

Canadian capital gains tax increase to take effect June 25

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Update:

On January 31, 2025, the Canadian federal government announced that it was deferring the previously announced increase to the capital gains inclusion rate until January 1, 2026. As a result, the existing one-half inclusion rate will continue to apply to capital gains realized through December 31, 2025. The proposed increase has not yet been enacted into law.

On June 10, 2024, the Government of Canada tabled a Notice of Ways and Means Motion (NWMM) in Parliament that proposes to increase the capital gains inclusion rate (consistent with the [2024 federal budget](#)). The NWMM was accompanied by a news release and two backgrounders. The House of Commons voted to approve the NWMM on June 11, 2024. Although the Conservative party voted against the NWMM, to date the Conservatives have not stated that whether, if the legislation is enacted and they are subsequently elected to form the government, they will repeal the amendments.

The NWMM confirms that taxpayers seeking to recognize accrued capital gains on property at the current one-half capital gains inclusion rate (rather than the new two-thirds inclusion rate) must dispose of that property before June 25, 2024. The government rejected requests to include a new elective deeming rule that could have prevented the resulting time and costs required for actual dispositions.

The [news release](#) that accompanied the NWMM notes that updated draft legislation will be introduced in July, at which time implementation details for the [Canadian Entrepreneurs' Incentive](#) proposed in Budget 2024 will also be released.

Notice of ways and means motions are introduced as precursors to bills. An implementation bill with the inclusion rate increase is expected to be introduced to Parliament in the fall.

The NWMM generally reflects the proposal in Budget 2024 regarding the capital gains inclusion rate. It increases the capital gains inclusion rate from one-half (50%) to two-thirds (66⅔%) for corporations and trusts. For individuals (including capital gains allocated by a partnership or trust), the inclusion rate will remain 50% for the first \$250,000 of capital gains in a taxation year (net of capital losses, including those carried forward or back from other taxation years, and certain specified capital gains). Capital gains realized by individuals in excess of \$250,000, net of the amounts listed above, will be subject to the 66⅔% inclusion rate.

The changes to the capital gains inclusion rate are proposed to apply to capital gains realized

on or after June 25, 2024, subject to the transitional rules described below. The \$250,000 threshold for individuals applies on an annual basis, cannot be aggregated or carried forward and will not be prorated for 2024.

Most of the amendments in the NWMM are consequential to the above, though the NWMM is missing a few required amendments that will presumably be added to the draft legislation to be released in July, including changes to the alternative minimum tax rules. Some of the more detailed amendments are discussed below.

Losses

An existing rule in the *Income Tax Act* (Canada) (ITA) provides that net capital losses from prior years that are carried forward will be adjusted to reflect the new inclusion rate (and, similarly, net capital losses carried back). For example, if a corporation carries forward a \$45-million net capital loss incurred in 2022 (representing capital losses net of capital gains of \$90 million) to 2025, it will effectively be allowed to carry forward \$60 million of net capital losses so as to fully offset a \$90-million capital gain incurred once the higher inclusion rate is effective.

In contrast, the NWMM provides that allowable business investment losses (ABILs) will not be adjusted to reflect the different inclusions rates. Thus, the full two-thirds of an ABIL realized after June 24, 2024, can be carried back to and deducted against income in the three prior taxation years, even if the 50% inclusion rate applied for those years. As a result, it may be preferable to defer realizing ABILs until after June 24, 2024.

Transitional rules

The NWMM provides further details on how the rate increase will be implemented. For taxation years that include both June 24 and 25, 2024, transitional rules specify what inclusion rate applies to capital gains and losses arising during the pre-June 25 and post-June 24 periods of that year. If a taxpayer realizes only net capital gains during both periods, or realizes only net capital losses during both periods, then the 50% and 66⅔% inclusion rates effectively apply to the net gains or losses realized in the respective periods (subject to the \$250,000 limit where applicable). For example, if a corporation has a taxation year ending December 31, 2024, and realizes \$100,000 of capital gains before June 25, 2024, and a further \$200,000 of capital gains after June 25, 2024, the corporation would effectively include \$50,000 of taxable capital gains for the pre-June 25 period and \$133,333 of taxable capital gains for the post-June 25 period. However, the actual mechanics differ in that they provide for a weighted inclusion rate to be applied to all capital gains or losses for that taxation year. This may have a significant impact on the calculation of a corporation's capital dividend account, which is determined from time to time.

However, if net capital gains arise in one period and net capital losses arise in the other, these amounts are effectively aggregated and subject to the inclusion rate for the period in which the greater quantum of net capital gains or losses arises. In other words, if the taxpayer realizes \$100 of net capital gains (or losses) in the pre-June 25 period, and \$25 of net capital losses (or gains) in the post-June 24 period, the aggregate \$75 of net capital gains (or losses) is subject to the 50% inclusion rate. If the taxpayer realizes \$25 of net capital gains (or losses) in the pre-June 25 period and \$100 of net capital losses (or gains) in the post-June 24, period, the aggregate of \$75 of net capital gains (or losses) is subject to the 66⅔% inclusion rate.

Joint Committee submission

The NWMM did not implement most of the suggestions made in a [submission](#) [PDF] by the

Joint Committee on Taxation of the Canadian Bar Association and the Chartered Professional Accountants of Canada. The Joint Committee suggested allowing taxpayers to make an election to crystallize capital gains by June 24, 2024, instead of requiring taxpayers to actually effect dispositions. The government's rejection of this suggestion means that taxpayers have only a limited number of days remaining to implement any transactions in response to the proposals in Budget 2024 and the NWMM.

