Explanatory Notes to Legislative Proposals Relating to the Income Tax Act and Regulations

Published by
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September 2024

Department of Finance Canada | Ministère des Finances Canada

Preface

These explanatory notes describe proposed amendments to the *Income Tax Act* and *Income Tax Regulations*. These explanatory notes describe these proposed amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

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These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

Income Tax Act and Income Tax Regulations

Amendments to the *Income Tax Act* (the “Act” or “ITA”) and the *Income Tax Regulations* (the “Regulations” or “ITR”)

Capital Gains Inclusion Rate Increase

Clause 2

Income for a taxation year

Income Tax Act (ITA)
3

Section 3 provides basic rules for determining a taxpayer's income for a taxation year for the purposes of Part I. This section sets out the separate sources of income and losses that are aggregated in determining income.

New paragraph 3(b.1) operates in conjunction with new section 38.01 to provide for an effective inclusion rate of 1/2 (rather than 2/3) for the portion of the net capital gains of individuals, graduated rate estates and qualified disability trusts, that does not exceed $250,000. Paragraph (b.1) reduces a taxpayer’s income inclusion by the amount determined for the year under section 38.01.

Section 38.01 provides an adjustment in computing income of an amount that is 1/6 (the difference between 2/3 and 1/2) of a taxpayer’s net capital gains up to $250,000, or $41,667. This adjustment effectively reduces the inclusion rate on the first $250,000 of net capital gains to 1/2.

For example, assume a taxpayer had a capital gain of $250,000 for the year and has no capital losses. Applying an inclusion rate of 2/3 would result in a taxable capital gain of $166,667. If section 38.01 applied to this capital gain, the taxpayer would be entitled to a reduction of $41,667 ($250,000 x 1/6) in computing their income. This would have the effect of reducing the taxpayer’s income inclusion to $125,000 ($166,667 - $41,667), resulting in an effective inclusion rate of 1/2 on the $250,000 capital gain.

This amendment applies to taxation years that end after June 24, 2024.

Clause 3

ITA
13(7)(b)

Paragraph 13(7)(b) determines the capital cost to a taxpayer of depreciable property originally acquired for a purpose other than gaining or producing income, where the taxpayer subsequently begins to use the property for the purpose of gaining or producing income.

Clause 13(7)(b)(ii) currently limits a taxpayer’s increase in their capital cost on a change in use to the amount that is equal to the taxpayer’s original cost of the property, plus 1/2 the excess of the property's fair market value over the property's original cost (to the extent a capital gains exemption was not claimed in respect of such excess). This essentially provides for an increase in the individual's going forward capital cost that is limited to the amount of the increase that was included in computing the taxpayer's income upon the change in use.

Consequential on the introduction of paragraph 3(b.1) and section 38.01 that provide for an effective inclusion rate of 1/2 on the first $250,000 of net capital gains realized by individuals, graduated rate estates and qualified disability trusts, the rules in clause 13(7)(b)(ii)(B) are being amended so that the increase in capital cost tracks the effective capital gains inclusion rate that applies in respect of the capital gain realized on the change in use.

New subsection 13(7.7) allows an individual to elect that all or a portion of a capital gain that results from a deemed disposition on a change in use be included within the $250,000 of capital gains that are subject to an effective capital gains inclusion of 1/2. If no election is made, the whole of the capital gain would be subject to the normal 2/3 inclusion rate. Where an election is made, 1/2 of the portion of the capital gain that is subject to this election would be added in computing the new capital cost of the property. For the portion of the capital gain that is not subject to an election, 2/3 of that portion would be added in computing the new capital cost of the property. In other words, the increase in the capital cost of the property corresponds to what is effectively the taxable portion of the capital gain (determined taking into account the adjustment under section 38.01).

The aggregate amount added in computing the new capital cost of the property is determined by the formula

$A + 2/3 \times (B – C – D)$

where

A is 1/2 of the elected amount under new subsection (7.7),

B is the amount, if any, by which the fair market value of the property exceeds the elected amount,

C is the cost of the property to the taxpayer, and

D is 1.5 times the amount deducted by the taxpayer under section 110.6 in respect of the amount, if any, by which the fair market value of the property exceeds the cost to the taxpayer of the property. Essentially, this is the amount of the capital gain, if any, for which the lifetime capital gains exemption has been claimed.

This amendment applies to changes in use of property that occur in taxation years that end after June 24, 2024. For changes in use of property that occur in a taxpayer's taxation year that begins before June 25, 2024 and ends after June 24, 2024, the fraction "2/3" in the formula would be replaced by the fraction determined by the transitional rules provided for in the amendments to section 38 and the reference to "1.5" in the description of D would be replaced by "twice" for transactions that occur before June 25, 2024.

ITA
13(7)(d)

Paragraph 13(7)(d) determines the capital cost of depreciable property where the use made of the property for the purposes of gaining or producing income changes relative to other uses made of the property.

Subparagraph 45(1)(c)(ii) provides for the deemed disposition of property where there has been a partial change in the use regularly made by a taxpayer of property for the purpose of gaining or producing income and the use regularly made by the taxpayer of that property for other purposes.

Clause 13(7)(d)(i)(B) provides that, on such a change in use, the capital cost of the property will be increased by 1/2 of the excess of the proceeds of disposition of the property, as determined under subparagraph 45(1)(c)(ii), over the capital cost of the property (to the extent that no capital gains exemption was claimed in respect of that excess). It is only that proportion of the original capital cost of the property that the percentage increase in income-producing use is of the whole use of the property that is to be included in determining that excess.

Consequential on the introduction of paragraph 3(b.1) and section 38.01 that provide for an effective inclusion rate of 1/2 on the first $250,000 of net capital gains realized by individuals, graduated rate estates and qualified disability trusts, the rules in clause 13(7)(d)(i)(B) are being amended so that the increase in the capital cost tracks the effective capital gains inclusion rate that applies in respect of the capital gain realized on the change in use. See the commentary above related to paragraph 13(7)(b) for more discussion.

The increase in cost is determined by the formula

$A + 2/3 \times (B - C - D)$

where

A is 1/2 of the elected amount under new subsection (7.7),

B is the amount, if any, by which the amount deemed under subparagraph 45(1)(c)(ii) to be the taxpayer’s proceeds of disposition of the property in respect of the change exceeds the elected amount in respect of the property,

C is that proportion of the cost to the taxpayer of the property (as determined under subclause 13(7)(d)(i)(A)(II)) that the amount of the increase in the use regularly made by the taxpayer of the property for that purpose is of the whole of the use regularly made of the property, and

D is 1.5 times the amount deducted by the taxpayer under section 110.6 in respect of the amount, if any, by which the amount deemed under subparagraph 45(1)(c)(ii) to be the taxpayer’s proceeds of disposition of the property exceeds the amount determined under the description of C. Essentially, this is the amount of the capital gain, if any, for which the lifetime capital gains exemption has been claimed.

This amendment applies to changes in use of property that occur in taxation years that end after June 24, 2024. For changes in use of property that occur in a taxpayer’s taxation year that begins before June 25, 2024 and ends after June 24, 2024, the fraction “2/3” in the formula would be replaced by the fraction determined by the transitional rules provided for in the amendments to section 38 and the reference to “1.5” in the description of D would be replaced by “twice” for transactions that occur before June 25, 2024.

ITA
13(7)(e)(i)

Paragraph 13(7)(e) contains special rules which apply to determine the capital cost of depreciable property where the property is acquired on a direct or indirect transfer between persons who do not deal at arm's length. The rules are intended to prevent taxpayers from increasing the undepreciated capital cost of property through the use of a non-arm's length transfer of depreciable property in respect of which the transferor’s capital gain on the disposition of the property is only included in income at the current 1/2 inclusion rate for capital gains or the transferor benefits from the capital gains exemption provided under section 110.6.

Consequential on the introduction of paragraph 3(b.1) and section 38.01 that provide for an effective inclusion rate of 1/2 on the first $250,000 of net capital gains realized by individuals, graduated rate estates and qualified disability trusts, the rules in clause 13(7)(e)(i)(B) are being amended so that the increase in capital cost tracks the effective capital gains inclusion rate that applies in respect of the capital gain realized on the disposition of the property.

New subsection 13(7.7) allows a transferor that is an individual and a transferee to jointly elect that all or a portion of a capital gain that results from a disposition of property to a non-arm’s length person be included within the $250,000 of capital gains that are subject to an effective capital gains inclusion of 1/2. If no election is made, the whole of the capital gain would be subject to the normal 2/3 inclusion rate. Where an election is made, 1/2 of the portion of the capital gain that is subject to this election would be added to the transferee’s capital cost of the property. For the portion of the capital gain that is not subject to an election, 2/3 of the capital gain would be added in computing the transferee’s capital cost of the property.

The transferee’s capital cost is equal to the transferor’s cost or capital cost, as the case may be, before the transfer (existing clause (A)) plus the amount determined by the following formula in amended clause (B):

$A + 2/3 \times (B – C – D)$

where

A is 1/2 of the elected amount in respect of the property under subsection (7.7),

B is the amount, if any, by which the transferor’s proceeds of disposition of the property exceeds the elected amount in respect of the property,

C is the cost or capital cost, as the case may be, to the transferor immediately before the particular time, and

D is 1.5 times the amount deducted by any person under section 110.6 in respect of the amount, if any, by which the transferor's proceeds of disposition of the property exceeds the amount determined under the description of C. Essentially, this is the amount of the capital gain, if any, for which the lifetime capital gains exemption has been claimed.

This amendment applies to acquisitions of property that occur in taxation years that end after June 24, 2024. For acquisitions of property that occur in a taxation year of the transferor that begins before June 25, 2024 and ends after June 24, 2024, the fraction "2/3" in the formula would be replaced by the fraction determined by the transitional rules provided for in the amendments to section 38 and the reference to "1.5" in the description of D would be replaced by "twice" for transactions that occur before June 25, 2024.

ITA
13(7)(e)(ii)

Subparagraph 13(7)(e)(ii) is similar to subparagraph 13(7)(e)(i), except subparagraph (ii) applies where the transferor was neither an individual resident in Canada nor a partnership any member of which was either an individual resident in Canada or another partnership. In such a case, the lifetime capital gains exemption is not available to the transferor.

Consequential on the introduction of the paragraph 3(b.1) and section 38.01 that provide for an effective inclusion rate of 1/2 on the first $250,000 of net capital gains realized by individuals, including capital gains on the disposition of taxable Canadian property by a non-resident individual, the rules in clause 13(7)(e)(ii)(B) are being amended to provide that the increase in capital cost tracks the effective capital gains inclusion rate that applies in respect of the capital gain realized on the disposition of the property. See the discussion above related to subparagraph 13(7)(e)(i).

The transferee's capital cost is equal to the transferor's cost or capital cost, as the case may be, before the transfer (existing clause (A)) plus the amount determined by the following formula in amended clause (B):

$A + 2/3 \times (B - C)$

where

A is 1/2 of the elected amount in respect of the property under subsection (7.7),

B is the amount, if any, by which the transferor's proceeds of disposition of the property exceeds the elected amount in respect of the property, and

C is the cost or capital cost, as the case may be, to the transferor immediately before the particular time.

This amendment applies to acquisitions of property that occur in taxation years that end after June 24, 2024. For acquisitions of property that occur in a taxation year of the transferor that begins before June 25, 2024 and ends after June 24, 2024, the fraction "2/3" in the formula would be replaced by the fraction determined by the transitional rules provided for in the amendments to section 38.

ITA
13(7)(f)(ii)

Paragraph 13(7)(f) applies to determine the capital cost of a property where a corporation is treated as having disposed of and reacquired depreciable property under paragraph 111(4)(e) (on an acquisition of control of the corporation).

The amendment to subparagraph 13(7)(f)(ii) replaces the fraction “1/2” with the fraction “2/3”. The change is consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

The amendment applies to acquisitions of property that occur in taxation years of a taxpayer that end after June 24, 2024. For acquisitions of property that occur in a taxation year of a taxpayer that includes June 25, 2024, the reference in subparagraph 13(7)(f)(ii) to the fraction “2/3” is to be read as a reference to the fraction in amended paragraph 38(a) that applies to the taxpayer for the year.

ITA
13(7.7)

New subsection 13(7.7) provides for the elections available in paragraphs 13(7)(b), (d) and (e). These elections address the introduction of paragraph 3(b.1) and section 38.01 that provide for an effective inclusion rate of 1/2 on the first $250,000 of net capital gains realized by individuals, graduated rate estates and qualified disability trusts. These elections operate to match the effective inclusion rate that applies to a capital gain realized on the disposition of a property with the increase in the capital cost of the property. Where the effective inclusion rate is 1/2, the increase in capital cost should be limited to 1/2 of the capital gain realized on the disposition of the property. Where the inclusion rate is the new increased inclusion rate of 2/3, the capital cost would be increased by 2/3 of the capital gain realized on the disposition of the property.

This matching is achieved by allowing an individual to elect, or if paragraph 13(7)(e) applies, the individual and the transferee of the property to jointly elect, to have the capital gain realized on the disposition of the property as a result of the change in use or transfer of the property be eligible for the effective 1/2 inclusion rate. This elected amount cannot exceed the lesser of:

(1) the amount of the individual’s capital gain for the taxation year in respect of the disposition, other than a capital gain in respect of which section 110.6 applies;

(2) The amount determined by the formula

$$A - B$$

where

A is the amount determined for the individual under paragraph 38.01(a) for the taxation year, being the portion of the individual's $250,000 threshold remaining after accounting for the portion of the threshold applied in respect of computing the individual's deduction in respect of stock option benefits; and

B is the amount determined under paragraph 38.01(b) for the individual for the taxation year (computed without reference to new subsection 13(7.7)), being the amount of the individual's net capital gains that would otherwise be included in income at the 2/3 inclusion rate.

The limitation in subparagraph (b)(ii) is intended to ensure that the election can only be made to the extent that the taxpayer does not have other gains that can instead benefit from the $250,000 threshold.

If two or more properties described under this subsection are disposed of, or are deemed to have been disposed of, in a taxation year of a taxpayer, an election may be made in respect of each such property, provided that the total of all amounts elected in respect of all such properties does not exceed the amount determined in (2) above.

This amendment applies to acquisitions of property that occur after June 24, 2024.

ITA
13(21.1)(b)

Generally, when depreciable property of a prescribed class is disposed of, the proceeds of disposition reduce the undepreciated capital cost of that class. If the proceeds exceed the undepreciated capital cost of a class, the excess, referred to as recaptured depreciation, must be included in income. If the proceeds are less than the undepreciated capital cost of a class and the property is the last remaining property in the class, the balance, referred to as a terminal loss, is deductible. Subsection 13(21.1) sets out rules that in certain cases adjust a taxpayer's proceeds of disposition in respect of land and buildings disposed of by the taxpayer.

Paragraph 13(21.1)(b) applies to determine the proceeds of disposition of a building where the land is not sold at the same time as the building and, at any time prior to the disposition, the taxpayer or a non-arm's length person owned the land. Where paragraph 13(21.1)(b) applies, it increases proceeds of disposition of the building by an amount equal to 1/2 the amount by which the greater of the cost of the building and the fair market value of the building immediately before the disposition, exceed the proceeds of disposition of the building. This essentially has the effect of treating the capital cost allowance claimed on the building (including any terminal loss) as economically equal to a capital loss.

The amendment to subparagraph 13(21.1)(b)(ii) replaces the reference to the fraction "1/2" with a reference to the fraction "1/3", as a consequence of the increase of the inclusion rate for capital gains and losses from 1/2 to 2/3.

This amendment applies to taxation years that end after June 24, 2024. For a taxpayer's taxation year that begins before June 25, 2024 and ends after June 24, 2024, the reference in subparagraph 13(21.1)(b)(ii) of the Act to the fraction "1/3" shall be read as a reference to the fraction determined when the fraction in paragraph 38(a) of the Act that applies to the taxpayer for the year is subtracted from 1.

Clause 4

ITA
20(1)(f)

Paragraph 20(1)(f) sets out rules concerning the deductibility of amounts paid by a taxpayer where the amounts paid are in respect of the principal amount of an obligation that was issued for less than its principal amount.

The amendment to subparagraph 20(1)(f)(ii) replaces the reference to the fraction "1/2" with a reference to the fraction "2/3", as a consequence of the change of the inclusion rate for capital gains from 1/2 to 2/3.

This amendment applies in respect of amounts that become payable after June 24, 2024.

ITA
20(1)(z.1)

Paragraph 20(1)(z.1) permits a taxpayer to deduct an amount in respect of amounts paid by the taxpayer to a lessee for the cancellation of a lease of a property where the property was not owned at the end of the year by the taxpayer or a non-arm's length person.

The amendment to paragraph 20(1)(z.1) replaces the reference to the fraction "1/2" with a reference to the fraction "2/3", as a consequence of the change of the inclusion rate for capital gains from 1/2 to 2/3.

This amendment applies in respect of amounts that become payable after June 24, 2024.

Clause 5

ITA
38(a)

Section 38 provides for the inclusion rates for a taxpayer's taxable capital gain, allowable capital loss and business investment loss from the disposition of property.

Paragraph 38(a) provides for a 1/2 inclusion rate for a taxpayer's capital gain from the disposition of property. The amendment to paragraph 38(a) replaces the reference to the fraction "1/2" with a reference to the fraction "2/3", as a consequence of the change of the inclusion rate for capital gains from 1/2 to 2/3.

ITA
38(a.3)

Paragraph 38(a.3) provides a reduction to the taxable portion of the capital gain arising from the exchange of an interest in a partnership (other than a prescribed interest in a partnership) for a publicly traded security, where subparagraph 38(a.1)(iii) would have applied to exempt the gain if the partnership interest had been a share, i.e. the security received in exchange for the partnership interest is donated within 30 days.

In general, the taxable capital gain will be the lesser of the taxable capital gain otherwise determined and 1/2 of the amount, if any, by which the cost to the donor of the exchanged partnership interest (including any contributions to partnership capital by the donor) exceeds the adjusted cost base to the donor of that interest (determined without reference to distributions of partnership capital).

The amendment to paragraph 38(a.3) replaces the reference to the fraction “1/2” with a reference to the fraction “2/3”, as a consequence of the change of the inclusion rate for capital gains from 1/2 to 2/3.

ITA
38(b) and (c)

Paragraph 38(b) provides that a taxpayer’s allowable capital loss for a taxation year is 1/2 of the taxpayer’s capital loss for the year from the disposition of property. The amendment to paragraph 38(b) replaces the reference to the fraction “1/2” with a reference to the fraction “2/3”, as a consequence of the change of the inclusion rate for capital gains and losses from 1/2 to 2/3.

A business investment loss is generally a loss from the disposition of the shares or debts owing of a small business corporation. Paragraph 38(c) provides that an allowable business investment loss of a taxpayer for a taxation year is 1/2 of the taxpayer’s business investment loss for the taxation year. Whereas an allowable capital loss can only be deducted from a taxable capital gain, an allowable business investment loss can be deducted from any source of income.

The amendment to paragraph 38(c) replaces the reference to the fraction “1/2” with a reference to the fraction “2/3”, as a consequence of the change of the inclusion rate for capital gains and losses from 1/2 to 2/3.

Coming into Force and Transitional Rules

The amendments to section 38 apply to the 2024 and subsequent taxation years with some modifications.

- For a taxation year of a taxpayer that includes June 25, 2024, the references to the fraction ‘‘2/3’’ in paragraphs 38(a), (b) and (c) and in subparagraph 38(a.3)(ii), shall be read as references to the fraction that applies to the taxpayer for that year, and for this purpose:
    - Where the taxpayer has only net capital gains, or only net capital losses, from dispositions of property in each of the period that began at the beginning of the year and ended at the end of June 24, 2024 (the ‘‘first period’’) and the period that begins at the beginning of June 25, 2024 and ends at the end of the year (the ‘‘second period’’), the fraction that applies to the taxpayer for the year is the fraction determined by the formula:

$$(1/2 \times A + 2/3 \times B) \div (A + B)$$

where

- A is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the first period, and
- B is the net capital gains or the net capital losses, as the case may be, of the taxpayer from dispositions of property in the second period.

  - This formula provides a blended rate in between 1/2 and 2/3 that is determined based on the proportion of net gains or losses, as the case me be, realized in each period. It is applicable in situations where the taxpayer has a net capital gain in both periods or a net capital loss in both periods. In situations where the taxpayer has a net capital gain in one period and a net capital loss in the other period, the rules described below determine the inclusion rate.
  - Where the amount of the taxpayer's net capital gains from dispositions of property in the first period exceeds the amount of the taxpayer's net capital losses from dispositions of property in the second, the fraction that applies to the taxpayer for the year is 1/2.
  - Where the amount of the taxpayer's net capital losses from dispositions of property in the first period exceeds the amount of the taxpayer's net capital gains from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 1/2.
  - Where the amount of the taxpayer's net capital gains from dispositions of property in the first period is less than the amount of the taxpayer's net capital losses from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 2/3.
  - Where the amount of the taxpayer's net capital losses from dispositions of property in the first period is less than the amount of the taxpayer's net capital gains from dispositions of property in the second period, the fraction that applies to the taxpayer for the year is 2/3.
  - Where the net capital gains and net capital losses of the taxpayer for the year are nil, the fraction that applies to the taxpayer for the year is 2/3. This may be relevant for other rules in Act that make reference to the taxpayer's inclusion rate for the year.
- In determining the fraction that applies to a taxpayer for the year, the following rules apply:
  - The net capital gains of the taxpayer from dispositions of property in a period is the amount, if any, by which the taxpayer's capital gains (other than capital gains in respect of which the taxpayer deducts an amount under section 110.6) from dispositions of property in the period exceed the taxpayer's capital losses from dispositions of property in the period.
  - The net capital losses of the taxpayer from dispositions of property in a period is the amount, if any, by which the taxpayer's capital losses from dispositions of property in the period exceed the taxpayer's capital gains (other than capital gains

in respect of which the taxpayer deducts an amount under section 110.6) from dispositions of property in the period.

- The net amount included as a capital gain of the taxpayer for a taxation year from a disposition of property before the year because of subparagraphs 40(1)(a)(ii) and (iii) of the Act is deemed to be a capital gain of the taxpayer from a disposition of property on the first day of the year.
- Each capital loss that is a business investment loss shall be determined without reference to subsections 39(9) and (10).
- Where an amount is included in computing the income of the taxpayer for the year because of subsection 80(13) in respect of a commercial obligation that is settled, the amount that would be determined under that subsection in respect of the obligation, if the value of E in the formula in that subsection were 1, is deemed to be a capital gain of the taxpayer from a disposition of property on the day on which the settlement occurs.
- The taxpayer's capital gains and losses from dispositions of property (other than taxable Canadian property) while the taxpayer is a non-resident are deemed to be nil.
- Where a net amount is included as a capital gain of a taxpayer for a taxation year because of the granting of an option under subsection 49(1), the net amount is deemed to be a capital gain of the taxpayer from a disposition of property on the day on which the option was granted.
- Where a net amount is included as a capital gain of a corporation for its taxation year under subsection 49(2) because of the expiration of an option that was granted by the corporation, the net amount is deemed to be a capital gain of the corporation from a disposition of property on the day on which the option expired.
- Where a net amount is included as a capital gain of a trust for its taxation year under subsection 49(2.1) because of the expiration of an option that was granted by the trust, the net amount is deemed to be a capital gain of the trust from a disposition of property on the day on which the option expired.
- Where a net amount is included as a capital gain of a taxpayer for a taxation year because of subsection 49(3), (3.01) or (3.1), the net amount is deemed to be a capital gain of the taxpayer from a disposition of property on the day on which the option was exercised.
- Where an election is made by a taxpayer under paragraph 104(21.41)(d), subsections 104(21.51), 130.1(4.4) or (4.5) or 131(1.7) or (1.9), for a year, the portion of the taxpayer's net capital gains for the year that are to be treated as being in respect of capital gains realized on dispositions of property that occurred in a particular period in the year is that proportion of those net capital gains that the number of days in the particular period is of the number of days in the year.
- Where an amount is designated under subsection 104(21) in respect of a beneficiary by a trust in respect of the net taxable capital gains of the trust for a taxation year of the trust and the trust does not elect under paragraph 104(21.4)(d), for the year, the deemed gains of the beneficiary referred to in

subsection 104(21.4), are deemed to have been realized in each period in the year in a proportion that is equal to the proportion that the net capital gains of the trust realized by the trust in that period is of all the net capital gains realized by the trust in the year.

