

2024 Federal Budget Review



Finance Minister Chrystia Freeland presented her fourth Budget in the House of Commons on April 16, 2024, entitled “Fairness for Every Generation.”

As expected, Budget 2024 highlighted the government’s objective to increase the housing supply (3.87 million new homes by 2031) and to support renters and lower the costs of home ownership, through key measures such as an enhanced Canadian Mortgage Charter, a new Canadian Renters’ Bill of Rights and increased withdrawal limits from the Home Buyer’s Plan. In addition, affordability measures and the stated goals of growing the economy in a way that’s shared by all, enhanced productivity, innovation and empowering entrepreneurship, were also highlighted. However, Budget 2024 seeks higher tax revenue from the wealthiest Canadians – \$21.9B over 5 years – and aims to improve the fairness of the tax system by achieving more equitable tax rates across revenue sources and income levels. Budget 2024 anticipates a deficit of \$40B for 2023-24 – slightly below the stated fiscal objective outlined in the 2023 Fall Economic statement – which is scheduled to improve to a \$20B deficit in 2028-29.

From a personal and small business tax perspective, which is the focus of this review, the most significant measure is the introduction of a higher capital gains inclusion rate (from one-half to two-thirds) for all capital gains realized by corporations and trusts, and for individuals on annual capital gains exceeding \$250,000. Conversely, an increase in the Lifetime Capital Gains Exemption (LCGE) and a lower capital gain inclusion rate to incent business owners – through the new Canadian Entrepreneurs’ Incentive (CEI) – were also introduced.

As expected, Budget 2024 made slight changes to the Alternative Minimum Tax (AMT) regime to lessen the impact on donors, and reaffirmed its effective date as January 1, 2024. For Canadian-Controlled Private Companies (CCPCs), in addition to the increased capital gains inclusion rate, higher LCGE and the aforementioned CEI, the most notable development was the release of details outlining the

temporary \$10M Employee Ownership Trust Tax Exemption, which was originally announced in the 2023 Fall Economic Statement last November.

For charities and donors, in addition to the amendments proposed to the treatment of donations for AMT purposes, modest changes to modernize and improve the operation of the tax legislation affecting charities were also introduced. Finally, as in prior years, the Budget proposes several specific measures that seek to improve the fairness and integrity of the tax system.

The most significant income tax measures affecting individuals and Canadian private companies are summarized below. **Note that the measures introduced are only proposals at this stage and may not ultimately be enacted into law as described or at all. Readers are cautioned to consult with their independent tax advisors for specific advice on how they may be affected by these proposals.**

Summary of Personal Income Tax Measures

Capital Gains Inclusion Rate

Under current tax legislation, one-half of a capital gain is included in computing a taxpayer’s income – referred to as the capital gains inclusion rate. The current one-half inclusion rate also applies to capital losses that can be claimed as an allowable capital loss.

Effective for capital gains realized on or after June 25, 2024, Budget 2024 proposes to increase the capital gains inclusion rate from one-half to two-thirds for corporations and trusts, and from one-half to two-thirds on the portion of capital gains realized annually in excess of \$250,000 by individuals.

The \$250,000 threshold would apply to capital gains realized by an individual, either directly or indirectly via a partnership or trust, net of any:

- Current year capital losses applied;
- 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 is claimed.

As a related measure, an individual claiming the employee stock option deduction would only be eligible for a one-third deduction of the taxable benefit to reflect the new capital gains inclusion rate. However, they would still be entitled to a deduction of one-half of the benefit up to a combined limit of \$250,000 for both employee stock options and capital gains.

Net capital losses of prior years would continue to be deductible against taxable capital gains in the current year by adjusting their value to reflect the inclusion rate of the capital gains being offset. Essentially, a capital loss realized prior to the rate change would still fully offset an equivalent capital gain realized after the inclusion rate change.

For tax years that straddle June 25, 2024, two different inclusion rates would apply. As a result, transitional rules would be required to separately identify capital gains and losses realized before and after the June 25 effective date. Taxpayers would be subject to the higher inclusion rate in respect of the portion of their net gains arising on or after the effective date that exceed the \$250,000 threshold, to the extent that these net gains are not offset by a net loss incurred in the year prior to June 25, 2024, or from any other taxation year.

Notably, the \$250,000 threshold for individuals will not be prorated for 2024 and would only apply in respect of net capital gains realized on or after the effective date of June 25, 2024.

The government intends to make other consequential amendments as a result of the inclusion rate increase and to release additional design details in the coming months.

