50% inclusion rate on the first $250,000 of annual capital gains, although trusts and corporations will not enjoy the annual allowance at the reduced rate. The exclusion of all corporations will have a broad impact on those Canadians who have chosen to hold investments in corporate form – including professional corporations.

A reciprocal adjustment is proposed for the employee stock option deduction that is incredibly impactful for anyone holding options with accrued benefits granted under equity-based compensation plans.

With a rate change that is only two months away, the proposal allows taxpayers to consider whether steps should be taken to realize capital gains or unrealized stock option benefits prior to June 25, 2024, on existing accrued gains. The estimated revenue impacts from the Department of Finance appear to contemplate this response from many taxpayers, with revenue of $6.9 billion being raised in 2024-2025, reducing to $3.4 billion in 2025-2026 and $375 million in 2026-2027, before gradually rebounding to $5.0 billion in 2028-2029.

This proposed change, while seemingly straightforward, has the potential to give rise to wide-ranging and unexpected impacts for individuals, small businesses, professional corporations, investment holding companies, and large multinational corporations. Everything from estate and retirement planning strategies to decisions concerning the repatriation of previously generated hybrid surplus have the potential to be affected. Furthermore, for many corporations, this increase will result in a one-time earnings reduction due to a recalculation of certain deferred tax amounts at the new rate, when the legislation receives Royal Assent. To the extent that individuals choose to donate publicly traded shares to registered charities with an accrued capital gain, the alternative minimum tax (AMT) will also need to be considered. As part of Budget 2024, the government confirmed the framework of the AMT which is effective January 1, 2024, while increasing the amount of charitable donations permitted in the AMT calculation from 50% to 80%.

A focus on housing affordability: Additional tax incentives

The government had previously announced several tax measures pertaining to housing, including the elimination of GST from new rental housing projects which commence construction after September 13, 2023. The GST exemption is expanded to include the construction of new student residences. Other previously announced measures included the Underused Housing Tax Act, denied deductions for rental housing not conforming to municipal bylaws, and the introduction of the First-Time Home Savings Account.

Budget 2024 expands on these measures to increase the rate of tax depreciation on newly constructed residential rental buildings from 4% to 10%. The enhanced capital cost allowance (CCA) rate would apply to buildings which commence construction on or after April

16, 2024, and before January 1, 2031, provided that the assets are available for use by January 1, 2036. An exemption from the rules which limit the deductibility of interest and financing expenses is also proposed for financing such projects. Furthermore, the government indicated a forthcoming consultation on the potential for a new tax on residentially zoned vacant land.

Canada's productivity challenge: Encouraging investment

Budget 2024 recognizes the continued productivity challenge that Canada is facing and is responding with a series of investments and tax incentives. Investments include programs announced pre-Budget, such as $2.4 billion for artificial intelligence support over five years, and new funding for Scientific Research and Experimental Development (SR&ED) at $600 million over the next four years. The details of the additional SR&ED funding is expected to be announced following a second phase of consultation.

To further encourage investment in capital assets, businesses will be permitted to fully write off the costs of capital investments in patents, data network infrastructure equipment, computers, and other data processing equipment. The measure applies to assets acquired on or after April 16, 2024, and before January 1, 2028.

A new incentive for entrepreneurs: The Canadian Entrepreneurs' Incentive

The government has proposed a new capital gains tax reduction for entrepreneurs, which will eventually halve the rate of taxation on up to $2 million of capital gains that are otherwise taxable when a business is sold and the measure is fully phased in on January 1, 2034. This reduction will be in addition to the lifetime capital gains exemption, which is being increased to $1.25 million effective June 25, 2024. The criteria for the Canadian Entrepreneurs Incentive are similar to the lifetime capital gains exemption but will require that the shares are held directly by the entrepreneur for a period of five years prior to the disposition, and that the entrepreneur was actively engaged in the business on a regular, continuous and substantial basis. Certain business sectors are excluded from the exemption, including those in food and accommodation, arts, recreation, or entertainment sectors.

While the new incentive provides additional tax relief for entrepreneurs over the long term, it will take time for this to be phased in.

New enforcement tools for the Canada Revenue Agency (CRA)

Budget 2024 contains several measures designed to empower the CRA in its audit and enforcement efforts. New penalties are proposed for taxpayers who fail to comply with notices and requirements issued by the CRA in respect of the provision of information and assistance. These new powers, which can include an extension to the normal reassessment period, are expected to continue to increase the cost of dispute resolutions with the CRA.

Further details on tax measures

Capital gains inclusion rate

The government proposes to increase the capital gains inclusion rate for capital gains realized on or after June 25, 2024, from one-half to two-thirds for corporations and trusts, and from one-half to two-thirds on any capital gains realized by individuals in excess of $250,000 annually. The one-half inclusion rate will continue to apply for all taxpayers on capital gains realized prior to June 25, 2024.