- If a taxation year begins before June 25, 2024, the inclusion rate that applies under paragraph 38(a) in respect of dispositions for which an amount is deducted under sections 110.6, is
    - 1/2, for property disposed of before June 25, 2024, and
    - 2/3, for property disposed of after June 24, 2024.

Clause 6

Capital gains reduction

ITA
38.01

New section 38.01 provides the computation that would determine the amount by which the net taxable capital gains for an individual, a graduated rate estate or a qualified disability trust are reduced. This reduction amount, the capital gains reduction amount, would reduce the taxable capital gains inclusion by 1/6 of net capital gains of up to $250,000. In effect, this provides these individuals and trusts with a 1/2 inclusion rate on their first $250,000 of net capital gains each year.

This amount, which reduces income under new paragraph 3(b.1), is 1/6 multiplied by the lesser of:

- $250,000 less six times the amount deducted for the year under paragraph 110(1)(d.4). This is essentially the amount of the individual's $250,000 capital gains threshold that has not been applied to reduce the effective inclusion rate on employee stock options. This adjustment, together with the deduction in paragraph 110(1)(d.4), allows an individual the choice of whether to apply the $250,000 threshold towards capital gains or stock option benefits (or to a combination of the two); and
- The amount determined by the formula "A – B – C – D + E". This formula determines the amount of a taxpayer's capital gains that are eligible for the adjustment.

Variable A of the formula is 1.5 times the amount determined under paragraph 3(b). This is the starting point of the calculation and represents the amount of the taxpayer's net capital gains for the year. This amount may be reduced by the adjustments in variables B through E.

Variable B is only applicable to a "graduated rate estate" or a "qualified disability trust". It is 1.5 times the total of all amounts designated by the trust for the taxation year under subsection 104(21). These trusts are eligible for the capital gains inclusion rate adjustment on the taxable capital gains of the trusts. To the extent that such a trust allocates out its taxable capital gain in a year to a beneficiary of the trust, this would reduce the amount of the trust's capital gain that is eligible for the 1/2 inclusion rate.

Variable C is the total of all amounts, each of which is deemed to be a capital gain of the taxpayer under paragraph 96(1.72)(f) or 104(21.7)(b), clause 130.1(4)(b)(ii)(A) or 131(1)(b)(ii)(A) or paragraph 138.1(3.1)(b). Each of these provides for a special transition year rule that is applicable to the inclusion of capital gains distributed from a partnership, mortgage investment corporation, mutual fund corporation or segregated fund that were in respect of property that has been disposed of prior to June 25, 2024. The transitional rules provide for an effective 1/2 inclusion rate on such amounts. As such, these capital gains would not be eligible for inclusion in the amount of gains that would be eligible for a reduction in their inclusion rate.

Variable D is the total of all amounts, each of which is a capital gain of the individual for the taxation year from the disposition or deemed disposition of property described in any of paragraphs (7)(b), (d) or (e). These paragraphs involve deemed dispositions, or non-arm's length transfers, of depreciable property. Capital gains from dispositions described in these paragraphs are not eligible for the $250,000 threshold unless an election is made under subsection 13(7.7). In that case, the gain is added back under variable E. See the commentary on subsections 13(7) and (7.7) for more information.

Variable E is the total of all amounts elected by the taxpayer under subsection 13(7.7) for the taxation year that relate to a capital gain of the taxpayer included in the description of D.

New section 38.01 applies to taxation years that end after June 24, 2024 with some modifications.

For the purpose of applying paragraph 38.01(b) for the 2024 taxation year, the amount determined under paragraph 3(b) shall be calculated as if:

- The individual's only taxable capital gains for the year were the individual's taxable capital gains for the year from the disposition of property other than listed personal property after June 24, 2024.
- The individual's allowable capital losses for the year were the amount, if any, by which the individual's allowable capital losses for the year from the disposition of property other than listed personal property exceed the individual's taxable capital gains for the year from the disposition of property other than listed personal property before June 25, 2025.
- The individual's taxable net gain for the year from the disposition of listed personal property was computed as if:
  - the individual's only gains for the year from the disposition of listed personal property were gains from the disposition of listed personal property after June 24, 2024, and
  - the individual's losses for the year from the disposition of listed personal property were the amount, if any, by which the individual's losses for the year from the disposition of listed personal property exceed the individual's gains for the year from the disposition of listed personal property before June 25, 2024.

- The only amounts designated under subsection 104(21) by a “graduated rate estate” or a “qualified disability trust” were from the dispositions of property that occurred after June 24, 2024.

Clause 7

Deduction from business investment loss

ITA
39(9)

Subsection 39(9) provides that in computing a business investment loss a taxpayer is required to deduct, from the amount of the business investment loss otherwise determined, the lesser of the amount of the business investment loss and the taxpayer's net capital gains for which a deduction was claimed under section 110.6, to the extent that such gains have not been used to reduce other business investment losses.

In calculating the net capital gains for which a deduction was claimed under section 110.6, such deductions are grossed-up by the reciprocal of the applicable inclusion rate. A number of amendments are made consequential to the change of the inclusion rate for capital gains from 1/2 to 2/3.

Paragraph 39(9)(b) is amended to add references to section 110.61, which provides a capital gain exemption for dispositions of shares pursuant to a qualifying business transfer to a trust that becomes an employee ownership trust.

Clause 39(9)(b)(i)(B) is amended to provide for a reduction in a business investment loss of twice the amounts deducted by the taxpayer under sections 110.6 and 110.61 for taxation years that ended prior to June 25, 2024.

New subclause 39(9)(b)(i.1)(A)(III) is added to provide for a reduction in a business investment loss of 3/2 times the amounts deducted by the taxpayer under sections 110.6 and 110.61 for taxation years that begin after June 24, 2024.

Paragraph 39(9)(b) is amended by adding new subparagraph (i.3). New subparagraph 39(9)(b)(i.3) addresses the fact that two capital gains inclusion rates would apply for taxation years that begin before June 25, 2024 and end after June 24, 2024. This new subparagraph provides for a reduction in a business investment loss by the amount determined by the formula

$A + B + C$

where

A is twice the amount deducted under section 110.6 in respect of dispositions of property in the year that are after 2023 and before June 25, 2024,

B is 1.5 times the amount deducted under section 110.6 in respect of dispositions of property in the year that are after June 24, 2024, and

C is the amount determined by multiplying the reciprocal of the fraction in paragraph 38(a) that applies to the taxpayer for that year by the total of the amounts deducted under section 110.61 in computing the taxpayer's taxable income for that year.

These amendments apply to taxation years that end after June 24, 2024.

Deduction from business investment loss, of a trust

ITA
39(10)

Pursuant to subsection 39(10), in computing a business investment loss of a trust, the trust is required to deduct from the amount of the business investment loss otherwise determined, the lesser of

- the amount of the business investment loss, and
- the amount by which the trust's capital gains exceed capital losses (i.e., net gains), to the extent that the net taxable capital gains derived from those net gains were the subject of a designation under subsection 104(21.2) in respect of a beneficiary and those net gains have not been used to reduce other business investment losses.

In calculating the net gains required to reduce the business investment loss, amounts designated in respect of beneficiaries under subsection 104(21.2) are grossed-up by the reciprocal of the fraction that applies to the trust in amended paragraph 38(a) (i.e. the trust's inclusion rate).

A number of amendments are made consequential to the change of the inclusion rate for capital gains from 1/2 to 2/3.

Clause 39(10)(b)(i)(B) is amended to provide for a reduction in a business investment loss of a trust of twice the amounts designated by the trust under subsection 104(21.2) for taxation years that ended prior to 1988 and begin after October 17, 2000 and end before June 25, 2024.

Clause 39(10)(b)(i.1)(A) is amended to provide for a reduction in a business investment loss of a trust of 3/2 times the amounts designated by the trust under subsection 104(21.2) for taxation years that begin after June 24, 2024.

Paragraph 39(10)(b) is amended by adding new subparagraph (i.3). New subparagraph 39(10)(b)(i.3) addresses the fact that two capital gains inclusion rates would apply for taxation years that begin before June 25, 2024 and end after June 24, 2024. This new subparagraph provides for a reduction in a business investment loss by the amount determined by the formula

A + B

where

A is twice the amount designated by the trust under subsection 104(21.2) in respect of a beneficiary in its return of income in respect of dispositions of property in the year that are after 2023 and before June 25, 2024, and

B is 1.5 times the amount designated by the trust under subsection 104(21.2) in respect of a beneficiary in its return of income in respect of dispositions of property in the year that are after June 24, 2024.

These amendments apply to taxation years that end after June 24, 2024.

Recovery of bad debt

ITA
39(11)

Subsection 39(11) deems a portion of a recovered bad debt in respect of eligible capital property to be a taxable capital gain. The portion that is deemed to be a taxable capital gain is the amount that relates to the portion of the bad debt that was previously deemed to be an allowable capital loss.

Subsection 39(11) is amended consequential to the change to the inclusion rate for capital gains, by replacing the fraction “1/2” with the fraction “2/3”.

This amendment applies to taxation years that end after June 24, 2024.

Clause 8

Taxable net gain – dispositions of listed personal property

ITA
41(1)

Subsection 41(1) defines a taxpayer's taxable net gain for a taxation year from dispositions of listed personal property as 1/2 of the taxpayer's net gain determined under subsection 41(2) from dispositions of such property.

Subsection 41(1) is amended to replace the reference to the fraction “1/2” with a reference to the fraction “2/3”. The amendment is consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

The amendment applies to taxation years that end after June 24, 2024. For taxation years that include June 25, 2025, the reference to the fraction ‘‘2/3’’ in subsection 41(1), shall be read as a reference to the fraction in paragraph 38(a) that applies to the taxpayer for the year.

Clause 9

ITA
53(2)(h)

Under paragraph 53(2)(h), certain amounts are generally deducted in computing the adjusted cost base (ACB) to a beneficiary of the beneficiary's capital interest in a trust (other than an interest in a personal trust that has never been acquired for consideration or an interest of a taxpayer in a trust described in any of paragraphs (a) to (e.1) of the definition “trust” in subsection 108(1)).

Subparagraph 53(2)(h)(i.1) generally ensures that distributions from a trust reduce the beneficiary's ACB of their capital interest in the trust, unless the amount:

- represents proceeds of disposition of the interest,
- is otherwise included in the beneficiary’s income (including as a taxable capital gain), or
- meets certain other exceptions.

Subclause 53(2)(h)(i.1)(B)(I) provides an exception for the non-taxable portion of the capital gain allocated to a beneficiary.

Subclause 53(2)(h)(i.1)(B)(I) currently refers to the full amount designated under subsection 104(21). Subsection 104(21) provides for the designation of taxable capital gains. Under the current 1/2 inclusion rate for capital gains, the amount designated under subsection 104(21) (i.e., the taxable portion of a capital gain) is also equal to the non-taxable portion of the capital gain. Consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3, subclause 53(2)(h)(i.1)(B)(I) is amended to add the expression “1/2 of”. This means that the amount in that subclause will be equal to half of the amount designated under subsection 104(21), which is in turn equal to 1/3 of the capital gain (i.e., the non-taxable portion of the capital gain).

This amendment applies to taxation years that end after June 24, 2024. Where a taxation year of the trust that includes June 25, 2024 ends in the taxpayer’s taxation year, the reference to ‘‘1/2’’ in that subclause shall be read as a reference to the fraction obtained when 1 is subtracted from the reciprocal of the fraction in paragraph 38(a) that applies to the trust for its taxation year.

Clause 10

Capital gain where current year capital loss

ITA
80(12)

Subsection 80(12) treats the unapplied portion of a forgiven amount in respect of a commercial obligation of a debtor settled in a year as a capital gain of the debtor for the year from the disposition of capital property to the extent of the lesser of the amount of the remaining unapplied portion and the amount of the debtor's net capital losses for the year. In calculating the amount of the net capital losses of the debtor for the year, clause 80(12)(a)(ii)(B) includes twice the amount of certain deductible net capital losses of a subsidiary of the debtor that has been wound up into the debtor.

Clause 80(12)(a)(ii)(B) is amended to replace the word “twice” with the expression “1.5 times”. The amendment is consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

This amendment applies to taxation years that end after June 24, 2024. For a debtor's taxation year that includes June 25, 2024, the reference to the fraction “1.5” is to be read as a reference to the fraction that is the reciprocal of the fraction in paragraph 38(a) that applies to the debtor for the year.

Income inclusion

ITA
80(13)

Subsection 80(13) includes an amount in computing the income of a debtor for the taxation year in respect of the remaining unapplied portion of the forgiven amount in respect of a commercial obligation settled in the year.

Subparagraph (a)(ii) of the description of D in subsection 80(13) is amended to replace references to the word “twice” with the expression “1.5 times”. The amendment is consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

This amendment applies to taxation years that end after June 24, 2024. For a debtor's taxation year that includes June 25, 2024, the reference to the fraction “1.5” is to be read as a reference to the fraction that is the reciprocal of the fraction in paragraph 38(a) that applies to the debtor for the year.

Paragraph (b) in the description of E in subsection 80(13) is amended to replace references to the fraction “1/2” with a reference to the fraction “2/3”. This amendment is consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

This amendment applies to taxation years that end after June 24, 2024. For a debtor's taxation year that includes June 25, 2024, the reference to the fraction “2/3” in paragraph (b) of the description of E in subsection 80(13), shall be read as a reference to the fraction in paragraph 38(a) that applies to the debtor for the year.

Clause 11

Subsequent payments in satisfaction of debt

ITA
80.01(10)

Subsection 80.01(10) permits, in certain circumstances, a debtor to deduct an amount in computing income in respect of a payment made in respect of the principal amount of a commercial debt obligation that was previously settled.

The amendment to subsection 80.01(10) replaces the reference to “0.5” with a reference to the fraction “2/3”. The amendment is consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

This amendment applies to taxation years that end after June 24, 2024. For a taxation year of a debtor that includes June 25, 2024, the reference to the fraction “2/3” in subsection 80.01(10), shall be read as a reference to the fraction in paragraph 38(a) that applied to the debtor for the year in which the commercial debt obligation was deemed to have been settled.

Clause 12

Rules for par. 84.1(2)(a.1)

ITA
84.1(2.1)

Paragraph 84.1(2)(a.1) applies to determine, for the purposes of subsection 84.1(1), the adjusted cost base to a taxpayer of a share that was acquired by the taxpayer after 1971 from a non-arm's length person, or that was a share substituted for such a share or for a share owned by the taxpayer at the end of 1971. The taxpayer's adjusted cost base, otherwise determined, of such a share is reduced under subparagraph 84.1(2)(a.1)(ii) by the lesser of the capital gain realized by the taxpayer or a non-arm's length person in respect of a previous disposition and the portion of the whole gain in respect of which a capital gains exemption was claimed by the taxpayer or the non-arm's length person. The effect of this reduction is to allow the adjusted cost base of a share to be increased on a non-arm's length transfer only to the extent that any capital gain arising on that transfer was taxed.

Subsection 84.1(2.1) is amended, for taxation years of transferors that end after June 24, 2024, to ensure that dispositions of shares in a year reflect the capital gains inclusion rate for that year, by:

- replacing the references to the word "twice" with a reference to the reciprocal of the specified multiplier; and
- replacing the reference to "1/2" with a reference to the specified multiplier.

The concept "specified multiplier" is defined in new subsection 84.1(2.11). It is 1/2 for dispositions before June 25, 2024 and 2/3 for later dispositions.

Clause 13

Definitions

ITA
89(1) "capital dividend account"

The definition "capital dividend account" is part of a mechanism intended to achieve integration by generally allowing the untaxed portion of capital gains to flow through a private corporation without attracting an extra level of tax. To the extent that a private corporation has a capital dividend account balance, it may generally elect to treat dividends that it pays as capital dividends. Capital dividends may be received tax-free by the corporation's shareholders.

Under paragraph (a) of the definition, the non-taxable portions of capital gains realized, and the non-taxable portions of capital gains received from a trust after September 15, 2016, are added to a corporation's capital dividend account. These non-taxable amounts are reduced by the non-allowable portions of the corporation's realized capital losses. This paragraph is amended in several respects as a consequence to the change in the capital gains inclusion rate from 1/2 to 2/3.

First, clause (a)(i)(A) of the definition "capital dividend account" is amended to disregard the special temporary rules (in paragraph 104(21.4)(a), subsection 104(21.7) and paragraph 104(21.8)(b)) introduced for a taxation year that begins before June 25, 2024, and ends after June 24, 2024 (the "transition year") that deem a beneficiary to have realized a capital gain if the trust designates, in respect of the beneficiary, an amount of its net taxable capital gains under subsection 104(21). This amendment ensures that the ordinary rule in subparagraph (a)(i.1) applicable to the non-taxable portion of capital gains distributed by a trust continues to apply during the transition year.

Second, new subparagraph (a)(i.2) of the definition "capital dividend account" effectively provides that the capital dividend account balance is increased by 1/3 of the total of all amounts, each of which is deemed to be a capital gain of the taxpayer under paragraph 96(1.72)(f), clause 130.1(4)(b)(ii)(A) or 131(1)(b)(ii)(A) or paragraph 138.1(3.1)(b). These provisions provide an effective inclusion rate of 1/2 for certain deemed capital gains distributed from a partnership, mortgage investment corporation, mutual fund corporation or segregated fund during the transition year by deeming the capital gain to be 3/4 of the deemed capital gain that is subject to a 2/3 inclusion rate. New subparagraph (a)(i.2) is necessary to ensure that the non-taxable portion of the capital gain (i.e., one half) realized by the partnership, mortgage investment corporation, mutual fund corporation or segregated fund and distributed to the corporation is included in computing the corporation's capital dividend account balance.

Third, new subparagraph (a)(iii) of the definition "capital dividend account" effectively provides that the capital dividend account balance is reduced by 1/3 of the total of all amounts, each of which is deemed to be a capital loss of the taxpayer under paragraph 96(1.72)(f) or 138.1(3.1)(b). These provisions provide an effective inclusion rate of 1/2 for certain deemed capital losses distributed from a partnership or segregated fund during the transition year by deeming the capital loss to be 3/4 of the deemed capital loss that is subject to a 2/3 inclusion rate. New subparagraph (a)(iii) is necessary to ensure that the non-allowable portion of the capital loss (i.e., one half) realized by the partnership, mortgage investment corporation, mutual fund corporation or segregated fund and distributed to the corporation is deducted in computing the corporation's capital dividend account balance.

These amendments apply in respect of taxation years that end after June 24, 2024.

For more information, see the commentary to subsections 89(1.3) and (1.4).

Capital dividend account – net capital loss carryover

ITA
89(1.3)

New subsection 89(1.3) provides a special rule for determining the amount of the "capital dividend account" ("CDA"), as defined in subsection 89(1), of a corporation at any time. CDA is part of a mechanism intended to achieve integration by generally allowing the non-taxable portion of capital gains net of the non-allowable portion of capital losses (determined based on the inclusion rate applicable to the capital gains or losses) to flow through a private corporation without attracting an extra level of tax.

This new subsection is relevant if the inclusion rate for capital gains and losses for the year in which the net capital losses ("NCLs") are generated differs from the inclusion rate for the year in which the NCLs are deducted under paragraph 111(1)(b) against taxable capital gains. In this scenario, typically paragraph 111(1.1)(a) adjusts the amount that may be deducted under paragraph 111(1)(b) in respect of the amount of NCLs claimed, so that capital losses of any year will equally offset the same amount of capital gains in another year. New subsection 89(1.3) applies a similar adjustment to the CDA balance to compensate for the differences in the inclusion rates between the two years.

New paragraph (a) applies to reduce the excessive CDA balance where NCLs for a taxation year (a "loss year") are carried back to offset taxable capital gains in a prior taxation year, that has a lower inclusion rate than the loss year. This new provision accomplishes this objective by deeming the corporation to have realized a capital loss at the end of the loss year, for the purposes of computing the CDA balance, equal to the amount determined by the formula 1 / (1 - A) x (B - C), where A is the inclusion rate for the loss year and (B - C) is the excess of the amount of those NCLs claimed by the corporation over the amount of those NCLs deducted by the corporation (as adjusted by subsection 111(1.1)).

New paragraph (b) applies to increase the insufficient CDA balance where NCLs for a loss year are carried forward to offset taxable capital gains in a subsequent taxation year, that has a higher inclusion rate than the loss year. This new provision accomplishes this objective by deeming the corporation to have realized a capital gain at the end of the subsequent year, for the purposes of computing the CDA balance, equal to the amount determined by the formula 1 / (1 - D) x (E - F), where D is the inclusion rate for the subsequent year and (E - F) is the excess of the amount of those NCLs deducted by the corporation (as adjusted by subsection 111(1.1)) over the amount of those NCLs claimed by the corporation.

Example – deemed capital loss

A private corporation realized $100 of capital gains in 2023 (where the inclusion rate was 1/2, the taxable capital gains were $50) and $100 of capital losses in 2025 (where the inclusion rate was 2/3, the allowable capital losses were $66.67).

The corporation's 2025 NCLs are equal to the amount of its allowable capital losses of $66.67. In order to completely offset the capital losses with the capital gains, the corporation must claim all $66.67 of its 2025 NCLs under paragraph 111(1)(b) for its 2023 taxation year because subsection 111(1.1) reduces the deduction to $50 ($66.67 x (1/2)/(2/3)).

However, without any further adjustments, the corporation would end up with an excessive CDA balance of $16.67 (the non-taxable portion of the capital gains of $50 ($100 - $50) less the non-allowable portion of the capital losses of $33.33 ($100 – $66.67)).

Since the corporation's NCLs for the loss year (2025) are carried back to offset capital gains in a prior year that has a lower inclusion rate (2023), for the purposes of computing the corporation's CDA balance, new paragraph (a) deems the corporation to have realized a capital loss of $50, determined by the formula 1 / (1 - A) x (B - C), or 1/(1 - 2/3) x ($66.67 – $50). Consequently, the CDA balance is reduced by $16.67, equal to the non-allowable portion of the deemed capital loss ($50 – (2/3 of $50)). This reduction eliminates the excessive CDA balance generated by the capital gains realized in 2023 that was offset against capital losses in 2025.

This amendment applies in respect of taxation years that end after June 24, 2024.

Capital dividend account – 2024 transition year

ITA
89(1.4)

New subsection 89(1.4) provides a special rule for determining the amount of the "capital dividend account" ("CDA"), as defined in subsection 89(1), of a corporation at any time, in respect of its taxation year that begins before June 25, 2024 and ends after June 24, 2024 (the "transition year").