Lifetime Capital Gains Exemption

The income tax system provides an individual with a lifetime tax exemption for capital gains realized on the disposition of qualified small business corporation shares and qualified farm or fishing property. The amount of the LCGE is \$1,016,836 in 2024 and is indexed to inflation.

Budget 2024 proposes to increase the LCGE to apply to up to \$1.25M of eligible capital gains. This measure would apply to dispositions that occur on or after June 25, 2024. Indexation of the LCGE would resume in 2026.

Canadian Entrepreneurs' Incentive

To encourage entrepreneurship, the government is proposing the Canadian Entrepreneurs' Incentive, which will reduce the tax rate on capital gains on the disposition of qualifying shares by an eligible individual. Specifically, this incentive would provide for a capital gains inclusion rate that is one-half of the prevailing inclusion rate on a lifetime maximum of up to \$2M in eligible capital gains per individual. The lifetime limit would be phased in by increments of \$200,000 per year, beginning on January 1, 2025, before ultimately reaching a value of \$2M by January 1, 2034.

Under the two-thirds capital gains inclusion rate proposed in Budget 2024, this measure would result in an inclusion rate of one-third (or 33.3%) for dispositions of qualifying shares of a corporation. Combined with the (increased) enhanced LCGE of \$1.25M, when this incentive is fully rolled out, entrepreneurs can benefit from a combined full or partial exemption of at least \$3.25M when selling all or part of a qualifying business.

Qualifying shares

A share of a corporation would be a qualifying share if certain conditions are met, including all of the following:

- At the time of sale, it was a share of a small business corporation (for the purposes of the Income Tax Act) owned directly by the individual.
- Throughout the 24 month period immediately before the disposition of the share, it was a share of a CCPC and more than 50% of the fair market value of the assets of the corporation were:
 - used principally in an active business carried on primarily in Canada by the CCPC, or by a related corporation,
 - certain shares or debts of connected corporations, or
 - a combination of these two types of assets.
- 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 certain types of businesses including a business:
 - operating in the financial, insurance, real estate, food and accommodation, arts, recreation, or entertainment sector; or
 - providing consulting or personal care services.

Eligible individual

This incentive will be available to individuals active in certain industry sectors, where the following conditions apply:

- The individual was a founding investor at the time the corporation was initially capitalized and held the share for a minimum of five years prior to disposition.
- The share must have been obtained for fair market value consideration.
- At all times since the initial share subscription until immediately before the sale of the shares, the individual directly owned shares amounting to more than 10% of the votes and fair market value of the issued and outstanding capital stock of the corporation.
- Throughout the five-year period immediately before the disposition of the share, the individual must have been actively engaged on a regular, continuous, and substantial basis in the activities of the business.

This measure would apply to dispositions that occur on or after January 1, 2025.

Alternative Minimum Tax

As initially highlighted in its 2021 Election Platform, the Liberal government is seeking to ensure that high income earners cannot artificially reduce their taxable income through excessive use of deductions or credits and therefore pay a minimum amount of (Federal) income tax each year. Introduced in 1986, the AMT is a parallel tax calculation that calculates an alternate taxable income that allows fewer deductions, exemptions, and tax credits than under the ordinary income tax rules, and applies a flat tax rate on this adjusted taxable income (exceeding a standard exemption amount) instead of the usual progressive rate structure. A taxpayer ultimately pays the AMT or regular tax, whichever is highest. Additional tax paid as a result of the AMT can generally be carried forward for seven years and can be credited against regular tax to the extent regular tax exceeds AMT in those years. The AMT does not apply in the year of death.

Last year's Federal Budget proposed several changes to the AMT calculation, with the stated goal of better targeting high-income individuals. Key design features of the new AMT regime are intended to broaden the AMT base, further limit tax preference items (i.e., exemptions, deductions and credits) and increase the AMT tax rate. Please see our *Alternative Minimum Tax* publication for a detailed overview of the broader amendments initially proposed to the AMT, which have not yet been formally enacted.

Budget 2024 proposes several additional amendments to the AMT proposals to address some of the concerns raised with the draft legislation. Most notably, in light of concerns regarding the potential impact to charitable donations, Budget 2024 proposes to allow individuals to claim 80% (instead of the previously proposed 50%) of the charitable donation tax credit when calculating AMT.

Other amendments proposed to the AMT would:

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

Finally, Budget 2024 also proposes several technical amendments to exempt certain Indigenous settlement and community trusts from AMT.