Similar changes are proposed with respect to the taxation of employee stock options with the stock option deduction being limited to one-third of the taxable benefit in order to reflect the new capital gains inclusion rate.

The annual threshold of $250,000 for individuals will apply to the aggregate capital gains and stock option benefit earned in a given year. Notably, the threshold will not be prorated in 2024.

Employers will need to consider the effect of the $250,000 annual allowance and the increase in the inclusion rate when determining the payroll tax deductions associated with stock option benefits.

Measures pertaining to businesses

Clean Electricity Investment Tax Credit

Budget 2024 sets out the design and implementation details for the previously announced Clean Electricity Investment Tax Credit, including information on the following items:

- **Eligible entities** (generally limited to Canadian corporations, including provincial and territorial Crown corporations whose jurisdictions have been designated by the federal Minister of Finance as having satisfied certain conditions, including making public commitments to pass the benefits of the investment tax credit (ITC) on to ratepayers).
- **Eligible properties** (generally comprised of property used to transmit electricity between provinces and territories, as well as a subset of property that is either described in Class 43.1 for CCA purposes, or property defined for purposes of the proposed Clean Technology ITC). To be eligible for the ITC, property must be acquired on or after April 16, 2024, and before 2035, and must not be part of a project that began construction before March 28, 2023.
- **Labour requirements** (identical to those proposed in Bill C-59 concerning prevailing wages and apprenticeships for other clean investment tax credits).
- **Requirements for claiming the ITC**, including a review by Natural Resources Canada as to whether various eligibility criteria have been satisfied.
- **Recapture and repayment requirements** generally in line with those proposed in respect of the Clean Technology ITC.
- **Confirmation that the Clean Electricity ITC cannot be claimed in respect of a particular expenditure if one of the following other tax credits is claimed** in respect of that same expenditure: the Clean Technology ITC, the Carbon Capture, Utilization, and Storage ITC, the Clean Hydrogen ITC, the Clean Technology Manufacturing ITC, and the Electric Vehicle Supply Chain ITC.

Clean Technology Manufacturing ITC

Adjustments to the Clean Technology Manufacturing ITC are proposed, effective for property acquired on or after January 1, 2024, to help ensure that expenditures incurred in relation to projects that involve the production of more than one kind of metal can qualify. A safe harbour rule is proposed to mitigate the impact of price volatility on the recapture mechanism in respect of the ITC.

Electric Vehicle Supply Chain ITC

A new 10% Electric Vehicle Supply Chain ITC is proposed to be introduced for businesses that invest in Canada across three key supply chain segments: electric vehicle assembly, electric vehicle battery production, and cathode active material production. Eligible property must be acquired and available for use on or after January 1, 2024. To be eligible, taxpayers together with related parties must claim the Clean Technology Manufacturing ITC in all three of the specified supply chain segments. Alternatively, groups may claim the Clean Technology Manufacturing ITC across two of the segments and hold a minority interest in an unrelated party that claims the credit in respect of the third segment.

Purpose-Built Rental Housing Incentives

Additional measures are proposed in order to incentivize the construction of purpose-built residential rental housing projects. Eligibility criteria in respect of such incentives are aligned with those under the temporary enhancement to the Goods and Services Tax (GST) new Residential Rental Property Rebate:

- **An accelerated CCA rate** of 10% is proposed for eligible projects that begin construction on or after April 16, 2024, and before 2031, and are available for use prior to 2036. The half-year rule would not apply to the cost of property put in use before 2028 in line with the Accelerated Investment Incentive.
- **An elective exemption from the Excessive Interest and Financing Expense Limitation** (EIFEL) rules for certain interest and financing expenses incurred before 2036 in respect of arm's length financing used to build or acquire eligible projects.

Accelerated CCA on patents and other technology assets

Budget 2024 proposes immediate expensing of the cost of the following types of property where the property is acquired on or after April 16, 2024, and before 2028: patents, rights to patented information (CCA Class 44), data network infrastructure equipment and related systems software (CCA Class 46), and general-purpose electronic data-processing equipment and systems software (CCA Class 50).

Canada Carbon Rebate for Small Businesses

Budget 2024 introduces a proposed rebate to return certain amounts collected under the federal backstop pollution pricing fuel charge to eligible small business corporations (Canadian-controlled private corporations (CCPCs) with less than 500 employees) via a refundable tax credit that will be available upon the filing of a corporate tax return for the corporation's 2023 taxation year on or before July 15, 2024, and will continue to apply for future fuel charge years.

Crypto-asset service providers

A new annual reporting requirement is proposed to be imposed on individuals and entities (referred to as crypto-asset service providers (or CASPs)) that provide services effectuating exchange transactions in crypto-assets, provided such persons are either resident in Canada or carrying on business in Canada. The reporting measures are proposed to come into force for 2026 and subsequent calendar years.