CDA is part of a mechanism intended to achieve integration by generally allowing the non-taxable portion of capital gains net of the non-allowable portion of capital losses (determined based on the inclusion rate applicable to the capital gains or losses) to flow through a private corporation without attracting an extra level of tax. To the extent that a private corporation has a CDA balance at any time, it may generally elect to treat dividends that it pays as tax-free capital dividends.

However, because of the change in the inclusion rate from 1/2 to 2/3 after June 24, 2024, paragraph 38(a), subparagraph 38(a.3)(ii) and paragraphs 38(b) and (c) (the "fractional inclusion rate provisions") consider all of a corporation's capital gains and losses for the transition year to determine its inclusion rate for that year (which may range from 1/2 to 2/3). See the commentary to section 38 for more information on the applicable inclusion rate. Thus, a corporation can only determine its inclusion rate in the transition year after the year ends. This timing consideration may be incompatible with the computation of the CDA balance, which is determined at any time in the year to establish the amount of dividends that the corporation can elect to pay as tax-free capital dividends.

Other section 38 provisions (i.e., non-fractional inclusion rate provisions) that apply to deemed capital gains realized on charitable donations of certain properties (described in paragraphs 38(a.1) and (a.2) and subparagraph 38(a.3)(i)) are not impacted by the change to the inclusion rate from 1/2 to 2/3 and are thus not subject to new subsection 89(1.4).

Paragraph (a) – inclusion rate

New paragraph (a) addresses uncertainty in computing a corporation's CDA balance during the transition year by deeming the corporations' taxable capital gain ("TCG") or allowable capital loss ("ACL") from the disposition of any property in that year to which any of the fractional inclusion rate provisions apply to be

a) if the disposition occurred before June 25, 2024, 1/2 of the capital gain or loss (i.e., the non-taxable or non-allowable 1/2 of the capital gain or loss is included in computing the CDA balance); or
b) if the disposition occurred after June 24, 2024, 2/3 of the capital gain or loss (i.e., the non-taxable or non-allowable 1/3 of the capital gain or loss is included in computing the CDA balance).

Furthermore, if there is a difference between the deemed inclusion rate under new paragraph (a) and the inclusion rate determined at the end of the transition year under section 38, for the purposes of determining the CDA balance, new paragraph (b) or (c) deems a capital gain or loss to adjust for that difference.

Paragraph (b) – deemed capital gain

If new paragraph (a) results in an excessive reduction to a corporation's CDA balance that does not reflect its actual inclusion rate for the transition year, new paragraph (b) deems the corporation to have realized a capital gain from the disposition of property at the end of the transition year. New paragraph (b) applies in the following two scenarios:

1. if the amount of the corporation's net taxable capital gains ("net TCGs", defined in new paragraph (d)) for the year determined under paragraph (a) (variable A) exceeds the amount of the corporation's net TCGs determined without reference to paragraph (a) ("determined under section 38") (variable B); and
2. if the amount of the corporation's net allowable capital losses ("net ACLs", defined in paragraph (d)) for the year determined under section 38 (variable C) exceeds the amount of the corporation's net ACLs determined under paragraph (a) (variable D).

More specifically, new paragraph (b) deems the corporation to have realized a capital gain from the disposition of a property at the end of its transition year equal to the amount determined by the formula 3 x (A – B + C – D).

Paragraph (c) – deemed capital loss

In contrast, if new paragraph (a) results in an excessive addition to a corporation's CDA balance that does not reflect its actual inclusion rate for the transition year, new paragraph (c) deems the corporation to have realized a capital loss from the disposition of property at the end of the transition year. New paragraph (c) applies in the following two scenarios:

1. if the amount of the corporation's net ACLs for the year determined under paragraph (a) (variable E) exceeds the amount of the corporation's net ACLs determined under section 38 (variable F); and
2. if the amount of the corporation's net TCGs for the year determined under section 38 (variable G) exceeds the amount of the corporation's net TCGs determined under paragraph (a) (variable H).

More specifically, new paragraph (c) deems the corporation to have realized a capital loss from the disposition of a property at the end of its transition year equal to the amount determined by the formula 3 x (E – F + G – H).

Paragraph (d) - definitions

To assist in the interpretation of this provision, paragraph (d) defines, for the purposes of this subsection, the net taxable capital gains and the net allowable capital losses.

The net taxable capital gains of the corporation is the amount, if any, by which the total of the corporation's TCGs for the year exceeds its ACLs for the year from dispositions of property to which the fractional inclusion rate provisions apply.

The net allowable capital losses of the corporation is the amount, if any, by which the total of the corporation's ACLs for the year exceeds its TCGs for the year from dispositions of property to which the fractional inclusion rate provisions apply.

As mentioned above, the inclusion rate applicable to determine a corporation's net TCGs or net ACLs will depend on whether the net TCGs or net ACLs determination is relevant under new paragraph (a) or under section 38 when applying paragraphs (b) and (c).

The following examples illustrate the application of new subsection 89(1.4).

Example – deemed capital loss

In the transition year, a private corporation realized a capital gain of $100 before June 25, 2024 (the "first period") on the disposition of property 1 and a capital loss of $100 after June 24, 2024 (the "second period") on the disposition of property 2.

<u>*Inclusion rates*</u>

Under new subparagraph (a)(i), for the purposes of determining the corporation's CDA balance, the taxable portion of the capital gain realized in the first period is $50 (1/2 of $100). Thus, the non-taxable portion of the capital gain of $50 ($100 - $50) is added to the CDA balance on the disposition of property 1.

Under new subparagraph (a)(ii), for the purposes of determining the corporation's CDA balance, the allowable portion of the capital loss realized in the second period is $66.67 (2/3 of $100). Thus, the non-allowable portion of the capital loss of $33.33 ($100 - $66.67) reduces the CDA balance on the disposition of property 2.

Under section 38, since the "net capital gains" and "net capital losses" (as defined in the amending clauses of that section) of the corporation were nil, the inclusion rate that applies for the year is 2/3.

Because the capital gains were offset against the capital losses in the year, without any further adjustments (described below), the corporation would end up with an excessive CDA balance of $16.67 ($50.00 - $33.33) as a result of the application of new paragraph (a).

<u>*Net TCGs and net ACLs*</u>

New subparagraph (d)(i) defines, for the purposes of this subsection, the amount of the corporation's net TCGs for its transition year determined under paragraph (a) to be nil (its TCG of $50 does not exceed its ACL of $66.67), and the amount determined under section 38 to be nil (its TCG of $66.67(2/3 of $100) does not exceed its ACL of $66.67 (2/3 of $100)).

Furthermore, new subparagraph (d)(ii) defines, for the purposes of this subsection, the amount of the corporation's net ACLs for its transition year determined under paragraph (a) to be

$16.67 (its ACL of $66.67 exceeds its TCG of $50), and the amount determined under section 38 to be nil (its ACL of $66.67 does not exceed its TCG of $66.67).

<u>Deemed capital gain or loss</u>

Paragraph (b) does not deem the corporation to have realized a capital gain because the amount of the corporation's net ACLs for the year determined under section 38 (nil) does not exceed the amount determined under paragraph (a) ($16.67). In other words, the amount determined by the formula in paragraph (b) is nil [3 x (0 – 0 + 0 – $16.67)].

However, paragraph (c) deems the corporation to have realized a capital loss at the end of the transition year because the amount of its net ACLs for the year determined under paragraph (a) ($16.67) exceeds the amount determined under section 38 (nil). The amount of the deemed capital loss, determined by the formula in paragraph (c), is $50 [3 x ($16.67 – 0 + 0 – 0)].

At the end of the transition year, the allowable portion of the deemed capital loss, pursuant to the 2/3 inclusion rate determined under subparagraph (a)(ii), is $33.33 (2/3 of $50). Thus, the CDA is reduced by the non-allowable portion of the deemed capital loss of $16.67 ($50 - $33.33). This reduction eliminates the excessive CDA balance generated by the capital gains realized in the transition year that was offset against capital losses in the year.

Example – 104(21.4) trust designations in respect of TCGs

A private corporation realized a capital loss of $100 in the transition year before June 24, 2024 (the "first period"). The corporation is a beneficiary of a trust, that realized a capital gain of $100 in the transition year after June 25, 2024 (the "second period") and designates $66.67 of its net TCGs under subsection 104(21) in respect of the corporation. The trust distributes $75 of the capital gains (representing $66.67 of the taxable portion and $8.33 of the non-taxable portion) and retains the remaining $25 in the trust.

<u>Inclusion rates</u>

Under new subparagraph (a)(i), for the purposes of determining the corporation's CDA balance, the allowable portion of the capital loss realized in the first period is $50 (1/2 of $100). Thus, the non-allowable portion of the capital loss of $50 ($100 - $50) reduces the CDA balance in the first period.

New subsections 104(21.4) and (21.7) provide special rules for a trust designation of TCGs in the transition year. See the commentary to those subsections for more information. Under those special rules, the corporate beneficiary of the trust is deemed to have realized a capital gain of $100 in the second period. Under new subparagraph 89(1.4)(a)(ii), the taxable portion of the capital gains realized in the second period is $66.67 (2/3 of $100). Thus, the non-taxable portion of the capital gain is $33.33 ($100 - $66.67). However, pursuant to the amendment to clause (a)(i)(A) of the definition of CDA in subsection 89(1), the special rules that deem a capital gain (including paragraph 104(21.4)(a) and subsection 104(21.7)) are disregarded for determining the CDA balance. Instead, the ordinary rule in subparagraph (a)(i.1) of the CDA definition applies to generally increase the CDA balance for the amount of the trust distribution that *exceeds the amount designated under subsection 104(21). In this case, although the corporation is deemed to have realized a capital gain of $100 from the trust distribution, it only increases the corporation's CDA balance by $8.33 ($75 – $66.67).*

Under section 38, since the "net capital gains" and "net capital losses" (as defined in the amending clauses of that section) of the corporation were nil, the inclusion rate that applies for the year is 2/3.

Without any further adjustments (described below), the corporation would end up with a CDA reduction of $41.67 ($50 - $8.33), despite an economic loss of only $25 ($100 capital loss less $75 of trust distribution).

<u>Net TCGs and net ACLs</u>

New subparagraph (d)(i) defines, for the purposes of this subsection, the amount of the corporation's net TCGs for its transition year determined under paragraph (a) to be $16.67 (its TCG of $66.67 exceeds its ACL of $50), and the amount determined under section 38 to be nil (its TCG of $66.67 (2/3 of $100) does not exceed its ACL of $66.67 (2/3 of $100)).

Furthermore, new subparagraph (d)(ii) defines, for the purposes of this subsection, the amount of the corporation's net ACLs for its transition year determined under paragraph (a) to be nil (its ACL of $50 does not exceed its TCG of $66.67), and the amount determined under section 38 to be nil (its ACL of $66.67 does not exceed its TCG of $66.67).

<u>Deemed capital gain or loss</u>

The corporation is deemed to have realized a capital gain at the end of the transition year of $50, determined by the formula in paragraph (b), [3 x ($16.67 – 0 + 0 – 0)].

Furthermore, the corporation is not deemed to have realized a capital loss because the amount determined by the formula in paragraph (c) is nil [3 x (0 – 0 + 0 – $16.67)].

At the end of the transition year, the taxable portion of the deemed capital gain, pursuant to the 2/3 inclusion rate determined under subparagraph (a)(ii), is $33.33 (2/3 of $50). Thus, the CDA is increased by the non-taxable portion of the capital gain of $16.67 ($50 - $33.33).

The overall impact to the CDA in the transition year is a reduction of $25 (-$50+$8.33+$16.67). Although the capital loss of $100 and the deemed capital gain from the trust distribution of $100 were offset in the year, the overall reduction of $25 to the CDA balance represents the undistributed non-taxable portion of the capital gains realized by the trust (which upon distribution, will increase the CDA balance by $25).

This amendment applies in respect of taxation years that end after June 24, 2024.

Clause 14

Corporations: deductions for amounts included under subsection (6) or (12)

ITA
90(9)

Subsection 90(9) provides relief from the upstream loan rules. The deduction under subsection 90(9) is for a particular amount in respect of the specified amount included in income under subsection 90(6) (or in respect of an amount included under subsection 90(12)), where the particular amount is the total of certain deductions that could have been claimed had the specified amount in respect of the upstream loan been instead distributed as dividends (as set out in paragraph 90(9)(a)), and where these same deductions have not been claimed in respect of other loans or distributions (as set out in paragraphs 90(9)(b) and (c)).

Subsection 90(9) is amended consequential to the increase in the capital gains inclusion rate from 1/2 to 2/3 and the related amendments bifurcating hybrid surplus into the new legacy hybrid surplus and successor hybrid surplus pools. Clause 90(9)(a)(i)(B) is amended to replace the references to “hybrid surplus” with references to “legacy hybrid surplus”, reflecting that the deductions historically available in respect of dividends paid out of hybrid surplus (predicated on the 1/2 capital gains inclusion rate) continue to be available in respect of dividends paid out of legacy hybrid surplus. New clause 90(9)(a)(i)(B.1) is added to reflect the deductions available in respect of dividends out of successor hybrid surplus (predicated on the new 2/3 capital gains inclusion rate). In effect, the existing clause (B) is split into two separate clauses to reflect the reduced level of deductibility conferred on dividends paid out of successor hybrid surplus, which in general terms comprises hybrid surplus from capital gains realized after June 24, 2024.

Consequential to the changes to paragraph 90(9)(a), paragraph 90(9)(b) is amended to replace the reference to “hybrid surplus” with references to “legacy hybrid surplus” and “successor hybrid surplus” in the list of tax attributes that may have already been used for deductions under this subsection, subsection 91(5) or 113(1), in which case they are not permitted to be used to support the subsection 90(9) deduction in question.

These amendments apply to loans received and indebtedness incurred after June 24, 2024. Thus, for loans received or indebtedness incurred before June 25, 2024, hybrid surplus is still used to calculate the amount deductible under subsection 90(9). However, in applying paragraph 90(9)(b) in respect of such pre-June 25, 2024 loans or indebtedness, the legacy hybrid surplus and successor hybrid surplus concepts are nonetheless relevant. For example, if the foreign affiliate pays a dividend to the corporation resident in Canada out of the affiliate’s legacy hybrid surplus after June 24, 2024 and this exhausts the affiliate’s legacy hybrid surplus, leaving the affiliate with only successor hybrid surplus, the affiliate will no longer have hybrid surplus available to support a deduction under subsection 90(9) in respect of such a loan or indebtedness following the dividend payment, since paragraph 90(9)(b) requires that the hybrid surplus that was available at the lending time to support a deduction not be used to support a deduction in respect of a subsequent dividend or loan.

Corporate partners: application of subsection (9)

ITA
90(10)

Subsection 90(10) is a mechanical rule that is intended to allow the deduction under subsection 90(9) to operate properly where the taxpayer is a partnership of which a corporation resident in

Canada is a member. This rule attributes amounts included in the partnership's income under subsection 90(6) to the corporate partner so that the corporation may claim a deduction under subsection 90(9). This rule is necessary because partnerships cannot claim deductions under subsection 113(1), only corporations can.

In line with the amendments to paragraph 90(9)(b), the "read-as" rule in paragraph 90(10)(d) is updated to replace the existing reference to "hybrid surplus" with references to "legacy hybrid surplus" and "successor hybrid surplus".

This amendment applies to loans received and indebtedness incurred after June 24, 2024.

Downstream surplus

ITA
90(11)

Subsection 90(11) is an application rule for subsection 90(9). It allows the creditor affiliate (or partnership) to aggregate so-called "downstream surplus" for the purposes of the hypothetical deductions determination in paragraph 90(9)(a).

Consequential to the amendments to subsection 90(9) and subparagraph 5902(1)(a)(i) of the Regulations in connection with the increase of the capital gains inclusion rate from 1/2 to 2/3, subsection 90(11) is amended to include, in the list of aggregated "downstream" amounts, the "legacy" and "successor" sub-categories of hybrid surplus, hybrid deficit and hybrid underlying tax.

This amendment applies to loans received and indebtedness incurred after June 24, 2024.

Clause 15

Disposition of shares of a foreign affiliate held by a partnership

ITA
93(1.2)

Paragraph 93(1.2)(a) is amended to replace the word "twice" with the expression "1.5 times", consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

This amendment applies to taxation years that end after June 24, 2024, except that, for a taxation year of a taxpayer or a foreign affiliate of a taxpayer that includes June 25, 2024, the reference to "1.5 times" is to be read as a reference to the fraction that is the reciprocal of the fraction in paragraph 38(a) that applies to the taxpayer or to the foreign affiliate, as the case may be, for the taxation year.

Loss limitation on disposition of share of foreign affiliate

ITA
93(2.01)

Subparagraphs (ii) and (iv) of the description of C in paragraph 93(2.01)(a) are amended to replace the word “twice” with the expression “1.5 times”, consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

These amendments apply to taxation years that end after June 24, 2024, except that, for a taxation year of a corporation that includes June 25, 2024, the references to “1.5” are to be read as references to the fraction that is the reciprocal of the fraction in paragraph 38(a) that applies to the taxpayer or the foreign affiliate, as the case may be, for the taxation year.

Loss limitation on disposition of foreign affiliate share by a partnership

ITA
93(2.11)

The description of B and subparagraphs (i) and (iii) of the description of C in paragraph 93(2.11)(a), and subparagraph 93(2.11)(b)(ii), are amended to replace the references to the fraction “1/2” with references to the fraction “2/3”, consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

These amendments apply to taxation years that end after June 24, 2024, except that, for a taxation year of a corporation that includes June 25, 2024, the references to the fraction “2/3” are to be read as references to the fraction in paragraph 38(a) that applies to the taxpayer or foreign affiliate, as the case may be, for that taxation year.

Loss limitation on disposition of partnership that has foreign affiliate shares

ITA
93(2.21)

Subparagraphs (ii) and (iv) of the description of C in paragraph 93(2.21)(a) are amended to replace the word “twice” with references to the expression “1.5 times”, consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

These amendments apply to taxation years that end after June 24, 2024, except that, for a taxation year of a corporation that includes June 25, 2024, the references to “1.5” are to be read as references to the fraction that is the reciprocal of the fraction in paragraph 38(a) that applies to the taxpayer or foreign affiliate, as the case may be, for that taxation year.

Loss limitation on disposition by a partnership of an indirect interest in foreign affiliate shares

ITA
93(2.31)

The description of B and subparagraphs (i) and (iii) of the description of C in paragraph 93(2.31)(a), and subparagraph 93(2.31)(b)(ii), are amended to replace the fraction “1/2” with references to the fraction “2/3”, consequential to the increase of the inclusion rate for capital gains from 1/2 to 2/3.

These amendments apply to taxation years that end after June 24, 2024, except that, for a taxation year of a corporation that includes June 25, 2024, the references to the fraction “2/3” are to be read as references to the fraction in paragraph 38(a) that applies to the taxpayer or foreign affiliate, as the case may be, for that taxation year.

Clause 16

Definitions

ITA
95(1)

“foreign accrual property income”

The description of A.1 is amended to replace the reference to the word “twice” with a reference to the expression “1.5 times”, consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3.

This amendment applies to taxation years of a foreign affiliate that end after June 24, 2024, except that, where a foreign affiliate’s taxation year includes June 24, 2024, the reference to “1.5” is to be read as a reference to the reciprocal of the fraction in paragraph 38(a) that applies to the foreign affiliate for the year.

Clause 17

Partnership transitional rule – application

ITA
96(1.72)

Existing subsection 96(1.7) adjusts the amount of a taxable capital gain or allowable capital loss included in a taxpayer's income as an allocation from the partnership when the taxpayer's capital gains inclusion rate for the taxpayer's taxation year in which the partnership's fiscal period ends is different from the partnership's inclusion rate used to calculate the partnership's taxable capital gain or allowable capital loss. The adjusted capital gain or allowable capital loss reflects the taxpayer's inclusion rate for the taxpayer's taxation year in which the fiscal period of the partnership ends. This is done by multiplying the taxpayer’s taxable capital gain, allowable capital loss or allowable business investment loss in respect of the partnership by a fraction. The numerator of the fraction is the taxpayer’s inclusion rate for the year. The denominator (the description of C) is the partnership’s inclusion rate for the fiscal period.

New subsection (1.72) provides a transitional rule that applies where a fiscal period of a partnership begins before June 25, 2024 and ends after June 24, 2024. This is consequential on the change in the capital gains inclusion rate from 1/2 to 2/3 on June 25, 2024. This special transitional rule provides that paragraph 96(1.7) does not apply for the transitional fiscal period and a number of other transitional rules apply with respect to the capital gains inclusions for taxpayers that are members of a partnership.

- A taxpayer's capital gain, capital loss or business investment loss in respect of the partnership for the fiscal period is equal to the amount of the taxable capital gain, the allowable capital loss or the allowable business investment loss of the taxpayer determined in respect of the partnership for the fiscal period, as the case may be, multiplied by the reciprocal of the fraction in section 38 that applies in respect of the gain or loss to the partnership for the fiscal period.
- A deemed capital gain, deemed capital loss or deemed business investment loss is deemed to be from a disposition of property in the taxation year and after June 24, 2024, if the taxable capital gain, allowable capital loss or allowable business investment loss is attributable to a disposition of property after June 24, 2024. This means that an inclusion rate of 2/3 would apply.
- If a taxpayer's taxation year begins before June 25, 2024, and the respective taxable capital gain, allowable capital loss or allowable business investment loss is attributable to a disposition of property before June 25, 2024, the deemed capital gain, deemed capital loss or deemed business investment loss is deemed to be from a disposition of property in the taxpayer's taxation year and before June 25, 2024. This means that an inclusion rate of 1/2 would apply.
- If a taxpayer's taxation year begins after June 24, 2024, the taxpayer is deemed to have a capital gain, a capital loss or a business investment loss, as the case may be, equal to ¾ of the deemed capital gain, deemed capital loss or deemed business investment loss from a disposition of property in the taxpayer's taxation year and after June 25, 2024, if the taxable capital gain, allowable capital loss or allowable business investment loss is attributable to a disposition of property before June 25, 2024. This results in the appropriate effective inclusion rate of 1/2 for a capital gain, capital loss or business investment loss that was incurred at a 1/2 rate (before June 25, 2024), but is included in computing the taxpayer's income at a 2/3 rate (2/3 x 3/4 = 1/2).
- The partnership is required to disclose to the taxpayer the total amount of all taxable capital gains, allowable capital losses or allowable business investment losses that are from either before June 25, 2024 or after June 24, 2024. This would allow taxpayers to determine the proper inclusion rate of the gain or loss.

This amendment applies in respect of fiscal periods of partnerships that begin before June 25, 2024.

Transition rule – subsection (1.72) inapplicable

ITA
96(1.73)

New subsection 96(1.73) is added as a consequence to the change in the capital gains inclusion rate from 1/2 to 2/3 on June 25, 2024. This subsection applies in limited circumstances to the taxation year of a taxpayer that begins before June 25, 2024 and ends after June 24, 2024 (the "transition year") during which the taxpayer is a member of a partnership with a fiscal period that either ends before June 25, 2024 or begins after June 24, 2024 (i.e., in circumstances where subsection 96(1.72) does not apply).