These amendments would apply to taxation years that begin on or after January 1, 2024 (i.e., the same timeframe as the broader AMT amendments previously released).

Other Personal Tax Measures

- Doubling of the Volunteer Firefighters Tax Credit and the Search and Rescue Volunteers Tax Credit, from \$3,000 to \$6,000 for 2024 and subsequent tax years;
- Extending eligibility for the Canada Child Benefit (and Child Disability Benefit) for six months after the child's death (for deaths that occur after 2024), if the individual would have otherwise been eligible for the CCB in respect of that particular child;
- Expanding the expenses eligible for the Disability Supports Deduction, subject to certain conditions, for the 2024 and subsequent taxation years;
- Proposing technical amendments to the Canada Pension Plan legislation to provide a top-up to the Death Benefit for certain contributors, amongst other items; and
- Possible amendments to the tax legislation to provide for a single, harmonized deduction for tradespeople's travel expenses.

Measures Affecting Registered Plans

Home Buyers' Plan

The Home Buyers' Plan (HBP) helps eligible home buyers save for a down payment by allowing them to withdraw up to \$35,000 from a registered retirement savings plan (RRSP) to purchase or build their first home, or a home for a specified disabled individual, without having to pay tax on the withdrawal. Eligible home buyers purchasing a home jointly may each withdraw up to \$35,000 from their own RRSP under the HBP. Amounts withdrawn under the HBP must be repaid to an RRSP over a period not exceeding 15 years, starting the second year following the year in which a first withdrawal was made. Otherwise, amounts due for repayment within a specific year are taxable as income for that year.

Budget 2024 proposes to increase the withdrawal limit and provide temporary repayment relief, as follows:

- increase the withdrawal limit from \$35,000 to \$60,000, effective for the 2024 and subsequent calendar years in respect of withdrawals made after Budget Day;
- temporarily defer the start of the 15-year repayment period by an additional three years for participants making a first withdrawal between January 1, 2022, and December 31, 2025. Accordingly, the 15-year repayment period would start the fifth year following the year in which a first withdrawal was made.

Qualified Investments for Registered Plans

Registered Plans, such as RRSPs, RRRIFs, RESPs, etc. can invest only in qualified investments for those plans. A broad range of assets are qualified investments, including mutual funds, publicly traded securities, government and corporate bonds, and guaranteed investment certificates. Since these rules were introduced in 1966, the qualified investment rules have been incrementally expanded to include over 40 types of assets and to reflect the introduction of new types of registered plans (including TFSAs in 2009 and FHSAs in 2023).

However, this incremental approach has resulted in qualified investment rules that can be inconsistent or unclear in some cases. Accordingly, the government announced in Budget 2024 that it will invite stakeholders to provide suggestions on how the qualified investment rules could be modernized on a prospective basis to improve the clarity and coherence of the registered plans regime.

Registered Educational Savings Plans (RESP) – Canada Learning Bond

Budget 2024 announced the government's intention to amend the Canada Education Savings Act to introduce automatic enrolment in the Canada Learning Bond for eligible children who do not have a RESP opened for them by the time the child turns four. Starting in 2028-29, all eligible children born in 2024 or later would have a RESP automatically opened for them and the eligible Canada Learning Bond payments would be auto-deposited in these accounts. Starting in 2028-29, caregivers of eligible children born before 2024 would also be able to request that Employment and Social Development Canada open a RESP for their child and auto-deposit the eligible Canada Learning Bond payments.

Budget 2024 also announced the government's intention to introduce changes to the Canada Education Savings Act to extend the age from 20 to 30 years to retroactively claim the Canada Learning Bond.

Measures Affecting Canadian Private Companies

Employee Ownership Trusts (EOT) – Tax Exemption

As outlined in our *Employee Ownership Trusts* (EOT) publication, an EOT is a form of employee ownership where a trust holds shares of a corporation for the benefit of the corporation's employees. EOTs can be used to facilitate the purchase of a business by its employees, without requiring them to pay directly to acquire shares. For business owners, an EOT can also provide an additional exit option or alternative strategy in their business succession planning.

Budget 2023 introduced new tax rules to facilitate the creation and use of EOTs to acquire and hold shares of a qualifying business. These legislative proposals are not yet enacted but are currently before Parliament in Bill C-59. The 2023 Fall Economic Statement proposed to exempt the first \$10M in capital gains realized on the sale of a business to an EOT from taxation, subject to certain conditions.