The annual value, in respect of each customer and each crypto-asset, would need to be reported for:

- Exchanges between the crypto-asset and fiat currency;
- Exchanges for other crypto-assets; and
- Transfers of the crypto-asset, including in situations where the crypto-asset service provider processes payments by a customer to a merchant supplying goods or services with a value exceeding US$50,000.

CASPs would also be required to report several pieces of identifying information in respect of each customer.

- Reporting would not be required in respect of central bank digital currencies and digital representations of fiat currencies.
- Supplementary amendments are proposed to the Common Reporting Standard (CRS) to align the treatment of registered and non-registered accounts, to remove Labour-sponsored Venture Capital Corporations from the list of non-reporting financial institutions, and to implement an anti-avoidance measure targeting arrangements, the primary purpose of which is to permit a person to avoid obligations under the CRS.

Payments for services rendered by non-residents

Budget 2024 proposes to ease the administrative burden in respect of applications for waivers of withholding tax imposed under Regulation 105 on payments to non-residents for services in Canada. In particular, it is proposed that the CRA be granted legislative authority to grant waivers in respect of multiple transactions over a specified period of time, where the recipient of the payment is exempt from tax under a treaty or is earning exempt income from international shipping or from operating an aircraft in international traffic.

Measures pertaining to interactions with the Canada Revenue Agency

Budget 2024 includes a variety of proposals concerning interactions between taxpayers and the CRA as follows:

- Authorizing the issuance by the CRA of a notice of non-compliance to taxpayers who have not complied with a notice or requirement to provide assistance or information. The issuance of a notice is subject to administrative and judicial review upon request of the taxpayer. The issuance of a notice of non-compliance will have several consequences including:
  - The extension of the normal reassessment period by the amount of time that the Notice remains outstanding;
  - The imposition of a penalty of $50 for each day that the notice remains outstanding, to a maximum of $25,000.
- Imposing a penalty in situations where the CRA has obtained a compliance order against a taxpayer. The penalty would be equal to 10% of the aggregate tax payable by a taxpayer in respect of a taxation year to which a compliance order relates, but only if the tax owing in respect of one of the years in question exceeds $50,000.

- Permitting the CRA to seek a compliance order when taxpayers fail to comply with a requirement to provide foreign-based information or documents.
- Allowing the CRA to specify that any required information (oral or in writing) or documentation must be provided under oath or affirmation.
- Broadening the rules which provide for a temporary pause in the statute of limitations while a taxpayer seeks judicial review of certain requirements or notices issued by the CRA to ensure that such “stop the clock” rules apply to requests for judicial review in respect of any requirement or notice issued in relation to the audit and enforcement process or during any period while a notice of non-compliance remains outstanding.
- Ensuring that general penalties pertaining to the failure to file or make a return or comply with certain specified rules do not apply to situations in which a taxpayer fails to file an information return in respect of a reportable or notifiable transaction under the mandatory disclosure rules.

Targeted anti-avoidance measures

The rules concerning avoidance of tax debts are proposed to be broadened to capture situations in which property is transferred by a tax debtor, and as part of the same series of transactions, there has been a transfer of property to a person not dealing at arm’s length with the tax debtor. Furthermore, a penalty is proposed for persons who engage in, participate in, assent to, or acquiesce in planning activities that can reasonably be expected to involve tax debt avoidance. The proposed penalty is equal to the lesser of 50% of the tax debt avoided, and the sum of $100,000 and any amount that the person or a related person is entitled to receive in respect of the planning.

Measures are proposed to prevent corporations from qualifying as mutual fund corporations if they are controlled by, or for the benefit of, a corporate group. The amendments apply for taxation years beginning after 2024 and are intended to prevent the inappropriate use of the conduit treatment of such vehicles in situations where they are not widely held.

Certain exceptions from the anti-avoidance rule which denies a dividend received deduction in respect of synthetic equity arrangements are proposed to be repealed effective for dividends received on or after January 1, 2025. Notably, the exception pertaining to tax-indifferent investors is proposed to be eliminated.

Certain rules pertaining to the forgiveness of debts of bankrupt corporations are proposed to be repealed in order to align their tax treatment with that of all other corporate debtors. Specifically, Budget 2024 proposes to eliminate the exception to the debt forgiveness rules and the loss restriction rule for bankrupt corporations. The proposals apply to bankruptcy proceedings that begin on or after April 16, 2024.

Personal tax measures

Canadian Entrepreneurs’ Incentive

The proposed Canadian Entrepreneurs’ Incentive (CEI) is intended to provide for a capital gains inclusion rate that is one half the prevailing inclusion rate on up to $2,000,000 of lifetime capital gains per individual on dispositions of qualifying small business corporation shares. Based on the currently proposed capital gains inclusion rate of two thirds, this would result in a one-third inclusion capital gains inclusion rate under the CEI. An individual may benefit from both the lifetime capital gains exemption and the CEI where eligibility criteria are otherwise met.