This special transitional rule provides that subsection 96(1.7) does not apply in respect of the partnership to the taxpayer's transition year. Instead, the taxpayer treats taxable capital gains, allowable capital losses and allowable business investment losses allocated to the taxpayer by the partnership as their own capital gains, capital losses and business investment losses for the purpose of calculating the taxpayer's inclusion rate under section 38 for the transition year. The gains or losses are considered to have been realized by the taxpayer from the disposition of property on the day on which the fiscal period of the partnership ends. More specifically, the taxpayer is deemed to have realized a capital gain, a capital loss or a business investment loss equal to the amount of the taxable capital gain, the allowable capital loss or the allowable business investment loss of the partnership allocated to the taxpayer multiplied by the reciprocal of the fraction in section 38 of the Act that applies in respect of the gain or loss of the partnership for the fiscal period.

Example

Assume that Corporation A has a June 30, 2024 taxation year end, is a member of Partnership B, and did not realize any other capital gains, losses or business investment losses during its 2024 taxation year. Assume further that Partnership B has a March 31, 2024 fiscal year end, realized a $60,000 capital gain ($30,000 taxable capital gain) on March 1, 2024, and allocated 50 per cent of the taxable capital gain ($15,000) to Corporation A. Given the fiscal year end of Partnership B is before June 25, 2024, subsection 96(1.72) does not apply. Instead, subsection 96(1.73) applies to deem Corporation A to have realized a capital gain of $30,000 ($15,000 x 2/1) on March 31, 2024, which is subject to an inclusion rate of 1/2 under paragraph 38(a).

This amendment applies to taxation years that begin before June 25, 2024 and end after June 24, 2024.

Clause 18

Disposition of interest in partnership

ITA
100(1)

Subsection 100(1) provides that a taxpayer's taxable capital gain for a taxation year from the disposition of an interest in a partnership to a person or partnership described in paragraphs 100(1.1)(a) to (d) — in general, tax-exempt entities and non-resident persons, along with partnerships and trusts that have such members or beneficiaries — is 1/2 of the portion of the capital gain from the disposition that can reasonably be attributed to increases in value of capital property other than depreciable property, plus the whole of the remaining portion of the gain.

Paragraph 100(1)(a) is amended to replace the reference to the fraction "1/2" with a reference to the fraction "2/3". The change is consequential to the increase in the capital gains inclusion rate from 1/2 to 2/3.

The amendment applies to taxation years that end after June 24, 2024. Where a taxation year of a taxpayer includes June 25, 2024, the reference to the fraction “2/3” in paragraph 100(1)(a) shall be read as a reference to the fraction in paragraph 38(a) that applies to the taxpayer for the year.

Clause 19

Disposition of farmland by partnership

ITA
101

Section 101 provides for a deduction in computing the income of a taxpayer for a taxation year of the taxpayer in which a fiscal period of a partnership ends where, in that fiscal period, the partnership has sold land used in farming. The deduction is equal to 1/2 of the farm losses that, because of section 31 (restricted farm losses), were not deductible and that relate to property taxes in respect of the farmland or interest on money borrowed to acquire the farmland sold.

The amendment to the preamble to section 101 replaces the reference to the fraction “1/2” with a reference to the fraction “2/3”. This amendment is consequential to the increase in the capital gains inclusion rate from 1/2 to 2/3.

This amendment applies to taxation years that end after June 24, 2024. Where a taxpayer’s taxation year includes June 25, 2024, the reference to the fraction “2/3”, shall be read as a reference to the fraction in paragraph 38(a) that applies to the taxpayer for the year.

Subparagraph 101(d)(ii) limits a partner’s deduction under subsection 101 to the partner’s share of the capital gain from the disposition of the land. The amendment to subparagraph 101(d)(ii) replaces the reference to the word “twice” with a reference to the phrase “1.5 times”. This amendment is consequential to the increase in the capital gains inclusion rate from 1/2 to 2/3.

This amendment applies to taxation years that end after June 24, 2024. Where a taxpayer’s taxation year includes June 25, 2024, the reference to the fraction “1.5” shall be read as a reference to the fraction that is the reciprocal of the fraction in paragraph 38(a) that applies to the taxpayer for the year.

Clause 20

Deemed gains – subsection (21) designation

ITA
104(21.4)

New subsection 104(21.4) provides a special rule that applies where a trust designates, for its taxation year that begins before June 25, 2024 and ends after June 24, 2024 (the “transition year”), an amount in respect of a beneficiary (the “allocated gain”) that is deemed because of subsection 104(21) to be a taxable capital gain of the beneficiary for the taxation year of the beneficiary in which the trust's year ends.

Generally, in other years, if a trust designates an amount of its net taxable capital gains for a year under subsection 104(21) in respect of a beneficiary under the trust, that amount is deemed to be a taxable capital gain of that beneficiary. However, because of the change in the capital gains inclusion rate from 1/2 to 2/3, for the transition year of a trust, new subsections 104(21.4) and (21.7) override the standard rule to determine the beneficiary's treatment of the allocated gain.

Under this subsection, the beneficiary is deemed to have realized a capital gain ("deemed gain") equal to the amount determined when the allocated gain is divided by the fraction that applies to the trust under amended paragraph 38(a). In other words, the beneficiary is deemed to have realized a deemed gain equal to the amount of capital gains that were realized by the trust, in respect of the allocated gain.

The trust is required to disclose to the beneficiary the portion of the deemed gain that is in respect of capital gains realized by the trust in each of two periods: before June 25, 2024, and after June 24, 2024. If the trust does not disclose that information to the beneficiary, the deemed gain is assumed to be in respect of capital gains realized in the later period (i.e., after June 24, 2024, which may be subject to a higher inclusion rate). See the commentary to section 38 for more information on the applicable inclusion rate.

Commercial trusts (meaning trusts that are not "personal trusts" as defined in subsection 248(1)) that might be uncertain of the timing of their dispositions of capital property during the taxation year, may elect to treat their gains as having been realized equally over the number of days in their transition year, so that the amount of gains realized in each of the two periods is determined proportionally based on the number of days in that period divided by the number of days in the transition year.

This amendment applies to taxation years that end after June 24, 2024.

See the commentary to subsection 104(21.7) for more information regarding the deemed gains of trust beneficiaries.

Deemed gains – no subsection (21) designation

ITA
104(21.5)

New subsection 104(21.5) provides a special rule for trusts (other than personal trusts) that applies where no amount is designated in respect of a beneficiary by a trust under subsection 104(21) in respect of its net taxable capital gains for a taxation year of the trust that begins before June 25, 2024 and ends after June 24, 2024.

Similar to the election in paragraph 104(21.4)(d), this subsection accommodates certain trusts (other than personal trusts) that may be uncertain of the timing of their dispositions of capital property in the taxation year. If a trust elects under this subsection, it can treat its net capital gains or net capital losses (each defined in new subsection 104(21.6)) as having been realized equally over the number of days in its year, so that the net capital gains and losses in each period is proportional based on the number of days in that period.

This amendment applies to taxation years that end after June 24, 2024.

See the commentary to subsection 104(21.6) for more information regarding the meaning of the terms “net capital gains” and “net capital losses”.

Capital gains – subsection (21.5) application

ITA
104(21.6)

New subsection 104(21.6) defines the terms “net capital gains” and “net capital losses” of a trust for purposes of subsection 104(21.5).

The net capital gains of a trust is defined as the amount, if any, by which the trust's capital gains from dispositions of property in the year exceeds the trust's capital losses from dispositions of property in the year.

The net capital losses of a trust is defined as the amount, if any, by which the trust's capital losses from dispositions of property in the year exceeds the trust's capital gains from dispositions of property in the year.

This amendment applies to taxation years that end after June 24, 2024.

See the commentary to subsection 104(21.5) for more information.

Deemed gains – subsection (21.4) applies

ITA
104(21.7)

New subsection 104(21.7) is added as a consequence to the change in the capital gains inclusion rate from 1/2 to 2/3 on June 25, 2024. For a taxation year of a trust that begins before June 25, 2024, and ends after June 24, 2024, if a trust designates an amount of its net taxable capital gains for a year under subsection 104(21) (“allocated gain”), new subsections 104(21.4) and (21.7) override the standard rule to determine the beneficiary’s treatment of the allocated gain.

Subsection 104(21.4) deems the beneficiary to have realized a capital gain in respect of the allocated gain (“deemed gain”). Further, subsection 104(21.4) requires the trust to disclose the portion of the deemed gain that is in respect of capital gains realized in each period (before June 25, 2024 or after June 24, 2025). See subsection 104(21.4) for more information.

Since the capital gains inclusion rate that applies to the beneficiary’s deemed gain depends on the period in which the trust disposed of property in respect of the allocated gain, this subsection determines the amount and the period in which the beneficiary realizes the deemed gain. This rule ensures that the amount designated by the trust is included in the appropriate period for the calculation of the beneficiary's capital gains inclusion rate under paragraph 38(a).

More specifically,

- if the deemed gains are in respect of capital gains from dispositions of property by the trust that occurred before June 25, 2024, and the beneficiary's taxation year (that includes the deemed gain) includes June 24, 2025, those deemed gains are deemed to be a capital gain of the beneficiary in the taxation year and before June 25, 2024 (i.e., subject to the 1/2 inclusion rate);
- if the deemed gains are in respect of capital gains from dispositions of property by the trust that occurred before June 25, 2024, and the beneficiary's taxation year (that includes the deemed gain) begins after June 24, 2025, 3/4 of those deemed gains are deemed to be a capital gain of the beneficiary in the taxation year, subject to the 2/3 capital gains inclusion rate. This rule functions to establish an effective inclusion rate of 1/2 (3/4 x 2/3); and
- in any other case, the deemed gains are deemed to be a capital gain of the beneficiary in the taxation year and after June 24, 2024 (i.e., subject to the 2/3 inclusion rate).

This amendment applies to taxation years that end after June 24, 2024.

Deemed gains – subsection (21.4) does not apply

ITA
104(21.8)

New subsection 104(21.8) is added as a consequence to the change in the capital gains inclusion rate from 1/2 to 2/3 on June 25, 2024. This subsection applies in limited circumstances to ensure the amount designated under subsection 104(21) by a trust is included in the appropriate period for the calculation of the beneficiary's capital gains inclusion rate under paragraph 38(a).

This subsection applies if the following conditions are met:

- a trust designates an amount of its net taxable capital gains under subsection 104(21) for a taxation year of the trust that ends in a taxation year of the beneficiary;
- the taxation year of the beneficiary begins before June 25, 2024 and ends after June 24, 2024; and
- subsection 104(21.4) does not apply because the taxation year of the trust does not begin before June 25, 2024 and ends after June 24, 2024.

If this subsection applies, an amount equal to the trust's designated amount divided by the capital gains inclusion rate that applied to the trust for its taxation year, is deemed to be a capital gain of the beneficiary on the day on which the trust's taxation year ends. The inclusion rate that applies to the beneficiary's capital gain will depend on whether that day is before June 25, 2024 or after June 24, 2024. See section 38 for more information on the inclusion rate.

Clause 21

ITA
107

Section 107 provides certain rules relating to the acquisition and disposition of a capital interest in a trust.

Subsection 107(2) applies where a personal trust or a prescribed trust described in section 4800.1 of the Regulations distributes property to a beneficiary and there is a resulting disposition of part or all of the beneficiary's capital interest in the trust. Under paragraph 107(2)(a), the trust is deemed to have disposed of the property for proceeds of disposition equal to the property's cost amount to the trust. Under paragraph 107(2)(b), the beneficiary is deemed to have acquired the property at this cost amount, plus an additional "bump" amount equal to the specified percentage of any excess of the adjusted cost base to the beneficiary of the capital interest over its cost amount (as defined by subsection 108(1)) to the beneficiary of the interest.

The specified percentage is set in subparagraph 107(2)(b.1) as 100% for non-depreciable capital property and 50% for depreciable capital property. Consequential on the increase in the capital gains inclusion rate from 1/2 to 2/3, subparagraph 107(2)(b.1)(iii) is amended to provide that the specified percentage for depreciable capital property is 66.67%.

This amendment applies to property distributed by a trust after June 24, 2024.

Clause 22

Employee options

ITA
110(1)(d)

Paragraph 110(1)(d) provides a deduction in computing the taxable income of a taxpayer if certain conditions are met. The deduction is equal to 1/2 of the amount of the benefit deemed by subsection 7(1) to have been received by the taxpayer in respect of a security under an employee stock option agreement. This deduction makes the net amount included in income in respect of an employee stock option equivalent to the amount included in income in respect of a capital gain of equal value.

Consequential on the increase in the inclusion rate for capital gains from 1/2 to 2/3, the deduction provided under paragraph 110(1)(d) is amended to provide that the deduction is 1/3 of the amount of the benefit deemed by subsection 7(1) to have been received by the taxpayer in respect of a security under an employee stock option agreement. This has the effect of providing for a 2/3 inclusion of the benefit.

This amendment applies to the 2024 and subsequent taxation years. The deduction provided under paragraph 110(1)(d) would continue to be 1/2 if the transaction, event or circumstance as a result of which a benefit is deemed to be received by the taxpayer under subsection 7(1) occurred before June 25, 2024. In the case of an option to which subsection 7(1.1) does not apply (i.e., a non-Canadian controlled private corporation option), this would be when the individual acquires shares under the option. For options to which subsection 7(1.1) applies (i.e., options of a Canadian-controlled private corporation), this would be the disposition of the underlying shares acquired under the option.

Charitable donation of employee option securities

ITA
110(1)(d.01)

Paragraph 110(1)(d.01) provides a special deduction where an employee makes a qualifying charitable donation of a security acquired under an employee option agreement. The deduction is also available — by virtue of subsection 110(2.1) — where an employee immediately disposes of such a security and makes a qualifying donation of all or part of the proceeds of disposition.

The special deduction is generally equal to 1/2 of the employment benefit that the employee is deemed by subsection 7(1) to have received in connection with the acquisition of the security. To qualify for the special deduction, the employee must also be eligible for the regular employee stock option deduction under paragraph 110(1)(d), which is equal to 1/2 of the employment benefit. The net effect will generally be to eliminate any taxation of the employment benefit associated with the acquisition of the option security.

Consequential on the increase in the capital gains inclusion rate from 1/2 to 2/3, and the corresponding change in the deduction in paragraph 110(1)(d) from 1/2 to 1/3, paragraph 110(1)(d.01) is amended to increase the deduction rate provided for the donation of employee stock options from 1/2 to 2/3 of the employment benefit. This would continue to generally eliminate any taxation of the employment benefit associated with the acquisition of the option security.

This amendment applies to the 2024 and subsequent taxation years. The deduction provided under paragraph 110(1)(d.01) would continue to be 1/2 if the transaction, event or circumstance as a result of which a taxpayer is deemed to have received a benefit under subsection 7(1) occurred before June 25, 2024.

Idem

ITA
110(1)(d.1)

Paragraph 110(1)(d.1) provides for a deduction in computing a taxpayer's taxable income in respect of certain stock option benefits, which are taxable under paragraph 7(1)(a) by virtue of subsection 7(1.1), where the taxpayer disposes of a share acquired after May 22, 1985 as a result of exercising a stock option granted by a Canadian-controlled private corporation and the share has not been disposed of or exchanged, otherwise than as a consequence of the taxpayer's death, within two years from the date the taxpayer acquired it. This has the effect of including the benefit in income at the same inclusion rate that applies to capital gains. As a result of the increase in the inclusion rates for capital gains from 1/2 to 2/3, this paragraph is being amended to reduce the amount of the deduction in respect of such benefits from 1/2 to 1/3 of the benefit.

This amendment applies to the 2024 and subsequent taxation years. The deduction provided under paragraph 110(1)(d.1) would continue to be 1/2 if the disposition or exchange of the securities as a result of which a benefit is deemed to have been received by a taxpayer under subsection 7(1), by virtue of subsection 7(1.1), occurred before June 25, 2024. Accordingly, the 1/3 deduction rate will apply for any securities first disposed or exchanged after June 24, 2024 (even if the option of was exercised prior to that date).

Prospector's and grubstaker's shares

ITA
110(1)(d.2)

Paragraph 110(1)(d.2) provides a deduction in computing the taxable income of a taxpayer where the taxpayer has included an amount in income for the year under paragraph 35(1)(d) as a result of a disposition or exchange of a share acquired in exchange for an interest in a mining property.

Consequential on the increase in the inclusion rate for capital gains from 1/2 to 2/3, the deduction provided under paragraph 110(1)(d.2) is amended to provide that the deduction is 1/3 of the amount included in the taxpayer's income under paragraph 35(1)(d). This has the effect of including the benefit in income at the same 2/3 inclusion rate that applies to capital gains.

This amendment applies to the 2024 and subsequent taxation years. The deduction provided under paragraph 110(1)(d.2) would continue to be 1/2 if the transaction, event or circumstance as a result of which an amount is included in income under paragraph 35(1)(d) occurred before June 25, 2024.

Employer's shares

ITA
110(1)(d.3)

Paragraph 110(1)(d.3) provides for a deduction in computing taxable income where a taxpayer has included an amount in computing income for the year under subsection 147(10.4) in respect of the disposition of employer shares that had been received as part of a single payment on the taxpayer's retirement or withdrawal from a deferred profit sharing plan after May 23, 1985. This has the effect of including the benefit in income at the same inclusion rate that applies to capital gains.

As a result of the increase in the inclusion rate for capital gains from 1/2 to 2/3, this deduction is being reduced from 1/2 to 1/3 of the amount included in income for the year under subsection 147(10.4).

This amendment applies to the 2024 and subsequent taxation years. The deduction provided under paragraph 110(1)(d.3) would continue to be 1/2 if the transaction, event or circumstance as a result of which an amount is included in computing income under subsection 147(10.4) occurred before June 25, 2024.

Additional deduction

ITA
110(1)(d.4)

New paragraph 110(1)(d.4) operates in conjunction with new section 38.01, which provides for an effective inclusion rate of 1/2 (rather than 2/3) for the taxable portion of the net capital gains of individuals, graduated rate estates and qualified disability trusts, that do not exceed $250,000. This effective 1/2 inclusion rate is also available in respect of stock option benefits that are eligible for the deduction under paragraph110(1)(d), (d.1), (d.2) or (d.3), provided the combined total of capital gains and employee stock option benefits to which the 1/2 inclusion rate applies does not exceed $250,000. An individual may choose how to allocate their $250,000 threshold.

To provide for an effective inclusion rate of 1/2, new paragraph 110(1)(d.4) provides an additional deduction for stock option benefits that are eligible for the 1/3 deduction under paragraph 110(1)(d), (d.1), (d.2) or (d.3). This additional deduction is equal to 1/6 of the lesser of $250,000 and the amount determined by the formula

B – C

where

B is three times the total of all amounts deducted by the individual for the taxation year under paragraph (d), (d.1), (d.2) or (d.3). This is essentially, the value of all stock option benefits in respect of which a deduction was claimed, and

C is 1.5 times the amount deducted by the individual for the taxation year under paragraph (d.01). This is essentially the value of donated stock options. The deduction in paragraph (d.01), combined with the deduction in paragraph 110(1)(d), already provides a full deduction for the benefit realized on stock options where the shares are donated. This reduction effectively prevents an individual from applying any of their available $250,000 capital gains threshold against options that are already fully excluded from income.

The 1/6 additional deduction and the 1/3 deduction would together provide a 1/2 deduction for income where an individual has chosen to allocate part or all of their annual $250,000 capital gains threshold to income for which a deduction is available under paragraph110(1)(d), (d.1), (d.2) or (d.3). To the extent an individual deducts an amount under paragraph 110(1)(d.4), this would reduce the $250,000 annual limit available for capital gains included at 1/2.

This amendment applies to the 2024 and subsequent taxation years. For the purpose of determining the amount under the description of B and C, the amount determined for the individual for the taxation year under each of paragraphs (d), (d.01), (d.1), (d.2) and (d.3) shall exclude all amounts determined in respect of any transaction, event or circumstance, including a disposition or exchange of securities, that occurred before June 25, 2024.

Clause 23

Capital gains deduction — qualified farm or fishing property

ITA
110.6(2)

Subsection 110.6(2) provides a deduction in computing the taxable income of a taxpayer in respect of taxable capital gains from the disposition of qualified farm or fishing property. For 2024, this would allow for a deduction of up to $518,418 of taxable capital gains. Given an inclusion rate of 1/2, this would effectively exempt up to $1,016,816 of capital gains from tax.

Consequential on the increase in the capital gains inclusion rate from 1/2 to 2/3 and the increase in the lifetime capital gains limit to $1,250,000, subsection 110.6(2) is amended to provide that it applies for taxation years that end before 2024. The deduction in computing the taxable income of a taxpayer in respect of taxable capital gains from the disposition of qualified farm or fishing property for the 2024 and subsequent taxation years will now be provided for under new subsections 110.6(2.01) and (2.02).

This amendment applies to the 2024 and subsequent taxation years.

Qualified farm and fishing property - 2024

ITA
110.6(2.01)

New subsection 110.6(2.01) provides a deduction in computing the taxable income of a taxpayer in respect of taxable capital gains from the disposition of qualified farm or fishing property. This subsection is applicable for the 2024 taxation year.

The permitted deduction under subsection 110.6(2.01) in respect of qualified farm or fishing property is equal to the least of four amounts:

1. The individual's unused lifetime exemption limit for the year in respect of net taxable capital gains on qualified farm or fishing property. For the 2024 taxation year, this amount would consist of two separate computations for taxable capital gains that are in respect of dispositions before June 25, 2024 and after June 24, 2024, respectively.
2. The individual's “cumulative gains limit” at the end of the year. This amount is defined in subsection 110.6(1).
3. The individual's “annual gains limit” for the year. This amount is defined in subsection 110.6(1).
4. The individual's net taxable capital gains for the year from the disposition of qualified farm or fishing property.

New subparagraph 110.6(2.01)(a)(i) provides for a computation of an individual’s lifetime capital gains limit as it would be determined if paragraph 110.6(2)(a) applied for 2024. Subparagraph 110.6(2.01)(a)(i) applies in respect of dispositions of qualified farm or fishing property that are after 2023 and before June 25, 2024. For dispositions after 2023 and before June 25, 2024, the limit is determined by the formula: $518,418 – ($518,418 – A).

A is the amount that would be determined for the individual under paragraph 110.6(2)(a) if subsection 110.6(2) applied to the 2024 taxation year.

Essentially, subparagraph 110.6(2.01)(a)(i) determines what the lifetime capital gains limit would be for an individual for 2024 if the pre-2024 lifetime capital gains exemption rules applied to a disposition. For dispositions of qualified farm or fishing property that are before June 25, 2024, an individual would apply an inclusion rate of 1/2 and would be able to deduct this taxable capital gain from their taxable income up to the remaining portion of their lifetime capital gains limit of $518,418.

New subparagraph 110.6(2.01)(a)(ii) applies in respect to dispositions of qualified farm or fishing property that are after June 24, 2024 and before 2025. As of June 25, 2024, the lifetime capital gains exemption limit would be increased to $1,250,000, or $833,333 of taxable capital gains given an inclusion rate of 2/3. The $833,333 limit will be indexed to inflation, beginning in 2026. For dispositions after June 24, 2024 and before 2025 the limit is determined by the formula: $833,333 – B.

B is the amount determined by the formula: 4/3 × ($508,418 – C + D).

The portion of the formula "$508,418 – C" is essentially the amount deducted by the individual prior to 2024. Variable D is the amount deducted for dispositions after 2023 and before June 25, 2024. These amounts are multiplied by 4/3 because they reflect gains which were included at a 1/2 inclusion rate (or, in the case of gains realized at a different inclusion rate in 2000 or earlier, they have already been adjusted to determine the amount under paragraph 2(a)).