Budget 2024 provides further details on the proposed exemption and conditions, as follows:

Qualifying Conditions

The exemption would be available to an individual (other than a trust) on the sale of shares to an EOT where the following conditions are met:

- The 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.

- The transaction is a qualifying business transfer (as previously defined in the proposed legislation for EOTs) in which the trust acquiring the shares is not already an EOT or a similar trust with employee beneficiaries.
- Throughout the 24 months immediately prior to the qualifying business transfer:
 - 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; and
 - over 50% of the fair market value of the corporation's assets were 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 qualifying business on a regular and continuous basis for a minimum period of 24 months.
- Immediately after the qualifying business transfer, at least 90% of the beneficiaries of the EOT must be resident in Canada.

If the above conditions are satisfied, an individual would be eligible to claim an exemption for up to \$10M in capital gains from the sale. If multiple individuals dispose of shares to an EOT and meet the above conditions, they may each claim the exemption, but the total exemption in respect of the qualifying business transfer cannot exceed \$10M. The individuals would be required to agree on how to allocate the exemption.

Disqualifying Events

A disqualifying event would occur if an EOT loses its status as an EOT or if less than 50% of the fair market value of the qualifying business' shares is attributable to assets used principally in an active business at the beginning of two consecutive taxation years of the corporation.

If a disqualifying event occurs within 36 months of the qualifying business transfer, the exemption would not be available and if the individual has already claimed the exemption, it would be retroactively denied.

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 the exempted capital gains realized by the individual vendor(s) on the sale to the EOT.

Interaction with AMT

The capital gain exempted on a qualifying business transfer to an EOT would be subject to an inclusion rate of 30% for AMT purposes, which is similar to the AMT treatment for capital gains eligible for the LCGE.

Administrative Elements

To claim this exemption, the individual and the EOT (and any corporation owned by the EOT that acquired the transferred shares) would need to elect to be jointly and severally, or solidarily, 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 after the sale. However, the trust would be solely liable for any tax realized on the deemed capital gain on any disqualifying event that occurs after the 36 month period following sale. As a result, the normal reassessment period of an individual for a taxation year in respect of this exemption is proposed to be extended by three years.

Budget 2024 also proposes to expand qualifying business transfers (along with related amendments to the Income Tax Act that facilitates transfers to EOTs) to include the sale of shares to a worker cooperative corporation as defined under the *Canada Cooperatives Act*.

These measures would apply to qualifying dispositions of shares that occur between January 1, 2024, and December 31, 2026.

Other Corporate Measures

- Extension of the Mineral exploration tax credit – The mineral exploration tax credit, equal to 15% of specified mineral exploration expenses incurred in Canada and renounced to flow-through share investors, will be extended to flow-through share agreements entered into on or before March 31, 2025. The credit was scheduled to expire on March 31, 2024.
- A new 10% Electric Vehicle Supply Chain investment tax credit on the cost of buildings used in key segments of the electric vehicle supply chain.
- The design and implementation details of the previously-announced Clean Electricity investment tax credit.
- Proposed adjustments to the Clean Technology Manufacturing investment tax credit to provide greater support and clarity to businesses engaged in these activities.
- Accelerated Capital Cost Allowance (CCA) of 10% for new eligible purpose-built rental projects that begin construction on or after Budget Day and before January 1, 2031, and are available for use before January 1, 2036.
- Immediate CCA expensing for new additions to classes 44, 46 and 50, if the property is acquired on or after Budget Day and becomes available for use before January 1, 2027.
- A new Canada Carbon Rebate for Small Businesses, which is an automatic, refundable tax credit for eligible businesses, sized in proportion to the number of persons they employ in a province, to return a portion of fuel charge proceeds from the province.

- Amendments to the Income Tax Act to preclude a corporation from qualifying as a mutual fund corporation where it is controlled by or for the benefit of a corporate group.

Measures Affecting Charities and Qualified Donees

In addition to the proposed changes to the AMT affecting donors, Budget 2024 proposes to amend the Income Tax Act and Income Tax Regulations to improve the operation of the rules related to registered charities and other qualified donees, as follows:

- extending the period for which qualifying foreign charities are granted status as a qualified donee from 24 months to 36 months;
- simplifying and modernizing the way in which the CRA provides services and communicates information relating to registered charities and other qualified donees (e.g., through digital communications); and
- changes to simplify the issuance of official donation receipts and to align the process for issuing receipts with modern practices of charities.