The NWMM does allow graduated rate estates and qualified disability trusts to benefit from the \$250,000 limit, another suggestion made by the Joint Committee.

Other recommendations by the Joint Committee were not addressed or were rejected in the NWMM (some of them explicitly in an accompanying [backgrounder](#)), including the following proposals:

- allowing individuals to share their \$250,000 limit with a private corporation or allowing private corporations to allocate capital gains to their shareholders
- allowing stock options granted by Canadian-controlled private corporations (CCPCs) that are exercised prior to June 25, 2024, to continue to benefit from the 50% deduction of the section 7 benefit under paragraph 110(1)(d.1) (as discussed below, the shares must be disposed of or exchanged; exercising the option is not enough)
- allowing individuals to carry forward their unused \$250,000 limit
Capital gains reserve

Subparagraph 40(1)(a)(iii) of the ITA allows taxpayers that dispose of a capital property but are only paid later to defer recognition of a portion of the capital gain until they are paid by claiming a reserve in respect of the unpaid amount (subject to certain limits). The NWMM includes a transitional measure for taxation years that include both June 24 and 25, 2024, such that any capital gains reserve brought into income for that year is subject to the 50% inclusion rate. For subsequent years, the new inclusion rate rules will apply even though the relevant disposition occurred before June 25, 2024.

No similar transitional relief is available in other situations involving payments over a number of years, notably earnouts.

Employee stock options

Budget 2024 proposed that the employee stock options rules will be adjusted to reflect the new capital gains inclusion rate. Claimants will generally only receive a one-third deduction of the stock option taxable benefit, but can still receive a one-half deduction of the taxable benefit up to the \$250,000 limit (combined with any capital gains, at the discretion of the optionholder regarding the allocation).

The NWMM aligns with the proposal in Budget 2024. However, there are a few transitional measures relating to the stock option benefit deduction in subsection 110(1) of the ITA that are of note. First, the NWMM clarifies that the deduction under paragraph 110(1)(d) will remain at $\frac{1}{2}$ if the transaction, event or circumstances that give rise to the option benefit under subsection 7(1) occur before June 25, 2024. In respect of options issued by CCPCs, the transition rules provide that the disposition or exchange of the securities acquired on the exercise of those options, which triggers the inclusion of the option benefit in the optionholder's income, must occur prior to June 25, 2024, in order to benefit from the one-half deduction. Exercising a CCPC stock option before June 25, 2024, but retaining the shares post-June 24, 2024, will result in the taxpayer being subject to the post-June 24 rules and only receiving a one-third deduction. The transitional provisions do not appear to take into

account the fact that taxpayers are required to hold the shares acquired on the exercise of CCPC options for at least two years in order to access the deduction under paragraph 110(1)(d.1) of the ITA for CCPC options.

Partnerships and trusts

As a transitional measure, partnerships with a fiscal period that include both June 24 and 25, 2024, would effectively be required to allocate capital gains, capital losses and business investment losses to partners (rather than taxable capital gains, allowable capital losses or ABILs). Partnerships are further required to provide partners with a prescribed form that sets out which amounts were realized before June 25, 2024, or after June 24, 2024. Once allocated, the amounts are generally deemed to retain their timing and character, allowing each partner to determine the applicable inclusion rate and whether the \$250,000 limit is available.

Similar rules apply to trusts resident in Canada with taxation years that include both June 24 and 25, 2024. Special rules apply for trusts resident in Canada with taxation years that do not include both June 24 and 25, 2024, but that end in a taxation year of a beneficiary that includes both June 24 and 25, 2024.

Special rules also apply to commercial trusts such as mutual fund trusts, as well as related segregated fund trusts. Notably, for taxation years that include both June 24 and 25, 2024, such trusts (as well as mutual fund corporations) can elect to allocate any capital gains between the pre-June 25 and post-June 24 periods based on the proportion of days in their taxation years that fall into each period, rather than based on the day on which any gains actually arose.

Further specialized rules apply to mutual fund corporations, mutual fund trusts and mortgage investment corporations. These rules are highly detailed and should be reviewed with care in order to preserve conduit treatment for shareholders and unitholders and to safeguard the capital gain refund.

Hybrid surpluses of foreign affiliates

Consequential changes are made to the foreign affiliate rules to reflect the new inclusion rate. These include changes to the hybrid surplus rules, which apply to capital gains and losses on dispositions of certain property (generally, shares of other foreign affiliates and partnership interests). The NWMM provides that the deduction available to corporations resident in Canada for dividends paid by a foreign affiliate out of hybrid surplus will reflect the capital gains inclusion rate relating to the underlying disposition that gave rise to the hybrid surplus, regardless of when the dividend is received. Accordingly, if a corporation resident in Canada receives a hybrid surplus dividend in 2025 that relates to a pre-June 25, 2024, disposition, it will still receive the current 50% deduction in respect of that dividend (as well as the deduction relating to applicable foreign taxes). If the hybrid surplus dividend relates to a post-June 24, 2024, disposition, it will only receive a one-third deduction in respect of that dividend (as well as the deduction relating to applicable foreign taxes). As a result, separate tracing of different hybrid surplus pools will be required.

Section 116 withholding

The withholding rate under section 116 for non-residents disposing of certain types of taxable Canadian property will be increased from 25% to 35% from January 1, 2025, onward to reflect the higher capital gains inclusion rate.

If you have any questions or require additional analysis on the NWMM, please contact any

member of our [National Tax Department](#).