For example, assume that an individual had deducted $500,000 (the equivalent of $1,000,000 in capital gains) under subsection 110.6(2) prior to 2024 and the individual had no dispositions of qualified farm or fishing property after 2023 and before June 25, 2024. The individual's remaining lifetime limit as of June 25, 2024 would be $833,333 – 4/3 × $500,000 = $166,667. Given a 2/3 inclusion rate for taxable capital gains, this leaves a remaining $250,000 of capital gains that can be exempted from tax.

This amendment applies to the 2024 and subsequent taxation years.

Qualified farm and fishing property – post-2024

ITA
110.6(2.02)

New subsection 110.6(2.02) provides a deduction in computing the taxable income of a taxpayer in respect of taxable capital gains from the disposition of qualified farm or fishing property. This subsection is applicable for taxation years that are after 2024. For taxation years after 2024, taxable capital gains are included at a 2/3 rate and can be deducted from the $833,333 lifetime limit (equivalent to $1,250,000 of capital gains). The $833,333 lifetime limit will be indexed to inflation, beginning in 2026.

For taxation years after 2024, an individual's lifetime capital gains exemption limit for dispositions of qualified farm or fishing property is the amount determined by the formula: $833,333 – (A + B + C + D).

A is the total of all amounts each of which is an amount deducted in respect of the lifetime capital gains exemption in computing the individual's taxable income for a preceding taxation year that ended after 2024. These amounts would be deducted at the 2/3 taxable capital gains inclusion rate.

B is the amount determined by the formula: 4/3 × (508,418 – E). This is essentially the total amount deducted prior to 2024 grossed up to the 2/3 inclusion rate.

C is the total of all amounts deducted under subsection (2.01) (qualified farm or fishing property) or (2.03) (qualified small business corporation shares) in computing the individual's taxable income for the 2024 taxation year.

D is 1/3 times the total of all amounts each of which is an amount deducted under subsection (2.01) or (2.03) in computing the individual's taxable income for the 2024 taxation year, in respect of taxable capital gains of the individual that are for dispositions of property that are after 2023 and before June 25, 2024. This grosses up dispositions that were subject to a 1/2 inclusion rate to an effective 2/3 inclusion rate for the purposes of calculating the remaining amount of the individual's $833,333 lifetime limit.

The other limiting factors continue to be applicable:

- The individual's "cumulative gains limit" at the end of the year. This amount is defined in subsection 110.6(1).
- The individual's "annual gains limit" for the year. This amount is defined in subsection 110.6(1).
- The individual's net taxable capital gains for the year from the disposition of qualified farm or fishing property.

This amendment applies to the 2024 and subsequent taxation years.

Qualified small business corporation shares - 2024

ITA
110.6(2.03)

New subsection 110.6(2.03) provides for a deduction in computing the taxable income of an individual (other than a trust) in respect of taxable gains from the disposition of qualified small business corporation shares for 2024. Subsection 110.6(2.03) applies in respect of the disposition of qualifying small business corporation shares in the 2024 taxation year. The computation of the deduction limit parallels the computation in new subsection 110.6(2.01).

New subparagraph 110.6(2.03)(a)(i) provides that for dispositions of qualifying small business corporation shares after 2023 and before June 25, 2024, the computation of an individual's lifetime capital gains exemption limit would be the amount determined under subparagraph (i) of the formula in paragraph 110.6(2.01)(a). New subparagraph 110.6(2.03)(a)(ii) provides that for dispositions of qualifying small business corporation shares after June 24, 2024 and before 2025, the computation of an individual's lifetime capital gains exemption limit would be the amount determined under subparagraph (ii) of the formula in paragraph 110.6(2.01)(a).

Similar to the rules for the dispositions of qualified farm or fishing property, the inclusion rate changes from 1/2 to 2/3 on June 25, 2024 and the lifetime capitals gains exemption limit increases to $1,250,000 ($833,333 of taxable capital gains at a 2/3 inclusion rate) on June 25, 2024.

The other limiting factors continue to be applicable:

- The individual's “cumulative gains limit” at the end of the year. This amount is defined in subsection 110.6(1).
- The individual's “annual gains limit” for the year. This amount is defined in subsection 110.6(1).
- The individual's net taxable capital gains for the year from dispositions of qualified small business corporation shares, less any such amount accounted for in paragraph 110.6(2.01)(d).

This amendment applies to the 2024 and subsequent taxation years.

Qualified small business corporation shares – post-2024

ITA
110.6(2.04)

New subsection 110.6(2.04) provides for a deduction in computing the taxable income of an individual (other than a trust) in respect of taxable gains from the disposition of qualified small business corporation shares for taxation years that end after 2024. The computation of the deduction limit parallels the computation in new subsection 110.6(2.02).

New paragraph 110.6(2.04)(a) provides that for dispositions of qualifying small business corporation shares for a taxation year that ends after 2024, the computation of an individual’s lifetime capital gains exemption limit would be the amount determined under the formula in paragraph 110.6(2.02)(a).

Similar to the rules for the dispositions of qualified farm or fishing property, the inclusion rate would now be 2/3 and the lifetime capitals gains exemption limit would be $1,250,000 ($833,333 of taxable capital gains at a 2/3 inclusion rate).

The other limiting factors continue to be applicable:

- The individual's “cumulative gains limit” at the end of the year. This amount is defined in subsection 110.6(1).
- The individual's “annual gains limit” for the year. This amount is defined in subsection 110.6(1).
- The individual's net taxable capital gains for the year from dispositions of qualified small business corporation shares, less any such amount accounted for in paragraph 110.6(2.02)(d).

This amendment applies to the 2024 and subsequent taxation years.

Capital gains deduction – qualified small business corporation shares

ITA
110.6(2.1)

Subsection 110.6(2.1) provides a deduction in computing the taxable income of a taxpayer in respect of taxable capital gains from the disposition of qualified small business corporation shares. For 2024, this would allow for a deduction of up to $518,418 of taxable capital gains. With an inclusion rate of 1/2, this would effectively exempt up to $1,016,816 of capital gains from tax.

Consequential on the increase in taxable capital gains inclusion rate from 1/2 to 2/3 and the increase in the lifetime capital gains limit to $1,250,000, subsection 110.6(2.1) is amended to provide that it applies for taxation years that end before 2024. The deduction in computing the taxable income of a taxpayer in respect of taxable capital gains from the disposition of qualified small business corporation shares will now be provided for under new subsections 110.6(2.03) and (2.04).

This amendment applies to the 2024 and subsequent taxation years.

Additional deduction — qualified farm or fishing property

ITA
110.6(2.2)

Subsection 110.6(2.2) provides that, in computing the taxable income of an individual (other than a trust) who was resident in Canada throughout the year and who disposed of qualified farm or fishing property in the year or in a preceding year (provided the disposition occurs on or after April 21, 2015), there may be deducted such amount as the individual may claim not exceeding the least of:

- the amount necessary to increase the base lifetime capital gains exemption (in subsection (2)) to $1,000,000, which is expressed as the amount by which $500,000 exceeds the total of
  - the indexed lifetime capital gains exemption limit for qualified farm or fishing property in subsection (2), and
  - the total of all amounts previously deducted by the individual under new subsection (2.2) in a preceding taxation year that ended after 2014.

With the increase in the lifetime capital gains exemption limit to $508,418 in subsection 110.6(2) (due to annual adjustments for inflation) and the introduction of the new lifetime capital gains exemption limit of $1,250,000 ($833,333 of taxable capital gains) on June 25, 2024, subsection 110.6(2.2) is repealed. It is no longer relevant since the general limit is now higher than the limit provided for in 110.6(2).

This amendment applies to the 2024 and subsequent taxation years.

Maximum capital gains deduction

ITA
110.6(4)

Subsection 110.6(4) provides the overall lifetime capital gains exemption limit for an individual. The subsection adopts the limit provided in paragraph 110.6(2)(a). As a consequence, notwithstanding any amounts computed as capital gains deductions under subsections 110.6(2) and (2.1), an individual is limited to an overall lifetime limit of $400,000 (indexed to inflation under subsection 117.1(1) or $518,418 in 2024) of deductions in respect of taxable capital gains.

Consequential on the increase in taxable capital gains inclusion rate from 1/2 to 2/3 and the increase in the lifetime capital gains exemption limit on June 25, 2024, subsection 110.6(4) is amended to change the references to subsections 110.6(2) and (2.1) to new subsections 110.6(2.01), (2.02), (2.03) and (2.04) which provide for the lifetime capital gains exemption deduction as of 2024.

Subsection 110.6(4) is also amended to provide that an individual will be limited to the amount determined by the formula in paragraph 110.6(2.01)(a) for the 2024 taxation year or (2.02)(a) for taxation years that are after 2024. Also, consequential on the repeal of subsection 110.6(2.2), the reference to that subsection is removed.

This amendment applies to the 2024 and subsequent taxation years.

ITA
110.6(5)

Subsection 110.6(5) provides that, where an individual is resident in Canada at any time in a particular taxation year, the individual is deemed to be resident in Canada throughout the particular year if the individual is resident in Canada throughout either the immediately preceding taxation year or the immediately following taxation year. Subsection 110.6(5) applies only for the purposes of subsections 110.6(2) to (2.2).

Subsection 110.6(5) is amended, consequential on the introduction of new subsections 110.6(2.01) to (2.04) and the repeal of subsection 110.6(2.2), to refer to subsection 110.6(2.1).

This amendment applies to the 2024 and subsequent taxation years.

ITA
110.6(6)

Subsection 110.6(6) denies a capital gains exemption for certain unreported net taxable capital gains notwithstanding that an amount that could have been claimed as a capital gains exemption under subsections 110.6(2) to (2.2).

Subsection 110.6(6) is amended, consequential on the introduction of new subsections 110.6(2.01) to (2.04) and the repeal of subsection 110.6(2.2), to refer to subsection 110.6(2.1).

This amendment applies to the 2024 and subsequent taxation years.

ITA
110.6(7)

Subsection 110.6(7) is an anti-avoidance rule that prevents, notwithstanding subsections 110.6(2) to (2.2), the conversion of certain corporate capital gains that are taxable into exempt capital gains of an individual.

Subsection 110.6(7) is amended, consequential on the introduction of new subsections 110.6(2.01) to (2.04) and the repeal of subsection 110.6(2.2), to refer to subsection 110.6(2.1).

This amendment applies to the 2024 and subsequent taxation years.

ITA
110.6(8)

Subsection 110.6(8) provides that, notwithstanding subsections 110.6(2) to (2.2), an individual may not claim the capital gains exemption with respect to a capital gain realized on a disposition of property if it is reasonable to conclude that a significant portion of the capital gain is attributable to the fact that dividend payments on a share (other than a prescribed share) have either not been made or have been deferred.

Subsection 110.6(8) is amended, consequential on the introduction of new subsections 110.6(2.01) to (2.04) and the repeal of subsection 110.6(2.2), to refer to subsection 110.6(2.1).

This amendment applies to the 2024 and subsequent taxation years.

Clause 24

Order of applying provisions – no double deduction

ITA
111.1

Section 111.1 sets out the order in which various deductions must be taken in computing taxable income.

Consequential on the introduction of new section 110.61 (employee ownership trusts), which provides for a new deduction in computing taxable income in respect of taxable capital gains realized on the dispositions of shares pursuant to a qualifying business transfer, section 111.1 is amended to form two new subsections.

New subsection 111.1(1) amends existing section 111.1 to include references to section 110.61 immediately after losses (section 111) and before the deduction under section 110.6 (lifetime capital gains exemption). Consequently, in computing taxable income, taxpayers are required to claim deductions under new section 110.61 before claiming deductions under section 110.6.

New subsection 111.1(2) provides that no amount may be deducted for a taxation year of an individual, under section 110.6, in respect of any portion of a taxable capital gain to the extent that the portion of the taxable capital gain has been deducted under section 110.61. This prevents the double deduction of an amount under both section 110.6 and section 110.61.

This amendment applies to taxation years that begin after 2023.

Clause 25

Addition to taxable income

ITA
111.2

New section 111.2 requires an individual to include an amount in computing taxable income. The inclusion of this amount is necessary to prevent a deduction in computing taxable income of certain amounts in respect of taxable capital gains that are already excluded from an individual's income because of new section 38.01. New section 38.01, along with new paragraph 3(b.1), provides a reduction from net taxable capital gains for an individual, a graduated rate estate or a qualified disability trust.

In general, new paragraph 3(b.1) provides for a reduction in computing income equal to 1/6 of the lesser of an individual's net capital gains for the year and $250,000. This amount is computed under new section 38.01 and results in an effective capital gains inclusion rate of 1/2 on up to $250,000 of capital gains. Since certain deductions (such as the lifetime capital gains exemption in section 110.6) are computed on the assumption that all taxable capital gains are included at a 2/3 rate, the amount deducted under those deductions may be excessive if it related to capital gains that were effectively included at a 1/2 rate. This section adds back an amount to taxable income to adjust for any excessive deductions.

New section 111.2 provides that there is to be added in computing an individual's taxable income for a taxation year the amount, if any, determined by the formula: $1/6 \times [A - (B - C - D - E)]$.

A is 6 times the amount determined for the individual for the taxation year under section 38.01. This is essentially the amount of capital gains that have been included in income for the taxation year at a 1/2 inclusion rate.

B is 1.5 times the amount determined for the individual for the taxation year under paragraph 3(b). This is essentially the individual's net capital gains for the taxation year.

C is, in the case of a "graduated rate estate" or a "qualified disability trust", 1.5 times the total of all amounts designated by the trust for the taxation year under subsection 104(21). This is essentially the amount of capital gains allocated to beneficiaries of the trust.

D is 1.5 times the total of all the amounts each of which is an amount deducted by the individual for the taxation year under paragraph 111(1)(b) or section 110.6 or 110.61 This is essentially the amount of capital gains that have been offset by net capital losses from other taxation years and the amount of capital gains that have been exempted under the lifetime capital gains exemption and the employee ownership trust exemption.

E is the total of all amounts each of which is deemed to be a capital gain of the individual under paragraph 96(1.72)(f) or 104(21.7)(b), clause 130.1(4)(b)(ii)(A) or 131(1)(b)(ii)(A) or paragraph 138.1(3.1)(b). This is essentially the amount of capital gains distributed from a partnership, mortgage investment corporation, mutual fund corporation or segregated fund that were effectively included in income at a 1/2 inclusion rate.

For example, assume that an individual realized a capital gain of $300,000 in their 2025 taxation year on the disposition of qualified small business corporation shares and a capital gain of $100,000 from the disposition of other capital property in the same taxation year. The individual claims the lifetime capital gains exemption and deducts $200,000 (2/3 of the capital gain from the disposition of the qualified small business corporation shares) under section 110.6.

In computing income, the individual would include $225,000 in respect of taxable capital gains. This is $266,667 (2/3 x $400,000) less the capital gains reduction of $41,667 computed under new section 38.01. In computing taxable income, the individual would deduct $200,000 under section 110.6 and include $25,000 under new section 111.2. The inclusion under new section 111.2 is equal to 1/6 × [A ($250,000) − (B ($400,000) − C ($0) − D ($300,000) – E ($0))] = 1/6 x $150,000 = $25,000.

The net result is that the individual's taxable income is effectively reduced by $175,000 ($200,000 - $25,000) in respect of the deduction under section 110.6. This is equal to a deduction of $100,000 in respect of the $150,000 portion of the capital gain that was effectively included at 2/3 and a deduction of $75,000 in respect of the $250,000 portion of the capital gain that was effectively included at 1/2 (as a result of the capital gains exemption under section 38.01).

New section 111.2 applies to taxation years that end after June 24, 2024. For the purpose of applying section 111.2 for the 2024 taxation year, the amounts determined under paragraph 3(b) and section 111.2 shall be calculated as if:

- The individual's only taxable capital gains for the year were the individual's taxable capital gains for the year from the disposition of property other than listed personal property after June 24, 2024.
- The individual's allowable capital losses for the year were the amount, if any, by which the individual's allowable capital losses for the year from the disposition of property other than listed personal property exceed the individual's taxable capital gains for the year from the disposition of property other than listed personal property before June 25, 2024.
- The individual's taxable net gain for the year from the disposition of listed personal property was computed as if:
    - the individual's only gains for the year from the disposition of listed personal property were gains from the disposition of listed personal property after June 24, 2024, and
    - the individual's losses for the year from the disposition of listed personal property were the amount, if any, by which the individual's losses for the year from the disposition of listed personal property exceed the individual's gains for the year from the disposition of listed personal property before June 25, 2024.

- The only amounts designated under subsection 104(21) by a trust described in the description of C of section 111.2 were from the dispositions of property that occurred after June 24, 2024.
- The only amounts deducted by the individual in the year under sections 110.6 and 110.61 were in respect of dispositions of property that occurred after June 24, 2024.
- In respect of amounts deducted under section 110.61 and paragraph 111(1)(b), the number “1.5” in the description of D of section 111.2 is to be read as “1 divided by the fraction in paragraph 38(a) that applies to the individual for the particular taxation year”.

Clause 26

Loss on share held by trust

ITA
112(3.2)

Paragraph 112(3.2)(a) provides that a trust's loss otherwise determined on the disposition of a share is reduced by certain dividends received by the trust on the share. However, subparagraph 112(3.2)(a)(iii) limits this reduction in the case where the trust is a graduated rate estate, the share was acquired as a consequence of the individual's death and the disposition occurs in the first taxation year of the estate. In this case, the loss reduction is reduced by one half of the lesser of the loss otherwise determined and the individual's capital gain from the disposition of the share immediately before the individual's death.

Consequential on the increase in the capital gains inclusion rate from 1/2 to 2/3, subparagraph 112(3.2)(a)(iii) is amended to change the reference to 1/2 to 1/3.

This amendment applies to taxation years of graduated rate estates of individuals who die after June 24, 2024.

Loss on share held by trust — special cases

ITA
112(3.3)

Subsection 112(3.2) provides a “stop-loss” rule that applies to reduce the loss of a trust (other than a mutual fund trust) on the disposition of a share of the capital stock of a corporation that was held by the trust as capital property. Subsection 112(3.3) applies, and subsection 112(3.2) does not apply, if the share was acquired by the trust because of subsection 104(4).

Consequential on the increase in the capital gains inclusion rate from 1/2 to 2/3, subparagraph 112(3.3)(a)(iii) is amended to change the reference to 1/2 to 1/3.

This amendment applies to dispositions that occur after June 24, 2024.

Clause 27

Deduction in respect of dividend received from foreign affiliate

ITA
113(1)

Subsection 113(1) permits a corporation resident in Canada to deduct specified amounts in respect of dividends received from a foreign affiliate out of the exempt, hybrid, taxable and pre-acquisition surpluses of the affiliate. The amounts so deductible are determined largely with reference to Part LIX of the Regulations.

Under the existing paragraph 113(1)(a.1), where a corporation resident in Canada receives a dividend from a foreign affiliate that is prescribed to be paid out of the affiliate's hybrid surplus, the corporation is entitled to a deduction from taxable income equal to 1/2 of the amount of the dividend plus an additional amount in respect of hybrid underlying tax and withholding tax.

Consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3, paragraph 113(1)(a.1) is being amended to replace the references to "hybrid surplus" with references to "legacy hybrid surplus", which is a new surplus pool generally comprising capital gains from dispositions that occur before June 25, 2024. As a result, the 1/2 deduction (reflecting the previous capital gains inclusion rate) will continue to apply to dividends paid out of legacy hybrid surplus. In connection with these changes, the portion of the paragraph 113(1)(a.1) deduction in respect of foreign tax paid will now be determined by reference to the affiliate's legacy hybrid underlying tax. The structure and effect of paragraph 113(1)(a.1), however, remains unchanged.

Also as a consequence of the increase of the capital gains inclusion rate, new paragraph 113(1)(a.2) is added to provide a 1/3 deduction for dividends paid out of successor hybrid surplus, which is a new surplus pool generally comprising capital gains from dispositions that occur after June 24, 2024. Paragraph 113(1)(a.2) also provides for an additional deductible amount in respect of foreign tax paid, which is determined by reference to the new concept of "successor hybrid underlying tax". The mechanics for computing this additional deductible amount are similar to those for computing the amount deductible in respect of foreign tax paid in relation to legacy hybrid surplus, except that the "gross-up" for foreign tax under subclause 113(1)(a.2)(ii)(A)(I) in the case of successor hybrid surplus is based on the relevant tax factor minus 2/3, whereas the analogous gross-up in the case of legacy hybrid surplus is based on the relevant tax factor minus 1/2.

These amendments apply to dividends received after June 24, 2024.

Clause 28

ITA
115(1)(d)

Paragraph 115(1)(d) allows certain deductions under subsections 110(1), 110.1(1) and 111(1) to be taken into account in determining the taxable income earned in Canada of a non-resident. Paragraph 115(1)(d) is amended to also allow a deduction under new paragraph 110(1)(d.4).

This amendment applies to the 2024 and subsequent taxation years.

For more information, see the commentary to new paragraph 110(1)(d.4).

ITA
115(1.1)

Section 115 provides rules for calculating a non-resident's "taxable income earned in Canada", which is subject to tax under Part I. Paragraphs 115(1)(a) to (c) provide the sources of income and losses to be included in this calculation (including employment and business income, taxable capital gains on taxable Canadian property, and certain other income amounts), while paragraphs 115(1)(d) to (f) provide the allowable deductions that may be taken.

Section 115 is amended to add new subsection (1.1), to ensure that a non-resident individual is required to include the amount determined under section 111.2 in computing their taxable income earned in Canada. The inclusion of this amount is necessary in cases where certain deductions in respect of taxable capital gains, along with the reduction to an individual's income because of new section 38.01, would otherwise result in inappropriately low taxable income. New section 38.01, along with new paragraph 3(b.1), reduces net taxable capital gains for an individual, a graduated rate estate or a qualified disability trust.

This amendment applies to the 2024 and subsequent taxation years.

For more information, see the commentary to new section 111.2.

Clause 29

ITA
116

Section 116 provides procedures for ensuring that tax is collected when non-residents dispose of certain taxable Canadian properties. A non-resident person may obtain a certificate of compliance in respect of a disposition, or proposed disposition, if tax on the capital gain is paid at a specific rate (or if sufficient security is provided). Absent this certificate, or if actual proceeds of disposition exceed the proceeds estimated on the certificate, the purchaser is required to withhold and remit tax at that specific rate, on either the proceeds or the differential, on behalf of the non-resident person. If tax remitted under section 116 results in an overpayment of tax for the year, the non-resident would receive a refund after filing their Part I tax return.

The rate in section 116 is intended to approximate the highest marginal combined federal and provincial tax rate on capital gains. Consequential on the increase in the inclusion rate for capital gains from 1/2 to 2/3, and to reflect current federal, provincial and territorial tax rates, the withholding rate referenced in subsections (2), (4) and (5) is increased from 25% to 35%.

This amendment applies to dispositions that occur after 2024.

Clause 30

Annual adjustment

ITA
117.1(2)

Subsection 117.1(1) provides for the indexing of various amounts in the Act, based on annual increases to the Consumer Price Index. The amounts that are subject to indexing are set out in subsection 117.1(2).

Paragraph 117.1(2)(c) provides the amount of $400,000 (indexed to $508,418 in 2024) for the lifetime capital gains exemption in subsection 110.6(2). With a 1/2 taxable capital gains inclusion rate, this would provide for a lifetime capital gains exemption of $1,016,816. Consequential on the increase in the lifetime capital gains exemption to $1,250,000, paragraph 117.1(2)(c) is amended to provide for indexing the amount of $833,333 in new paragraph 110.6(2.02)(a).