Other Notable Measures

As in previous budgets, Budget 2024 continues the government's efforts to make legislative adjustments to help ensure that the tax system is functioning as intended and introduces certain measures to maintain the fairness and integrity of the tax system, as noted below.

Avoidance of Tax Debts

The Income Tax Act includes an anti-avoidance rule that is intended to prevent taxpayers from avoiding paying their tax liabilities by transferring their assets to non-arm's length persons. The effect of this tax debt avoidance rule is to make the transferee jointly and severally, or solitarily, liable with the transferor for the transferor's tax debts, to the extent that the value of the property transferred exceeds the amount of consideration given by the transferee for the property.

As a result of planning that is intended to circumvent the tax debt avoidance rule, Budget 2024 proposes to introduce a supplementary rule to strengthen the tax debt anti-avoidance rule, extend existing penalties to tax debt avoidance planning that is subject to the proposed supplementary rule, and ensure that taxpayers who participate in tax debt avoidance planning be jointly and severally, or solidarily, liable for the full amount of the avoided tax debt.

These measures would apply to transactions or series of transactions that occur on or after Budget Day.

Information Requests

Budget 2024 proposes several amendments to the information gathering provisions in the Income Tax Act. These proposed amendments are intended to enhance the efficiency and effectiveness of tax audits and facilitate the collection of tax revenues on a timelier basis.

Previously Announced Measures

Finally, Budget 2024 confirms the government's intention to proceed with many previously announced tax and related measures that have not yet been formally enacted, including the following notable measures affecting individuals and Canadian private companies that originated from Budget 2023 and the 2023 Fall Economic Statement:

- Underused Housing Tax (UHT);
- Employee Ownership Trusts;
- Strengthening the Intergenerational Business Transfer Framework;
- The AMT for High-Income Individuals; and
- Modernizing the General Anti-Avoidance Rule (GAAR).

Budget 2024 also reaffirms the government's commitment to move forward as required with other technical amendments to improve the certainty and integrity of the tax system.



The **2024 Federal Budget Review** was developed by our in-house tax professionals in the Wealth Planning and Advisory Services Group at BMO Private Wealth; **John Waters**, Vice-President, Director of Tax Consulting Services and **Dante Rossi**, Director, Tax Planning. For more insights, visit bmo.com/wealthinsights

If you have any questions regarding these budget proposals, please consult with your independent tax advisor for further details.

This document is a summary of the Federal Budget and does not represent BMO Financial Group's view on the tax policies expressed in the Federal Budget.



BMO Private Wealth is a brand name for a business group consisting of Bank of Montreal and certain of its affiliates in providing private wealth management products and services. Not all products and services are offered by all legal entities within BMO Private Wealth. Banking services are offered through Bank of Montreal. Investment management, wealth planning, tax planning, and philanthropy planning services are offered through BMO Nesbitt Burns Inc. and BMO Private Investment Counsel Inc. Estate, trust, and custodial services are offered through BMO Trust Company. Insurance services and products are offered through BMO Estate Insurance Advisory Services Inc., a wholly-owned subsidiary of BMO Nesbitt Burns Inc. BMO Private Wealth legal entities do not offer tax advice. If you are already a client of BMO Nesbitt Burns Inc., please contact your Investment Advisor for more information. Nesbitt Burns Inc. is a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada. BMO Trust Company and BMO Bank of Montreal are Members of CDIC.

"BMO Financial Group" and "BMO Bank of Montreal" are marketing names (also referred to as trade names or brand names) used by Bank of Montreal.

BMO Global Asset Management is a brand name that comprises BMO Asset Management Inc., BMO Investments Inc., BMO Asset Management Corp., BMO Asset Management Limited and BMO's specialized investment management firms.

These comments are general in nature, provided for information purposes only, and do not constitute legal, investment, trust, estate, accounting or tax advice. Technical content in this report is provided for general guidance, based on information believed to be accurate and complete, but we cannot guarantee its accuracy or completeness. It is your responsibility to consult with the appropriate professionals in those areas regarding your specific circumstances. Unless otherwise qualified, any opinions, estimates and projections in this report are subject to change without notice, and may not reflect those of Bank of Montreal, BMO Private Wealth or BMO Global Asset Management. This report may not reflect all available information. None of Bank of Montreal, BMO Private Wealth, BMO Global Asset Management nor the authors or any other person accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. Interest rates, market conditions, tax rules, and other investment factors are subject to change. This report is not to be construed as an offer to sell or a solicitation for or an offer to buy any securities.