In order to qualify, the individual must be a founding investor at the time the corporation was initially capitalized and needs to have held the shares for a period of five years prior to their disposition during which time they need to have been actively engaged in the business. In addition to meeting the criteria to be considered qualified small business corporation shares, the shares must also carry at least 10% of the voting power, must represent at least 10% of the fair value of the issued and outstanding stock and must have been obtained for fair value consideration.

The CEI does not apply to shares held in certain corporations including:

- professional corporations, a corporation whose principal asset is the reputation or skill of one or more employees, or

- a corporation that carries on certain types of businesses including operating in the financial, insurance, real estate, food and accommodation, arts, recreation, or entertainment sector; or providing consulting or personal care services.

The incentive is being phased in incrementally by $200,000 per year beginning January 1, 2025, and expected to reach the maximum of $2,000,000 by January 1, 2034.

Lifetime Capital Gains Exemption
Budget 2024 proposes to increase the lifetime capital gains exemption from $1,016,836 (Indexed to inflation) to $1,250,000 for capital gains realized on the disposition of qualified small business corporation shares and qualified farm or fishing property. The increase is applicable on dispositions that occur on or after June 25, 2024, with indexation to resume in 2026.

Alternative Minimum Tax
Budget 2024 contains further revisions to the previously proposed change to the AMT. Most notably, it is proposed that individuals will be able to claim 80% of the Charitable Donation Tax Credit in the computation of AMT compared to the previously proposed 50%. The other notable amendments are an exemption from AMT for Employee Ownership Trusts and a 30% inclusion rate for gains subject to the Employee Ownership Trust Tax Exemption. The AMT amendments are applicable to taxation years that begin on or after January 1, 2024.

Budget 2024 proposes a further exemption from the AMT for certain trusts for the benefit of Indigenous groups. A consultation period has been announced for interested stakeholders with submissions being accepted until June 28, 2024.

Employee Ownership Trust Tax Exemption
Budget 2023 and the 2023 Fall Economic Statement introduced the concept of an Employee Ownership Trust (EOT) as a means to allow for an alternative succession for small business owners. The proposals included an exemption for the first $10,000,000 in capital gains realized on the sale of a business to an EOT. The $10,000,000 limit must be shared by a group of investors selling the same business. In the event that the EOT undergoes a disqualifying event (e.g., a loss of EOT status) within 36 months of the sale, there is a retroactive denial of the exemption realized by the vendors. This measure would apply to qualifying dispositions of shares that occur between January 1, 2024, and December 31, 2026.

Budget 2024 provides further details on the exemptions and conditions for an individual (other than a trust) to qualify for the EOT exemption and expands the exemption to:

- include qualifying business transfers to a worker cooperative corporation,
- extend the normal reassessment period of an individual for a taxation year in which the exemption is claimed by a further three years; and
- require a joint election between the individual and the EOT regarding the joint and several liability for the tax payable by the individual if the exemption was subsequently denied due to a disqualifying event.

Increase to the Volunteer Firefighters and Search and Rescue Volunteer Tax Credit from a 15% non-refundable tax credit based on an amount of $3,000 to $6,000 to yield the tax relief to $900 applicable to the 2024 and subsequent taxation years.

Extension of the Mineral Exploration Tax Credit for flow-through share investors for flow-through share agreements entered into on or before March 31, 2025.

Amendments to the Home Buyers' Plan including the increase to the withdrawal limit from $35,000 to $60,000 and allowing for a temporary deferral of the start of the 15-year repayment period by an additional three years for withdrawals made during a qualifying period. This measure would apply to withdrawals made after April 16, 2024.

Increases to the list of qualified expenses for the Disability Supports Deduction applicable for 2024 and subsequent taxation years.

The government has opened a consultation period with respect to **Qualified Investments for Registered Plans** with submissions being accepted up to July 15, 2024.

Indirect and excise tax measures

Amendments are proposed to permit not-for-profit universities, public colleges, and school authorities to claim the enhanced (100%) GST rental rebate in respect of any new student residence acquired or constructed primarily for the purpose of providing a place of residence for their students. The rebate is available in respect of construction that begins after September 13, 2023, and before 2031, provided that construction is complete before 2036.

Changes to the duty rates in respect of certain tobacco and vaping products, together with other administrative measures in respect of such products, are proposed.

Changes to the First Nations Goods and Services Tax Act are proposed to permit interested indigenous governments to levy a value-added sales tax on fuel, alcohol, cannabis, tobacco, and vaping products within their reserves or settlement lands.

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