This amendment applies to taxation years that begin after 2025. Accordingly, the amount will first increase in 2026.

Clause 31

Taxable capital gain

ITA
120.4(4)

Subsection 120.4(4) generally provides that a taxable capital gain of a specified individual from a disposition of certain shares that are transferred to a person that does not deal at arm's length with the individual is deemed to be a taxable dividend (which is consequently subject to the tax on split income under subsection 120.4(2)). More specifically, twice the amount that would otherwise have been the individual's taxable capital gain in respect of the disposition is deemed to be a taxable dividend received by the taxpayer in the year and is consequently included in the individual's “split income” as defined under subsection 120.4(1). Consequential on the increase in the capital gains inclusion rate from 1/2 to 2/3, the reference in subsection 120.4(4) to “twice the amount” is changed to “1.5 times the amount”.

This amendment applies to the 2024 and subsequent taxation years. The reference to “1.5 times” in subsection 120.4(4) is to be read as “twice” in respect of dispositions that occur prior to June 25, 2024.

Taxable capital gain of trust

ITA
120.4(5)

Subsection 120.4(5) generally recharacterizes as a taxable dividend certain taxable capital gains of a specified individual who has not attained the age of 17 years and would otherwise be required under subsection 104(13) or subsection 105(2) to include the amount in computing their income for the taxation year (which is consequently subject to the tax on split income under subsection 120.4(2)). More specifically, twice the amount that would otherwise have been the individual's taxable capital gain is deemed to be a taxable dividend received by the individual in the year and is consequently included in the individual's “split income” as defined under subsection 120.4(1). Consequential on the increase in the capital gains inclusion rate from 1/2 to

2/3, the reference in subsection 120.4(5) to “twice the amount” is changed to “1.5 times the amount”.

This amendment applies to the 2024 and subsequent taxation years. The reference to “1.5 times” in subsection 120.4(5) is to be read as “twice” in respect of dispositions that occur prior to June 25, 2024.

Clause 32

Definitions

ITA
122.1

A SIFT trust's “non-portfolio earnings” for a taxation year is the total of two amounts. The first amount, in paragraph (a) of the definition, is the total net amount of the SIFT trust's incomes for the year from businesses it carried on in Canada and from “non-portfolio properties”. Besides the netting of any losses for the taxation year from such sources, taxable dividends are excluded from this amount. The second amount, in paragraph (b) of the definition, is the net amount of the SIFT trust's taxable capital gains from dispositions in the taxation year of non-portfolio properties.

Consequential on the increase of the capital gains inclusion rate from 1/2 to 2/3, clause (b)(1)(B) is amended to change the reference from one-half to 2/3.This amendment applies to taxation years of a SIFT trust that end after June 24, 2024. For a taxation year that ends after June 24, 2024 and begins before June 25, 2024, the reference to the fraction “2/3” is to be read as a reference to the fraction in paragraph 38(a) of the Act that applies to the SIFT trust for the year.

Clause 33

Alternative minimum tax

ITA
127.52(1)(g)

Paragraph 127.52(1)(g) is relevant to calculating the alternative minimum tax (AMT) of a trust. It deals with taxable capital gains of a trust that are generally deductible by the trust and included in the income of a beneficiary (including, if applicable, for AMT purposes). More specifically, paragraph 127.52(1)(g) provides that, for the purpose of computing the adjusted taxable income of a trust for a year, the non-taxable portion of certain net taxable capital gains of the trust is to be deducted. These net taxable capital gains are those designated by the trust under subsection 104(21), those included by virtue of subsection 104(13) or section 105 in computing the income of a non-resident beneficiary and those paid to a beneficiary by a trust governed by an employee benefit plan.

Under subparagraph (g)(i) the trust can deduct the amount otherwise deductible under section 127.52, which is, prior to June 25, 2024, generally 1/2 of relevant capital gains (i.e., the taxable capital gain amount). Under existing subparagraph (g)(ii), the trust can deduct an extra 1/2 of those amounts. As such, the trust’s deduction for AMT purposes is now 100% (i.e., 1/2 + 1/2 =

100%) of relevant capital gains that are allocated to beneficiaries. This matches the new 100% AMT inclusion by the recipient of the allocated amount.

As of June 25, 2024, under subparagraph (g)(i) the trust can deduct the amount otherwise deductible under 127.52, which is generally 2/3 of relevant capital gains (i.e., the taxable capital gain amount).

Consequential on the increase in the capital gains inclusion rate to 2/3 as on June 25, 2024, subparagraph (g)(ii), is amended to provide that the trust can deduct an extra 1/2 of those amounts referenced in clauses (A) and (B). This provides an additional deduction of 1/3 of the capital gain (i.e., 1/2 × 2/3 = 1/3). As such, the trust's deduction for AMT purposes continues to be 100% (i.e., 1/3 + 2/3 = 100%) of relevant capital gains that are allocated to beneficiaries. This matches the 100% AMT inclusion by the recipient of the allocated amount.

This amendment applies to taxation years that end after 2023. If the taxation year of a trust begins before June 25, 2024 and ends after June 24, 2024, the reference to “1/2” in the portion of subparagraph 127.52(1)(g)(ii) of the Act is to be read as a reference to “(1 - A) ÷ A” where A is the fraction in paragraph 38(a) that applies to the trust for the particular taxation year.

ITA
127.52(1)(h)

Paragraph 127.52(1)(h) limits, for the purposes of computing an individual’s AMT, the amounts deductible under sections 110 to 110.7. Only those amounts specifically listed in paragraph 127.52(1)(h) may be deducted.

Subparagraph 127.52(1)(h)(ii) provides for the deduction under subsections 110.6(2) and (2.1) (the lifetime capital gains exemption) and paragraph 110(1)(d.01) (the deduction for donated stock options of publicly listed shares). For the purposes of computing an individual’s AMT, these deductions are increased by a factor of 7/5. As such, with the capital gains inclusion rate and stock option rate being 100%, an increased 7/5 deduction for the lifetime capital gains exemption and donated stock options, provides that the AMT net inclusion rate for capital gains that are subject to the lifetime capital gains exemption and income from donated stock options will be 30%.

Consequential on the increase in the capital gains inclusion rate to 2/3 and the introduction of new subsections 110.6(2.01), (2.02), (2.03) and (2.04) for the lifetime capital gains exemption, subparagraph 127.52(1)(h)(ii) is amended to provide that under the AMT, the deduction for the lifetime capital gains exemption and donated stock options would be increased by a factor of 1.05. This amendment provides for a continued 70% (1.05 x 2/3 = .70) deduction under the AMT for gains that were subject to the lifetime capital gains exemption or donated stock options. This continues to result in a net inclusion rate of 30%.

This amendment applies to taxation years that end after 2023. The reference to “1.05 times” in subparagraph 127.52(1)(h)(ii) of the Act is to be read as a reference to the fraction “7/5” if

- paragraph 110(1)(d.01) applies to a donation in respect of which the transaction, event or circumstance as a result of which a benefit is deemed by subsection 7(1) of the Act to have been received by a taxpayer occurred before June 25, 2024, or

- subsections 110.6(2.01) or (2.03) apply in respect of capital gains of the individual that are from dispositions of qualified farm or fishing property or shares of a small business corporation that are after 2023 and before June 25, 2024.

This amendment applies to taxation years that end after 2023.

Clause 34

Mortgage Investment Corporations

ITA
130.1

Section 130.1 of the Act sets out rules that apply to mortgage investment corporations and their shareholders. A mortgage investment corporation is essentially treated as a conduit in that its income may be flowed through to its shareholders and taxed in their hands rather than in the corporation. Section 130.1 is amended consequential to the change in the capital gains inclusion rate from 1/2 to 2/3.

Deduction from Tax

ITA
130.1(1)(a)(ii)

Subsection 130.1(1) of the Act provides rules for calculating the income of a mortgage investment corporation for a taxation year. The amendment to subparagraph 130.1(1)(a)(ii) replaces the reference to the fraction “1/2” with a reference to the fraction “2/3”, consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3.

The amendment applies to taxation years that end after June 24, 2024, except that, for a taxation year of a mortgage investment corporation that includes June 25, 2024, the reference to the fraction “2/3” is to be read as a reference to the fraction in amended paragraph 38(a) of the Act that applies to the corporation for the year. These modifications are required in order to reflect the capital gains inclusion rate for the taxation year.

Election re Capital Gains Dividend

ITA
130.1(4)

Subsection 130.1(4) permits a mortgage investment corporation to elect, in respect of the full amount of a dividend paid by the corporation, to deem the amount to be a capital gains dividend to the extent the amount does not exceed twice the taxed capital gains of the corporation for the year minus prior capital gains dividends paid. Such amounts are deemed to be a capital gain of the dividend recipient from the disposition of property in the year in which the dividend was received.

The amendment to subparagraph 130.1(4)(a)(i) replaces the reference to the word "twice" with a reference to "1.5 times". The amendment is consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3.

The amendment applies to taxation years that end after June 24, 2024, except that, for a taxation year of a mortgage investment corporation that includes June 24, 2024, the reference to "1.5 times" in subparagraph 130.1(4)(a)(i) is to be read as a reference to the fraction that is the reciprocal of the fraction in paragraph 38(a). This modification is required in order to reflect the capital gains inclusion rate for the taxation year.

Paragraph 130.1(4)(b) deems a capital gains dividend received by a taxpayer in a taxation year to be a capital gain of the taxpayer from the disposition of property in the year. The amendment to paragraph 130.1(4)(b), which is applicable for taxation years that end after June 24, 2024, is consequential to the capital gains inclusion rate change. Since the capital gains inclusion rate that applies to the taxpayer's deemed gain depends on the period in which the mortgage investment corporation disposed of the property in respect of the capital gains dividend, this amendment determines the amount and the period in which the taxpayer realizes the deemed gain. This ensures that the capital gains dividend paid by the mortgage investment corporation is included in the appropriate period for the calculation of the taxpayer's capital gains inclusion rate under paragraph 38(a).

More specifically:

- if the taxation year of the dividend recipient began after June 24, 2024, and the capital gains dividend was paid out of capital gains from property disposed of before June 25, 2024, 3/4 of the dividend is deemed by clause 130.1(4)(b)(ii)(A) to be a capital gain from the disposition of capital property in the recipient's taxation year. This rule functions to establish an effective inclusion rate of 1/2 (3/4 x 2/3);
- if the taxation year of the dividend recipient began before June 25, 2024, and the capital gains dividend was paid out of capital gains from property disposed of before June 25, 2024, the dividend is deemed by clause 130.1(4)(b)(ii)(B) to be a capital gain from the disposition of capital property in the recipient's taxation year and before June 25, 2024 (i.e., subject to the 1/2 inclusion rate); and
- in any other case, under clause 130.1(4)(b)(ii)(C) the dividend is deemed to be a capital gain of the recipient from the disposition of capital property after June 24, 2024, and in the taxation year of the recipient in which the dividend was received (i.e., subject to the 2/3 inclusion rate).

Capital Gains Dividend – Reporting and Allocation

ITA
130.1(4.2), (4.3), (4.4) and (4.5)

Where subsection 130.1(4) applies in respect of a dividend paid in a taxation year by a mortgage investment corporation to a shareholder of any class of shares of its capital stock, new subsection 130.1(4.2) requires the corporation to disclose to the shareholder in prescribed form the amount of the dividend that can reasonably be considered to have been paid out of its capital gains realized on dispositions by the corporation of property before June 25, 2024 and after June 24, 2024. If it does not do so, the dividend is deemed to be in respect of capital gains realized on dispositions of property that occurred after June 25, 2024.

New subsection 130.1(4.3) of the Act applies where the corporation does not elect under new subsection 130.1(4.4) to treat its capital gains to be realized evenly over the year that begins before June 25, 2024 and ends after June 24, 2024. In those circumstances, deeming rules apply to determine the portion of the dividend that is in respect of capital gains from dispositions of property by the mortgage investment corporation that occurred:

- in the year and in the period that begins at the beginning of the year and ended at the end of June 24, 2024 (the "first period"), and
- in the year and in the period that begins at the beginning of June 25, 2024 and ends at the end of the year (the "second period").

Specifically, the portion of the dividend that is deemed to be in respect of capital gains of the corporation from dispositions before June 25, 2024, is the proportion of the dividend that the corporation's net capital gains from dispositions of property in the first period is of the total of the corporation's net capital gains from dispositions of property in the first and second periods.

The portion of the dividend that is deemed to be in respect of capital gains of the corporation from dispositions after June 24, 2024, is the proportion of the dividend that the corporation's net capital gains from the disposition of property in the second period is of the total of the corporation's net capital gains from dispositions of property in the total of the first and second periods.

For the purposes of this subsection, net capital gains of a mortgage investment corporation from dispositions of property in a period mean the amount, in any, by which the corporation's capital gains form dispositions of property in the period exceeds the corporation's capital losses from dispositions of property in the same period.

Subsection 130.1(4.4) provides that a mortgage investment corporation can elect, for its taxation year that includes June 24, 2024, to apportion its capital gains dividends for the year amongst the two periods in the year that are before June 25, 2024 and after June 24, 2024.

The portion for each period is determined to be that proportion of the dividend that the number of days that are in the year and in that period is of the number of days in the year.

New subsection 130.1(4.5) of the Act provides a special rule that applies where no dividend to which subsection 130.1(4.4) applies is paid by a mortgage investment corporation in respect of its net taxable capital gains for its taxation year that includes June 24, 2024.

Where the corporation elects, it can treat its net capital gains or net capital losses as having been realized equally over the number of days in its taxation year, so that the net capital gains and losses in each of the periods will equal that proportion of the net capital gains and losses that the number of days in the year of the corporation that are in each period is of the number of days in the year. This election will permit a mortgage investment corporation to treat its net capital gains and losses as having been realized equally throughout the year for the purpose of calculating its capital gains inclusion rate for the year.

For the purpose of subsection 130.1(4.5), net capital gains of a mortgage investment corporation is defined as the amount, if any, by which the corporation’s capital gains from dispositions of property in a taxation year exceeds the corporation’s capital losses from dispositions of property in the year, and net capital losses of a mortgage investment corporation is defined as the amount, if any, by which the corporation’s capital losses from dispositions of property in a taxation year exceeds the corporation’s capital gains from dispositions of property in the year.

Subsections 130.1(4.2) to (4.5) apply to taxation years that end after June 24, 2024.

Clause 35

Mutual Fund Corporations

ITA
131

Section 131 of the Act sets out rules relating to the taxation of mutual fund corporations and their shareholders. Section 131 of the Act is amended consequential to the change of the capital gains inclusion rate from 1/2 to 2/3.

Election re Capital Gains Dividend

ITA
131(1)(b)

Where a mutual fund corporation elects in respect of the full amount of a dividend, the dividend, to the extent that it does not exceed the corporation’s capital gains dividend amount, is deemed to be a capital gains dividend and the dividend recipient is deemed to have a capital gain for the taxation year in which the dividend is received from the disposition of property in the year.

The amendment to paragraph 131(1)(b) of the Act, which is applicable for taxation years that end after June 24, 2024, is consequential to the change to the capital gains inclusion rate. Since the capital gains inclusion rate that applies to the taxpayer’s deemed gain depends on the period in which the mutual fund corporation disposed of the property in respect of the capital gains dividend, this amendment determines the amount and the period in which the taxpayer realizes the deemed gain. This ensures that the capital gains dividend paid by the mutual fund corporation is included in the appropriate period for the calculation of the taxpayer’s capital gains inclusion rate under paragraph 38(a).

More specifically:

- if the taxation year of the dividend recipient began after June 24, 2024, and the capital gains dividend was paid out of capital gains from property disposed of before June 25, 2024, 3/4 of the dividend is deemed by clause 131(1)(b)(ii)(A) to be a capital gain from the disposition of property in the recipient's taxation year. This rule functions to establish an effective inclusion rate of 1/2 (3/4 x 2/3);

- if the taxation year of the dividend recipient began before June 25, 2024, and the capital gains dividend was paid out of capital gains from property disposed of before June 25, 2024, the dividend is deemed by clause 131(1)(b)(ii)(B) to be a capital gain from the disposition of property in the recipient's taxation year and before June 25, 2024 (i.e., subject to the 1/2 inclusion rate); and
- in any other case, under clause 131(1)(b)(ii)(C) the dividend is deemed to be a capital gain of the recipient from the disposition of capital property after June 24, 2024, and in the taxation year of the recipient in which the dividend was received (i.e., subject to the 2/3 inclusion rate).

Ordering

ITA
131(1.01)

Section 131 is amended to add new subsection 131(1.01), applicable for taxation years that end after June 24, 2024. For the purposes of subparagraphs 131(1)(b)(i) and (ii), dividends paid by a corporation are deemed to be paid in respect of the corporation's net capital gains in the order in which those net capital gains were realized by the corporation. Additionally, capital gains redemptions are deemed to be made in respect of net capital gains in the order in which those net capital gains were realized by the corporation to the extent that they are not reduced by dividends. In the case of mutual fund corporations, which can pay capital gain dividends under subsection 131(1) to the extent of their capital gains dividend account, such an ordering rule provides clarity in situations where the capital gains dividend account of a corporation includes amounts of capital gains incurred over the course of multiple years (including the transition year).

For the purposes of applying paragraphs 131(1.01)(a) and (b),

- net capital gains of a corporation for a year is the amount by which the corporation's capital gains from dispositions of property in the year exceed the corporation's capital losses from dispositions of property in the year;
- net capital losses of a corporation for a year is the amount by which the corporation's capital losses from dispositions of property in the year exceed the corporation's capital gains from dispositions of property in the year;
- net capital gains of a corporation for a year are deemed to be realized evenly throughout the year; and
- net capital losses of a corporation for a year are deemed to be a capital loss of the corporation from the disposition of property in the following year.

Capital Gains Dividend – Reporting and Allocation

ITA
131(1.5) to (1.9)

Where a capital gains dividend, pursuant to subsection 131(1) of the Act, is paid by a mutual fund corporation to a shareholder of any class of shares of its capital stock, new subsection 131(1.5) provides that the corporation must disclose to the shareholder in prescribed form the amount of the dividend that can reasonably be considered to have been paid out of its capital gains realized on dispositions by the corporation of property before June 25, 2024. If it does not do so, the dividend is deemed to be in respect of capital gains realized on dispositions of property that occurred after June 24, 2024.

Subsections (1.6) to (1.9) include new rules related to a mutual fund corporation's taxation year that begins before June 25, 2024 and ends after June 24, 2024 (referred to as the "transition year"). New subsection 131(1.6) of the Act applies where the mutual fund corporation does not elect under new subsection 131(1.7) to treat its capital gains to be realized evenly over the transition year. In those circumstances, deeming rules apply to determine the portion of the dividend that is in respect of capital gains from dispositions of property by the mutual fund corporation that occurred:

- in the year and in the period that begins at the beginning of the year and ended at the end of June 24, 2024 (the "first period"), and
- in the year and in the period that begins at the beginning of June 25, 2024 and ends at the end of the year (the "second period").

Specifically, the portion of the dividend that is deemed to be in respect of capital gains of the corporation from dispositions before June 25, 2024, is the proportion of the dividend that the corporation's net capital gains from the disposition of property in the first period is of the total of the corporation's net capital gains from dispositions of property in the total of the first and second periods. The portion of the dividend that is deemed to be in respect of capital gains of the corporation from dispositions after June 24, 2024 is the proportion of the dividend that the corporation's net capital gains from the disposition of property in the second period is of the total of the corporation's net capital gains from dispositions of property in the first and second periods.

For the purposes of subsection 131(1.6), the net capital gains of a corporation for a period is the amount, in any, by which the corporation's capital gains from dispositions of property in the period exceed the corporation's capital losses from dispositions of property in the same period.

- Subsection 131(1.7) provides that a mutual fund corporation can elect, for its taxation year that includes June 25, 2024, to treat a portion of its capital gains dividends for the year to be in respect of capital gains realized on dispositions of property before June 25, 2024, and
- in the period that begins at the beginning of June 25, 2024, and ends at the end of the year.

The portion is determined as that proportion of the dividend that the number of days that are in the year and in that period is of the number of days in the year.

New subsection 131(1.8) applies where the total amount of dividends paid under subsections 131(1.6) and (1.7) by a mutual fund corporation in the period that begins 60 days after the beginning of the corporation's transition year and ends 60 days after the end of that taxation year and to which subsection 131(1) applies, exceeds the total amount of the corporation's net capital gains from dispositions of property in that year.

In that case, the amount of those dividends to which subsections 131(1.6) and (1.7) apply is the amount of the corporation's net capital gains from dispositions of property in that year. The amount, if any, by which the total amount of the dividends paid by the corporation in the period exceeds the total amount of the corporation's net capital gains from dispositions of property in that year is deemed to be a dividend in respect of capital gains from dispositions of property in the first period (described in subsection 131(1.6)).

New subsection 131(1.9) provides a special rule that applies where no dividend to which subsection 131(1.7) applies is paid by a mutual fund corporation in respect of its net taxable capital gains for its transition year.

If the corporation elects, it can treat its net capital gains or net capital losses as having been realized equally over the number of days in its taxation year, so that the net capital gains and losses in each of the periods will equal that proportion of the net capital gains and losses that the number of days in the year of the corporation that are in each period is of the number of days in the year. This election will permit a mutual fund corporation to treat its net capital gains and losses as having been realized equally throughout the year for the purpose of calculating its capital gains inclusion rate for the year.

For the purpose of new subsection 131(1.9), net capital gains of a mutual fund corporation is defined as the amount, if any, by which the corporation's capital gains from dispositions of property in the year exceeds the corporation's capital losses from dispositions of property in the year, and net capital losses of a mutual fund corporation is defined as the amount, if any, by which the corporation's capital losses from dispositions of property in the year exceeds the corporation's capital gains from dispositions of property in the year.

Capital Gains Refund to Mutual Fund Corporation

ITA
131(2)(a)(i)(A)

A mutual fund corporation is entitled to a capital gains refund for a taxation year equal to the total of 14% of the total of its capital gains dividends paid for the year, its capital gains redemptions for the year and the amount of its refundable capital gains tax on hand at the end of the year.

Generally, the refundable capital gains tax on hand of a mutual fund corporation is 28% of its taxed capital gains (or 14% of its capital gains for the year where the relevant inclusion rate for capital gains is 1/2). The refundable capital gains tax on hand could be less than 14% of capital gains where the taxable income of the mutual fund corporation is less than its taxed capital gains.

The amendment to clause 131(2)(a)(i)(A) of the Act replaces the reference to "14%" with a reference to "18.67%". This amendment is consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3.

The amendment applies to taxation years that end after June 24, 2024, except that, for the taxation year of a mutual fund corporation that includes June 25, 2024, the reference to the percentage "18.67%" in clause 131(2)(a)(i)(A) is to be read as reference to the percentage determined when 28% is multiplied by the fraction in amended paragraph 38(a) that applies to the corporation for the year. These modifications are required in order to reflect the capital gains inclusion rate for the year.

Definitions

ITA
131(6)

Subsection 131(6) of the Act defines a number of terms used in section 131. Consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3, the definitions "capital gains dividend account" and "capital gains redemptions" are amended.

"capital gains dividend account"

The "capital gains dividend account" of a mutual fund corporation represents the cumulative net undistributed capital gains of the corporation on which it paid refundable capital gains tax. A mutual fund corporation's capital gains dividend account is relevant in determining the extent to which the mutual fund corporation can pay capital gains dividends to its shareholders. The definition is amended consequential to the change of the capital gains inclusion rate from 1/2 to 2/3.

Paragraph (a) of this definition describes the amounts included in a mutual fund corporation's capital gains dividend account. Subparagraph (a)(ii) provides for the inclusion in a mutual fund corporation's capital gains account of an amount in respect of a capital gains distribution made by a trust to the corporation. Subparagraph (a)(ii) is amended such that the subparagraph will no longer apply to the taxation year of the mutual fund corporation that includes June 25, 2024, nor any subsequent taxation year.

New subparagraph (a)(iii) of the definition "capital gains dividend account" applies to the taxation year of the mutual fund corporation that includes June 25, 2024, and any subsequent taxation year, to allow for the inclusion in a mutual fund corporation's capital gains dividend account of an amount in respect of a capital gains distribution made by a trust to the corporation. Subparagraph (a)(iii) does not apply to an amount deemed to be a capital gain of the corporation under new paragraph 104(21.4)(a) or new paragraph 104(21.8)(b) as those amounts are deemed to be capital gains and, as such, will already be included in the mutual fund corporation's capital dividend account under subparagraph (a)(i) of this definition.

Under paragraph (a)(iii), an amount of a taxable capital gain distributed by a mutual fund trust to the corporation will be included in the capital gains dividend account. The amount added to the capital gains will be equal to the formula 1.5 x A, where A is the amount designated under subsection 104(21) by the trust in respect of the net taxable capital gains of the trust attributable to those capital gains.

Paragraph (b) of the definition “capital gains dividend account” describes the amounts deducted from a mutual fund corporation’s capital gains dividend account. Subparagraph (b)(iii) of the definition provides that an amount equal to 100/14 of the mutual fund corporation’s capital gain refund for any taxation is deducted from its capital gains dividend account. Subparagraph (b)(iii) is amended so that it no longer applies for taxation years that include June 25, 2024, or any subsequent taxation year.

New subparagraph (b)(iv) applies to the taxation year that includes June 25, 2024, and all subsequent taxation years. Subparagraph (b)(iv) is similar to subparagraph (b)(iii) except, as a consequence of the change in the capital gains inclusion rate, the fraction 100/14 is replaced with 100/18.67.

- These amendments apply to taxation years that end after June 24, 2024, except that, for a taxation year of a mutual fund corporation that includes June 25, 2024, the reference to “1.5” in subparagraph (a)(iii) is to be read as a referenced to the reciprocal of the fraction in paragraph 38(a) that applies to the corporation for the year.
- the reference to the fraction “100/18.67” in subparagraph (b)(iv) is to be read as a reference to the fraction “100/(28 x Z)”, where “Z” is the fraction in paragraph 38(a) that applies to the corporation for the year.

These modifications are required in order to reflect the capital gains inclusion rate of the mutual fund corporation for the year.

“capital gains redemptions”

The “capital gains redemptions” of a mutual fund corporation for a year are used in determining the mutual fund corporation's capital gains refund for the year. In calculating the capital gains redemptions, the corporation must allocate accrued capital gains and undistributed realized net capital gains across all payments on the redemption of shares in the year.

The amendment to the description of C in the definition “capital gains redemptions” replaces the fraction “100/14” with the fraction “100/18.67” and is consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3.

The amendment applies to taxation years that end after June 24, 2024, except that, for a taxation year of a mutual fund corporation that includes June 25, 2024, the reference to the fraction “100/14” in the description of C in the definition “capital gains redemptions” is to be read as a reference to the fraction “100/(28 x Z)”, where “Z” is the fraction in amended paragraph 38(a) that applies to the corporation for the year.

This modification is required in order to reflect the capital gains inclusion rate for the year.

Clause 36

Capital Gains Refund to Mutual Fund Trust

ITA
132(1)(a)(i)(A)

A mutual fund trust pays tax each year on the capital gains that it realizes and does not distribute to its beneficiaries. Capital gains that are realized and distributed in the same year are taxed in the beneficiaries' hands. These rules prevent a deferral of tax on realized capital gains. However, to ensure that those capital gains are taxed only once, and at the beneficiaries' effective rates of tax, a mutual fund trust's capital gains tax for a taxation year is refunded to it in a later year to the extent that it distributes those capital gains to its beneficiaries through the redemption of its units. This special refund regime for mutual fund trusts is intended to operate as an integration, not a deferral, mechanism.

Paragraph 132(1)(a) computes a mutual fund trust's capital gains refund as the lesser of two amounts. Under clause 132(1)(a)(i)(A), the first amount is determined by multiplying the trust's capital gains redemptions for the year by the trust's tax rate on capital gains. This rate is currently 16.5%. The 16.5% rate is based on the top personal tax rate of 33%, and a capital gains inclusion rate of 1/2.

Clause 132(1)(a)(i)(A) is amended to replace "16.5%" with "22%", consequential to the increase in the capital gains inclusion rate from 1/2 to 2/3.

The amendment applies to taxation years that end after June 24, 2024, except that, for a taxation year of a mutual fund trust that includes June 25, 2024, the reference to "22%" in paragraph 132(1)(a) is to be read as a reference to the percentage determined when 33% is multiplied by the fraction in amended paragraph 38(a) that applies to the trust for the year.

Definitions

ITA
132(4)

"capital gains redemptions"

Subsection 132(4) defines the "capital gains redemptions" of a mutual fund trust for a year which is used in determining the trust's capital gains refund for the year. In computing the amount the trust must allocate across all payments made on a redemption of trust units, its accrued capital gains and its previously realized but undistributed realized net capital gains.

The definition "capital gains redemptions" in subsection 132(4) applies a formula, variable C of which computes the previously realized but undistributed realized net capital gains by multiplying the trust's refundable capital gains tax on hand at the end of the year by the reciprocal of the tax rate applied to such gains.

Consequential on the increase of the capital gains inclusion rate from 1/2 to 2/3, the descriptions of C and E of the formula are amended.

The description of C in that definition is amended to replace the reciprocal “100/16.5” with the reciprocal “100/22”. This amendment applies to taxation years that end after June 24, 2024, except that, for a taxation year of a mutual fund trust that includes June 25, 2024, the reference to the fraction “100/22” is to be read as a reference to the fraction “100/(33 x Z)”, where “Z” is the fraction in amended paragraph 38(a) that applies to the trust for the year.

The description of E of the definition is amended to replace “twice” with “1.5 times”.

This amendment applies to taxation years that end after June 24, 2024, except that, for a taxation year of a mutual fund trust that includes June 25, 2024, the reference to the “1.5 times” is to be read as a reference to the fraction that is the reciprocal of the fraction in paragraph 38(a). These modifications are required in order to reflect the capital gains inclusion rate for the year.

TCP Gains Distribution

ITA
132(5.1)

Subsection 132(5.1) treats a distribution that a Canadian mutual fund trust pays out of its gains on taxable Canadian property as Canadian-source trust income, and thus ensures that it is subject to non-resident withholding tax under paragraph 212(1)(c). Paragraph 132(5.1)(a) provides that, if a mutual fund trust designates an amount under subsection 104(21) for a taxation year of the trust in respect of a beneficiary under the trust for the purposes of Part I and Part XIII, each beneficiary in respect of which the designation is made is deemed to have received from the trust, a TCP gains distribution equal to the lesser of twice the amount designated and the beneficiary's *pro rata* portion of the mutual fund trust's TCP gains balance for the taxation year.

The tax consequences of this characterization depend on the residence and status of the beneficiary. If the beneficiary is not resident in Canada, the tax consequences are described in paragraph (5.1)(b). In general, a beneficiary resident in Canada will be unaffected: the amount designated under subsection 104(21) will remain a taxable capital gain to the beneficiary from the disposition of a capital property. If the beneficiary is another mutual fund trust or a mutual fund corporation, the amount of the TCP gains distribution must be added to its own TCP gains balance.

Subparagraph 132(5.1)(a)(i) is amended to replace “twice” with “1.5 times”. This amendment is consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3. The amendment applies to taxation years that end after June 24, 2024, except that, for a taxation year of a mutual fund trust that includes June 25, 2024, the reference to the “1.5 times” is to be read as a reference to the fraction that is the reciprocal of the fraction in paragraph 38(a). These modifications are required in order to reflect the capital gains inclusion rate for the year.

Subparagraphs 132(5.1)(b)(i) and (ii) are amended to replace “one half” with “2/3”. The amendment reflects that the TCP capital gains will be taxed at the new capital gains inclusion rate of 2/3. The amendment applies to taxation years that end after June 24, 2024, except that, for a taxation year of a mutual fund trust that includes June 25, 2024, the references to the fraction

“2/3” is to be read as a reference to the fraction in paragraph 38(a). These modifications are required in order to reflect the capital gains inclusion rate for the year.

Allocation to Redeemers

ITA
132(5.3)(b)

Subsection 132(5.3) limits the deduction of certain amounts allocated to beneficiaries that have redeemed units of a mutual fund trust. The opening portion of subsection 132(5.3) sets out the conditions for the application of these rules. In particular, one of these conditions is that the trust has paid or made payable to a beneficiary an amount, on a redemption by that beneficiary of a unit of the trust, that was not included in the beneficiary's proceeds on the redemption. That amount is referred to in subsection 132(5.3) as the “allocated amount”.

Where the provision applies, paragraph 132(5.3)(b) denies the mutual fund trust a deduction in computing its income for a taxation year for the portion of the allocated amount that is paid out of the mutual fund trust's taxable capital gains that exceeds one half of the gain that would have been realized by the redeeming beneficiary but for the allocated amount. This denied amount is determined by the formula: A – 1/2 (B + C – D).

The formula in paragraph 132(5.3)(b) is amended to replace “1/2” with “2/3”. This amendment is consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3. The amendment applies to taxation years that end after June 24, 2024, except that, for a taxation year of a mutual fund trust that includes June 25, 2024, the references to the fraction “2/3” is to be read as a reference to the fraction in paragraph 38(a). These modifications are required in order to reflect the capital gains inclusion rate for the year.

Clause 37

Rules Relating to Segregated Funds

ITA
138.1(3.1) and (3.2)

Section 138.1 provides rules governing the operation of segregated fund trusts established by insurance companies. Subsection 138.1(3) deems capital gains and capital losses from dispositions of property of a related segregated fund trust to be capital gains or losses of the policyholder or other beneficiary.

New subsections 138.1(3.1) and (3.2) are added to provide the appropriate inclusion rate for capital gains realized by a related segregated fund trust in a taxation year that includes June 25, 2024, that are deemed to be the capital gain or losses of a policyholder, or other beneficiary, of the related segregated fund trust.

Subsection 138.1(3.1) determines the amount and the period in which the policyholder, or other beneficiary of the trust, realizes the deemed gain. This is relevant since the capital gains inclusion rate that applies to the policyholder’s, or other beneficiary’s, deemed gain or loss depends on the period in which the related segregated fund trust disposed of the property. This ensures that the amount of the policyholder's, or other beneficiary's, deemed gain or loss is included in the appropriate period for the calculation of the policyholder's capital gains inclusion rate under paragraph 38(a).

More specifically:

- if the taxation year of the policyholder began before June 25, 2024, and the capital gains dividend was paid out of capital gains from property disposed of before June 25, 2024, the gain is deemed by new paragraph 138.1(3.1)(a) to be a capital gain from the disposition of property in the policyholder's taxation year and before June 25, 2024 (i.e., subject to the 1/2 inclusion rate);
- if the taxation year of the policyholder began after June 24, 2024, and the capital gains dividend was paid out of capital gains from property disposed of before June 25, 2024, 3/4 of the gain is deemed by new paragraph 138.1(3.1)(b) to be a capital gain from the disposition of property in the policyholder's taxation year. This rule functions to establish an effective inclusion rate of 1/2 (3/4 x 2/3); and
- in any other case, under new paragraph 138.1(3.1)(c), the dividend is deemed to be a capital gain of the recipient from the disposition of capital property after June 24, 2024, and in the taxation year of the policyholder in which the dividend was received (i.e., subject to the 2/3 inclusion rate).

The related segregated fund trust must disclose to the policyholder, or other beneficiary of the trust in prescribed form the amount of the capital gain or capital loss that is in respect of dispositions on property that occurred before June 25, 2024.

Subsection 138.1(3.2) provides a special rule where an amount is deemed under subsection 138.1(3) to be a capital gain or capital loss of a policyholder or other beneficiary in respect of capital gains or losses realized in a taxation year of the related segregated fund trust that began before June 25, 2024, and ends after June 24, 2024. If the related segregated fund trust elects, the deemed gains or losses for each of the pre-June 25, 2024 period and the period that begins after June 24, 2024 can be treated as having been realized evenly over the number of days in its taxation year, so that the gains or losses in each of the periods will equal that proportion of the gains or losses that the number of days that are in the year of the trust that are in each period is of the number of days in the year.

These amendments apply to taxation years that end after June 24, 2024.

Clause 38

ITA
164(6.1)

Subsection 164(6.1) applies where an employee or former employee dies and, within the first taxation year of the deceased's estate, the deceased's legal representative exercises a right to acquire shares under an agreement to sell or issue shares to which subsection 7(1) applied. Where this is the case and the legal representative so elects, the deceased's gain in respect of the right that arises under paragraph 7(1)(e) for the taxation year of death is offset under paragraph 164(6.1)(a) by a specified amount.

The specified amount in respect of a right is treated as a loss from employment of the deceased. It is equal to the decline in value of the right after the death and before the exercise of the right, offset by an amount not exceeding the 1/2 deduction under paragraph 110(1)(d) in respect of the associated gain.

Consequential on the increase in the capital gains inclusion rate from 1/2 to 2/3, with the corresponding decrease in the stock option deduction from 1/2 to 1/3, subparagraph 164(6.1)(a)(iii) is amended to provide that the specified amount is equal to the decline in value of the right after the death and before the exercise of the right, offset by an amount not exceeding the 1/3 deduction under paragraph 110(1)(d) in respect of the associated gain.

The 2/3 inclusion rate is applicable to capital gains above $250,000. For capital gains below $250,000, the 1/2 inclusion rate continues to apply. Individuals may allocate this $250,000 limit to stock options, in which case, the income inclusion for stock options would be 1/2. This lower inclusion rate is provided by an additional 1/6 deduction under new paragraph 110(1)(d.4). To account for this possible additional deduction, subparagraph 164(6.1)(a)(iii) is also amended to provide an additional amount for the specified amount, as described above. This additional amount is the lesser of:

- 1/6 of the amount, if any, by which the amount determined under subparagraph (i) exceeds the amount determined under subparagraph (ii), and
- the amount that was deducted under paragraph 110(1)(d.4) in respect of the benefit deemed by paragraph 7(1)(e) to have been received by the taxpayer in that year by reason of paragraph 7(1)(e) in respect of that right.

This amendment applies to deaths that occur after June 24, 2024.

Clause 39

ITA
247(1)

“transfer pricing capital adjustment”

Section 247 provides rules concerning transfer pricing and related matters. Subsection 247(1) defines a number of terms for the purpose of section 247.

The “transfer pricing capital adjustment” of a taxpayer as defined in subsection 247(1) represents the transfer pricing adjustments made under subsection 247(2) that are in respect of the adjusted cost base of capital property and the capital cost of depreciable capital property of the taxpayer. The adjustment includes 1/2 of the adjustments to the adjusted cost base of non-depreciable capital property and 100% of the adjustments to the capital cost of depreciable capital property.

Consequential on the increase in the capital gains inclusion rate from 1/2 to 2/3, the fraction 1/2 in subparagraphs (a)(i) and (b)(i) is changed to 2/3.

This amendment applies to taxation years that end after June 24, 2024. For a taxation year of a taxpayer that includes June 25, 2024, the reference to the fraction “2/3” is to be read as a reference to the fraction in paragraph 38(a) of the Act that applies to the taxpayer for the year.

Deemed dividends to non-residents

ITA
247(12)

Where the terms or conditions of a transaction or series of transactions do not reflect arm's length terms and conditions, subsection 247(2) may adjust, for tax purposes, any amounts related to the transactions or series to reflect arm's length terms and conditions. This is commonly referred to as a “primary adjustment”.

In general terms, subsection 247(12) provides that a corporation that is resident in Canada for the purposes of Part XIII and that is subject to a primary adjustment will be deemed to have paid a dividend to each non-arm's length non-resident participant in the transaction or series of transactions equal to the benefit conferred on the non-resident. This is commonly referred to as a “secondary adjustment”.

The amount of the deemed dividend is determined under paragraph 247(12)(b) and it is the amount that is the portion of the total of the particular corporation's transfer pricing capital and income adjustments that exceed the transfer pricing capital and income setoff adjustments that could reasonably be considered to relate to the particular non-resident person (if the definition “transfer pricing capital adjustment” in subsection 247(1) were read without reference to the references therein to “1/2 of” and “3/4 of” and the only transactions or series of transactions undertaken by the particular corporation were those in which the particular non-resident was a participant). The reference to “1/2 of” relates to the 1/2 capital gains inclusion rate. The reference to “3/4 of” relates to the now repealed eligible capital property regime and is no longer applicable due to an earlier amendment to the definition “transfer pricing capital adjustment”.

Consequential on the increase in the capital gains inclusion rate from 1/2 to 2/3 (and the corresponding changes to the definition “transfer pricing capital adjustment”), the references to “1/2 of” in clauses 247(12)(b)(i)(B) and (ii)(B) are replaced by “2/3 of”. The references to “3/4” are also removed since they are no longer relevant.

This amendment applies to taxation years that end after June 24, 2024. For a taxation year of a taxpayer that includes June 25, 2024, the references to the fraction “2/3” are to read as a references to the fraction in paragraph 38(a) of the Act that applies to the taxpayer for the year.

Clause 40

Dividends out of exempt, taxable and pre-acquisition surplus

ITR
5900(1)

The primary function of subsection 5900(1) is to prescribe various amounts that are relevant in determining the amounts deductible by a corporation resident in Canada under subsection 91(5) and section 113 of the Act in respect of dividends from a foreign affiliate. It also prescribes the amounts to be included in a foreign affiliate’s exempt surplus, hybrid surplus and taxable surplus in respect of dividends paid by another foreign affiliate.

Subsection 5900(1) is being amended to add new paragraphs (a.2), (a.3), (c.2) and (c.3), to prescribe amounts in respect of “legacy hybrid surplus”, “legacy hybrid underlying tax”, “successor hybrid surplus” and “successor hybrid underlying tax”, as defined in subsection 5907(1). Those new concepts are introduced consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3.

Paragraph 5900(1)(a.1) is also being amended, such that it continues to prescribe the portion of a dividend paid by a foreign affiliate out of the affiliate’s hybrid surplus for the purposes of Part LIX but is no longer applicable for the purposes of paragraph 113(1)(a.1). Similarly, amended paragraph 5900(1)(c.1) prescribes the foreign tax applicable to the hybrid surplus portion of a dividend for the purposes of Part LIX but is no longer applicable for the purposes of paragraph 113(1)(a.1). Because amended paragraphs 5900(1)(a.1) and (c.1) continue to apply for the purposes of Part LIX, they remain relevant in determining increases to an affiliate’s hybrid surplus and hybrid underlying tax resulting from inter-affiliate dividends.

New paragraph 5900(1)(a.2) prescribes the portion of a dividend paid by a foreign affiliate out of the affiliate’s legacy hybrid surplus, including for the purpose of determining the amount deductible by a corporation resident in Canada under amended paragraph 113(1)(a.1) of the Act in respect of the dividend.

New paragraph 5900(1)(c.2) prescribes the foreign tax applicable to the portion of a dividend prescribed to be paid out of a foreign affiliate’s legacy hybrid surplus, including for the purpose of determining the amount deductible under amended subparagraph 113(1)(a.1)(ii) of the Act.

New paragraph 5900(1)(a.3) prescribes the portion of a dividend paid by a foreign affiliate out of the affiliate’s successor hybrid surplus, including for the purpose of determining the amount deductible by a corporation resident in Canada under new paragraph 113(1)(a.2) of the Act in respect of the dividend.

New paragraph 5900(1)(c.3) prescribes the foreign tax applicable to the portion of a dividend prescribed to be paid out of a foreign affiliate’s successor hybrid surplus, including for the purpose of determining the amount deductible under new subparagraph 113(1)(a.2)(ii) of the Act.

For more information, see the commentary to subsection 5901(1) and the new definitions “legacy hybrid surplus”, “legacy hybrid underlying tax”, “legacy hybrid underlying tax applicable”, “successor hybrid surplus”, “successor hybrid underlying tax” and “successor hybrid underlying tax applicable”, in subsection 5907(1).

These amendments apply to dividends received after June 24, 2024.

Clause 41

Order of surplus distributions

ITR
5901(1)

Section 5901 sets out ordering rules in respect of a whole dividend paid by a foreign affiliate on its shares. Under those rules, a whole dividend is generally treated as having been paid out of exempt surplus (until that surplus is exhausted), then hybrid surplus (until that surplus is exhausted), then taxable surplus (until that surplus is exhausted) and then, finally, pre-acquisition surplus to the extent of any remaining portion of the dividend.

Subsection 5901(1) is amended, consequential to the introduction of the new “legacy hybrid surplus” and “successor hybrid surplus” sub-categories of hybrid surplus, by adding new paragraphs (a.2) and (a.3). These amendments do not alter the existing surplus ordering rules, which continue to deem a whole dividend to be paid out of a foreign affiliate’s surplus accounts in the following order: exempt surplus, hybrid surplus, taxable surplus and, finally, pre-acquisition surplus. Rather, the amendments provide an additional ordering rule, under which any portion of a dividend that is deemed to be paid out of a foreign affiliate’s hybrid surplus under paragraph 5901(1)(a.1) is first deemed to be paid out of the affiliate’s legacy hybrid surplus (until that surplus is exhausted) and then out of its successor hybrid surplus.

These amendments apply to dividends received after June 24, 2024.

ITR
5901(1.1)

In recognition that taxable surplus may in some cases be more valuable to a taxpayer than hybrid surplus, subsection 5901(1.1) gives taxpayers the ability to elect, in respect of a whole dividend, to have that dividend be paid out of taxable surplus in priority to hybrid surplus. Similar to the amendments to subsection 5901(1), the amendments to subsection 5901(1.1) provide an additional ordering rule, under which any amounts deemed to be distributed from a foreign affiliate’s hybrid surplus are deemed to be distributed first from its legacy hybrid surplus (until that surplus is exhausted) and then its successor hybrid surplus.

These amendments apply to dividends received after June 24, 2024.

Clause 42

Election in respect of capital gains

ITR
5902(1)

Subsection 5902(1) provides rules to compute a foreign affiliate’s surplus accounts, and the amount of a whole dividend, which are used in applying subsection 5901(1) for the purposes of subsection 5900(1) with respect to an elected dividend under subsection 93(1).

Subsection 5902(1) is amended consequential to the introduction of the definitions “legacy hybrid surplus”, “legacy hybrid underlying tax”, “successor hybrid surplus” and “successor hybrid underlying tax", and the amendments to subsection 5900(1) to reflect those new concepts. Subparagraph 5902(1)(a)(i) is amended to include references to those new defined terms, ensuring that the rules in paragraph (a) apply for the purposes of computing those amounts. Subparagraphs 5902(1)(b)(i.1) and (i.2) are amended to provide that the affiliate's hybrid surplus and hybrid underlying tax are reduced in respect of the portions of a dividend that are deemed to be paid out of legacy hybrid surplus and successor hybrid surplus.

These amendments apply in respect of elections made in respect of dispositions that occur after June 24, 2024. Also, the amendments to subparagraph 5902(1)(a)(i) apply after June 24, 2024, to the extent that subparagraph is used in determining a foreign affiliate's "downstream surplus" in conjunction with amended subsection 90(11) of the Act, or its "tax-free surplus balance" in conjunction with amended subsection 5905(5.6).

Clause 43

ITR
5903.1(1) and (2)

Subsections 5903.1(1) and (2) are amended to add references to new subsection 5903.1(1.1). For more information, see the note to the latter subsection.

These amendments apply in respect of capital losses of a foreign affiliate incurred in taxation years of the affiliate ending after August 19, 2011.

ITR
5903.1(1.1)

Section 5903.1 provides the rules for determining and claiming a foreign accrual capital loss (FACL) for the purposes of the description of F.1 in the definition "foreign accrual property income" (FAPI) in subsection 95(1) of the Act.

Consequential on the increase in the inclusion rate for capital gains from 1/2 to 2/3, new subsection 5903.1(1.1) is added to provide an adjustment similar to the one in subsection 111(1.1) of the Act, to compensate for the difference between the inclusion rate applicable for the foreign affiliate's taxation year (referred to as the "loss year") in which the FACL arises and the inclusion rate for capital gains for the year in which the FACL is designated. The purpose of this adjustment is to ensure that a capital loss (giving rise to a FACL) for a loss year will be able to offset an equal amount of a capital gain included in computing the FAPI of a foreign affiliate in another year, where the capital gains inclusion rate differs between the loss year and the year in which the capital gains arises and the FACL is claimed.

New subsection 5903.1(1.1) applies in respect of capital losses of a foreign affiliate incurred in taxation years of the affiliate ending after August 19, 2011. This corresponds to the application rule that applied when section 5903.1 was first introduced and ensures that all FACLs designated will be subject to the proper adjustment.

Example

Facts

1. *Canco, a corporation resident in Canada, owns 100% of the shares of FA, a non-resident corporation.*
2. *FA has a FACL of $100 (1/2 x $200) for its 2022 taxation year and a FACL of $150 (1/2 x $300) for its 2023 taxation year. These FACLs have not been designated by Canco for the purpose of computing FA's FAPI for any taxation years other than 2024.*
3. *FA has a capital gain of $300 for its 2024 taxation year, which results in a taxable capital gain of $200 that is included in computing its FAPI.*

Analysis

Assuming Canco designates $100 in respect of FA's FACL for 2022 and $50 in respect of FA's FACL for 2023, the amounts determined under subsection 5903.1(1.1), for the purpose of computing the prescribed amount under subsection 5903.1(1) for FA's 2024 taxation year, are:

- *in respect of FA's FACL for 2022: $100 x ⅔ / 1/2 = $133.33 (Amount A), and*
- *in respect of FA's FACL for 2023: $50 x ⅔ / 1/2 = $66.67 (Amount B)*

Thus, in computing FA's FAPI for 2024, the prescribed amount for the purposes of the description of F.1 of the definition "foreign accrual property income" in subsection 95(1) is the total of Amount A and Amount B, which equals $200.

Clause 44

ITR
5905(5.5)

Subsections 5905(5.5) and (5.6) provide the meaning of the term "tax-free surplus balance" (TFSB) for the purposes of subsections 5905(5.2), (5.4), (7.2) and (7.3).

The TFSB of a particular foreign affiliate is defined in subsection 5905(5.5) and is a measure of the "good" surplus inherent in the particular affiliate. "Good" surplus is, generally, the aggregate of exempt surplus, the tax-free portion of the hybrid surplus, and the grossed-up amount of underlying foreign tax (i.e., taxes paid in respect of taxable surplus).

Subsection 5905(5.5) is amended consequential to the introduction of the concepts of legacy hybrid surplus and successor hybrid surplus.

Paragraph 5905(5.5)(a.1) is amended in two ways. First, it is amended to provide that the amount included in a foreign affiliate's TFSB under that paragraph (where the requisite condition is met) is the lesser of:

- the affiliate's hybrid surplus less its offsetting deficit determined under subsection 5905(5.7), and

- the affiliate's legacy hybrid surplus.

The lesser of those two amounts is referred to as the "distributable legacy hybrid surplus".

Second, the formula is revised to refer to "legacy hybrid underlying tax" in variable A and "legacy hybrid surplus" in variable C. The distributable legacy hybrid surplus is only included in the affiliate's TFSB if the amount determined under the formula is greater than or equal to the legacy hybrid surplus.

New paragraph 5905(5.5)(a.2) determines the "good" surplus available in respect of successor hybrid surplus. This paragraph is similar to the amended paragraph 5905(5.5)(a.1) with a few key differences. First, the amount added to a foreign affiliate's TFSB under paragraph (a.2) (where the requisite condition is met) is the lesser of:

- the foreign affiliate's successor hybrid surplus, and
- the amount by which the affiliate's hybrid surplus exceeds the total of the affiliate's offsetting deficit determined under subsection 5905(5.7) and its distributable legacy hybrid surplus.

Second, the formula in new paragraph 5905(5.5)(a.2) refers to "successor hybrid underlying tax" in variable A and "successor hybrid surplus" in variable C, and treats 1/3 of the successor hybrid surplus, plus a gross-up for the successor hybrid underlying tax based on the relevant tax factor minus 2/3, as the "good" surplus in respect of the successor hybrid surplus. This formula is similar to the one included in new clause 90(9)(a)(i)(B.1) of the Act.

Consistent with amended paragraph 5905(5.5)(a.1), the distributable amount of successor hybrid surplus is included in the tax-free surplus balance under new paragraph 5905(5.5)(a.2) only if the amount determined under the formula is greater than or equal to the successor hybrid surplus.

Amended paragraph 5905(5.5)(a.1) and new paragraph 5905(5.5)(a.2) are intended to operate in a similar manner to the surplus ordering rules in new paragraphs 5901(1)(a.2) and (a.3), which treat any amount deemed to be paid out of a foreign affiliate's hybrid surplus as being paid first out of its legacy hybrid surplus (until that surplus is exhausted) and then out of its successor hybrid surplus to the extent the hybrid surplus distribution exceeds the legacy hybrid surplus.

These amendments come into force on June 25, 2024.

ITR
5905(5.6)

Subsection 5905(5.6) provides that, for the purpose of subsection 5905(5.5), the surplus balances of a foreign affiliate include its share of the surplus balances of any foreign affiliates in which the affiliate has a direct or indirect interest. This is accomplished by a reference to the surplus aggregation rule in subparagraph 5902(1)(a)(i).

Consequential to the amendments to subparagraph 5902(1)(a)(i) and the introduction of the definitions "legacy hybrid surplus", "legacy hybrid deficit", "legacy hybrid underlying tax", "successor hybrid surplus", "successor hybrid deficit" and "successor hybrid underlying tax" in subsection 5907(1), subsection 5905(5.6) is amended to include in the list of surplus, deficit and underlying tax items the "legacy" and "successor" sub-categories of hybrid surplus, hybrid deficit and hybrid underlying tax.

These amendments come into force on June 25, 2024.

ITR
5905(5.7)

With the addition of new paragraph 5905(5.5)(a.2), subsection 5905(5.7) is amended to include a reference to that paragraph because the deficit amounts determined under this subsection are also relevant in determining the amount, if any, in respect of successor hybrid surplus that is included in the TFSB.

This amendment comes into force on June 25, 2024.

Clause 45

Interpretation

ITR
5907(1)

"legacy hybrid deficit"

Similar to the way the existing term "hybrid deficit" is defined by reference to the definition "hybrid surplus", the new term "legacy hybrid deficit" applies when legacy hybrid surplus would (in the absence of section 257 of the Act) be negative. This definition includes the same requirement as in the definition "legacy hybrid surplus", to undertake legacy hybrid surplus or deficit determinations in respect of other foreign affiliates to the extent this is relevant to the calculation of the subject affiliate's legacy hybrid deficit because of the application of subsection 5905(1), (3), (5) or (5.1). For more information, see the commentary to the definition "legacy hybrid surplus" in subsection 5907(1).

This definition applies after June 24, 2024.

"legacy hybrid surplus"

The new definition "legacy hybrid surplus" draws on the existing definition "hybrid surplus" but adapts the amounts included in that definition to ensure that only amounts that ultimately derive from capital gains or capital losses in respect of dispositions occurring before June 25, 2024 (when the increase of the capital gains inclusion rate from 1/2 to 2/3 generally takes effect) are included. The portion of a dividend received by a corporation resident in Canada that is prescribed under paragraph 5900(1)(a.2) to be paid out of a foreign affiliate's legacy hybrid surplus qualifies for the 1/2 deduction under amended paragraph 113(1)(a.1) of the Act.

Paragraphs (a) to (c) of the "hybrid surplus" definition remain unaltered for the purposes of the "legacy hybrid surplus" definition, meaning that the start and end dates for the period in respect of which a foreign affiliate's (referred to as a the "subject affiliate") legacy hybrid surplus is determined are the same as the dates applicable for determining its hybrid surplus.

The subject affiliate's opening hybrid surplus and opening hybrid deficit, as determined under section 5905, are included under subparagraph (i) of the descriptions of A and B, respectively, in the definition “hybrid surplus”. In particular, subsections 5905(1), (3), (5) and (5.1) provide rules for resetting or establishing (depending on the provision) the amount of the surpluses, deficits and underlying foreign tax balances of a foreign affiliate (and, in general, of each other foreign affiliate in which the affiliate has an equity percentage) in certain cases involving dispositions or acquisitions of the affiliate’s shares or reorganizations involving the affiliate. In applying those subsections, for the purpose of determining the subject affiliate’s hybrid surplus (which is necessary in determining its legacy hybrid surplus), it is in some cases necessary to determine the hybrid surplus or hybrid deficit of one or more other foreign affiliates. For example, if there is a foreign merger of two or more corporations and the resulting merged corporation is a foreign affiliate of a Canadian-resident corporation, the opening hybrid surplus balance of the affiliate is determined under subparagraph 5905(3)(a)(ii.1) to be the net hybrid surplus of the predecessor corporations in respect of the Canadian corporation, adjusted to account for any change in surplus entitlement percentage resulting from the merger.

To ensure that only amounts satisfying the restrictions in paragraphs (a) to (d) of the “legacy hybrid surplus” definition (described below) are included in computing the legacy hybrid surplus of the subject affiliate, the definition “legacy hybrid surplus” provides that those restrictions must be applied to the determination of the hybrid surplus or hybrid deficit of any other foreign affiliates that are relevant in applying subsections 5905(1), (3), (5) and (5.1), in determining the subject affiliate’s opening hybrid surplus or deficit. Otherwise, the opening hybrid surplus or deficit that is included in the subject affiliate’s legacy hybrid surplus may contain amounts that are ultimately derived from capital gains or capital losses in respect of dispositions occurring after June 24, 2024.

Paragraph (a) of the definition “legacy hybrid surplus” is intended to narrow the capital gains and losses included in the calculation of legacy hybrid surplus to only those realized from dispositions occurring before June 25, 2024. Narrowing the amounts referred to in subparagraph (ii) of the description of A, and subparagraphs (ii) and (iii) of the description of B, of the “hybrid surplus” definition in this way also ensures that the only amounts included under subparagraph (iii) of the description of A, and subparagraph (iv) of the description of B, of the “hybrid surplus” definition in computing an affiliate’s legacy hybrid surplus are amounts in respect of pre-June 25, 2024 capital gains or losses.

Paragraph (b) adapts the “hybrid surplus” definition to take into account only dividends paid or received by the subject affiliate out of hybrid surplus before June 25, 2024, and those paid or received out of legacy hybrid surplus (which is a surplus pool that exists only after June 24, 2024). This prevents dividends that are ultimately derived from capital gains realized from dispositions occurring after June 24, 2024, from being included in legacy hybrid surplus, while ensuring that amounts derived from capital gains from dispositions occurring before June 25, 2024, are included in legacy hybrid surplus as they are paid up the corporate chain.

Paragraph (c) concerns adjustments to surplus, deficit and underlying tax accounts, in respect of income or profits tax, because of the adjustment provisions in subsections 5907(1.092), (1.1) and (1.2). These provisions generally ensure that appropriate surplus adjustments are made where a foreign affiliate is a fiscally transparent entity or a shareholder of such an entity (subsection

5907(1.092)) or a member of a consolidated group (subsection 5907(1.1)), or is entitled to deduct losses of another foreign affiliate. Paragraph (c) limits the amounts added or deducted under subparagraph (v) of the description of A and subparagraph (vii) of the description of B of the "hybrid surplus" definition, for the purpose of determining the subject affiliate's legacy hybrid surplus, to only those amounts that it is reasonable to regard as being in respect of capital gains or losses, or dividends paid or received, that are included in legacy hybrid surplus or deficit. This effectively requires a tracing or matching of the income or profits tax paid (which gives rise to the adjustment under the relevant adjustment provision) to the underlying income or loss to which the tax relates, and limits legacy hybrid surplus to amounts traced or matched to pre-June 25, 2024, capital gains and losses or legacy hybrid surplus dividends.

Paragraph (d) limits the reduction to hybrid surplus effected under subparagraph (vi) of the description of B in the "hybrid surplus" definition to section 5902 adjustments that occur before June 25, 2024, or that are made because a portion of any elected dividend is paid out of legacy hybrid surplus. For more information, see the commentary to subsection 5902(1).

This definition applies after June 24, 2024.

"legacy hybrid underlying tax"

The new definition "legacy hybrid underlying tax" is structured in a similar manner to the new definition "legacy hybrid surplus". It draws on the existing definition "hybrid underlying tax," but adapts that definition to filter out tax and tax refunds associated with amounts that ultimately derive from capital gains or losses in respect of dispositions occurring after June 24, 2024.

Paragraph (a) of this definition provides that any amount of hybrid surplus or hybrid deficit that is relevant in determining the legacy hybrid underlying tax of a foreign affiliate (referred to as the "subject affiliate") must be determined on the basis that the "hybrid surplus" and "hybrid deficit" definitions are adapted in the manner set out in paragraphs (a) to (d) of the "legacy hybrid surplus" definition. This rule ensures that no tax or tax refund in respect of an amount that ultimately derives from capital gains or losses in respect of dispositions occurring after June 24, 2024, is included in the legacy hybrid underlying tax of the subject affiliate.

The restrictions contained in paragraphs (b) to (e) of this definition generally track those in paragraphs (b) to (d) of the "legacy hybrid surplus" definition, with such variations as are required to account for the specific context (in particular, that the definition "legacy hybrid underlying tax" deals only with tax amounts and not capital gains and losses).

Paragraph (c) generally provides that additions and reductions to hybrid underlying tax resulting from the application of subsection 5907(1.092), (1.1) or (1.2) are to be included only to the extent they relate to amounts included in computing legacy hybrid surplus. That paragraph is intended to be interpreted analogously to paragraph (c) of the definition "legacy hybrid surplus". For more information, see the commentary to that definition.

Paragraphs (b) and (d) concern tax amounts relating to dividends received or paid by the subject affiliate. They generally limit the amounts included in computing legacy hybrid underlying tax to only tax amounts applicable in respect of dividends received or paid by the subject affiliate before June 25, 2024, or applicable in respect of dividends paid out of legacy hybrid surplus (which are necessarily paid after June 24, 2024).

The subject affiliate's opening hybrid underlying tax, as determined under section 5905, is included under subparagraph (i) of the description of A in the definition "hybrid underlying tax". In applying subsections 5905(1), (3), (5) and (5.1) to determine the subject affiliate's opening hybrid underlying tax, for the purpose of determining its legacy hybrid underlying tax, the restrictions in paragraphs (a) to (e) of the "legacy hybrid underlying tax" definition must be applied to the determination of the hybrid surplus, hybrid deficit and hybrid underlying tax of any other foreign affiliates that are relevant in applying any of those subsections. This ensures that the opening hybrid underlying tax included in the subject affiliate's legacy hybrid underlying tax contains only amounts that ultimately relate to capital gains or capital losses from dispositions occurring before June 25, 2024. For more information, see the commentary to the definition "legacy hybrid surplus".

This definition applies after June 24, 2024.

"legacy hybrid underlying tax applicable"

The new definition "legacy hybrid underlying tax applicable" is relevant for determining the amount deductible by a corporation resident in Canada under amended paragraph 113(1)(a.1) of the Act, in respect of a dividend paid out of the legacy hybrid surplus of a foreign affiliate of the corporation. For the purposes of paragraph 113(1)(a.1) of the Act, new paragraph 5900(1)(c.2) of the Regulations prescribes the foreign tax applicable to the portion of a dividend prescribed to have been paid out of the legacy hybrid surplus of the affiliate by reference to the legacy hybrid underlying tax applicable.

The legacy hybrid underlying tax applicable, in respect of a corporation, to a whole dividend paid at any time is the proportion of the legacy hybrid underlying tax of the affiliate at that time in respect of the corporation that the portion of the whole dividend deemed to have been paid out of the affiliate's legacy hybrid surplus in respect of the corporation is of the affiliate's legacy hybrid surplus at that time in respect of the corporation.

This definition applies after June 24, 2024.

"successor hybrid deficit"

The new definition "successor hybrid deficit" is structured similarly to the new definition "legacy hybrid deficit", except that the successor hybrid deficit includes only amounts that ultimately derive from capital gains or capital losses in respect of dispositions occurring after June 24, 2024. For more information, see the commentary to the definitions "legacy hybrid surplus", "legacy hybrid deficit" and "successor hybrid surplus" in this subsection.

This definition applies after June 24, 2024.

"successor hybrid surplus"

The new definition “successor hybrid surplus”, like the new definition “legacy hybrid surplus”, draws on the existing definition “hybrid surplus” but adapts the amounts included in that definition to ensure that only amounts that ultimately derive from capital gains or capital losses in respect of dispositions occurring after June 24, 2024 (when the increase of the capital gains inclusion rate from 1/2 to 2/3 generally takes effect) are included. The portion of a dividend received by a corporation resident in Canada that is prescribed under paragraph 5900(1)(a.3) to be paid out of a foreign affiliate’s successor hybrid surplus (which is necessarily a dividend paid after June 24, 2024) qualifies for the 1/3 deduction under new paragraph 113(1)(a.2) of the Act.

This definition is structured similarly to the new definition “legacy hybrid surplus”, except that the successor hybrid surplus includes only amounts that ultimately derive from capital gains or capital losses in respect of dispositions occurring after June 24, 2024. For more information, see the commentary to the definition “legacy hybrid surplus”.

This definition applies after June 24, 2024.

“successor hybrid underlying tax”

The new definition “successor hybrid underlying tax” is relevant for determining the amount deductible by a corporation resident in Canada under new paragraph 113(1)(a.2) of the Act, in respect of a dividend paid out of the successor hybrid surplus of a foreign affiliate of the corporation. This definition is structured similarly to the new definition “legacy hybrid underlying tax”, except that the successor hybrid underlying tax includes only tax and tax refunds associated with amounts that ultimately derive from capital gains and losses in respect of dispositions occurring after June 24, 2024.

For more information, see the commentary to the definition “legacy hybrid underlying tax”.

This definition applies after June 24, 2024.

“successor hybrid underlying tax applicable”

The new definition “successor hybrid underlying tax applicable” is relevant for determining the amount deductible by a corporation resident in Canada under new paragraph 113(1)(a.2) of the Act, in respect of a dividend paid out of the successor hybrid surplus of a foreign affiliate of the corporation. For the purposes of paragraph 113(1)(a.2) of the Act, new paragraph 5900(1)(c.3) of the Regulations prescribes the foreign tax applicable to the portion of a dividend prescribed to have been paid out of the successor hybrid surplus of the affiliate, by reference to the successor hybrid underlying tax applicable.

The successor hybrid underlying tax applicable, in respect of a corporation, to a whole dividend paid at any time is the proportion of the successor hybrid underlying tax of the affiliate at that time in respect of the corporation that the portion of the whole dividend deemed to have been paid out of the affiliate’s successor hybrid surplus in respect of the corporation is of the affiliate’s successor hybrid surplus at that time in respect of the corporation.

This definition applies after June 24, 2024.

“hybrid underlying tax applicable”

The definition “hybrid underlying tax applicable” is amended to provide that the hybrid underlying tax applicable to a whole dividend is the sum of the legacy hybrid underlying tax applicable to the whole dividend and successor hybrid underlying tax applicable to the whole dividend. These amendments are consequential to the introduction of the definitions “legacy hybrid underlying tax applicable” and “successor hybrid underlying tax applicable”, as well as the related amendments to subsection 113(1) of the Act and subsection 5900(1) of the Regulations. For more information, see the commentary to subsection 5900(1) and the definitions “legacy hybrid underlying tax applicable” and “successor hybrid underlying tax applicable”.

This amendment applies to dividends paid after June 24, 2024.

ITR
5907(1.01)

Existing subsection 5907(1.01) provides that, for the purposes of section 113 of the Act, “exempt surplus”, “hybrid surplus” and “taxable surplus” have the meanings assigned by subsection 5907(1).

Subsection 5907(1.01) is amended to similarly provide that “legacy hybrid surplus” and “successor hybrid surplus” have the meanings provided by subsection 5907(1).

This amendment applies after June 24, 2024.

ITR
5907(13)

Subsection 5907(13) prescribes the amount to be added to the foreign accrual property income of a foreign affiliate that immigrates to Canada for the purposes of paragraph 128.1(1)(d) of the Act. Essentially, this rule forces the recognition of the affiliate’s taxable and hybrid surplus immediately before the immigration.

Variable Y of the formula in this subsection, which contains the hybrid surplus component of the prescribed amount, is being amended consequential to the increase of the capital gains inclusion rate from 1/2 to 2/3 and the resulting introduction of legacy and successor hybrid surplus, deficit and underlying tax accounts.

Paragraph (a) of variable Y is being amended to replace references to “hybrid underlying tax” with references to “successor hybrid underlying tax”. This is because any capital gain or loss in respect of a deemed disposition of property under subsection 128.1(1)(b) taking place on or after the effective date of these amendments (June 25, 2024) will necessarily only be capable of giving rise to successor hybrid underlying tax (and not legacy hybrid underlying tax).

Paragraph (b) of variable Y is being amended to split the existing formula for determining the amount that would be the tax-sheltered portion of a distribution of hybrid surplus into two, with variable T.1 representing the legacy hybrid surplus component and variable T.2 representing the successor hybrid surplus component.

ITR
5907(14)

Since variable Q in the formula in paragraph (a) of variable Y in subsection 5907(13) now references “successor hybrid underlying tax” instead of “hybrid underlying tax”, the reference in the preamble of subsection 5907(14) to “hybrid underlying tax” is likewise changed to “successor hybrid underlying tax”.

For more information, see the commentary on subsection 5907(13).

ITR
5907(15)

Since variable S in the formula in paragraph (a) of variable Y in subsection 5907(13) now references “successor hybrid underlying tax” instead of “hybrid underlying tax”, the reference in the preamble of subsection 5907(15) to “hybrid underlying tax” is likewise changed to “successor hybrid underlying tax”.

For more information, see the commentary on subsection 5907(13).

In addition, a typographical error is being corrected by the insertion of the word “is” following the words “the total of all amounts each of which” in the preamble to this subsection.