



## Canadian Tax & Legal Alert

### Parliamentary prorogation: Effect on capital gains inclusion rate and other draft legislation

January 17, 2025

#### Context

On January 6, 2025, the Governor General, on the advice of Prime Minister Justin Trudeau, prorogued Parliament until March 24, 2025. The prorogation results in the termination of a parliamentary session and brings to an end all proceedings before Parliament, including bills which have not yet received Royal Assent.

Budget 2024, released on April 16, 2024, proposed an increase to the capital gains inclusion rate from one half to two thirds for capital gains realized on or after June 25, 2024. An initial Notice of Ways and Means Motion (NWMM), which commences the legislative process for revenue measures, was passed by the House of Commons on June 11, 2024, by a vote of 208 to 118, and a revised NWMM, which addressed various technical changes, was tabled on September 23, 2024. The revised NWMM was not voted on before the prorogation and, as a result, no bill was introduced by the government.

On January 7, 2025, the Canada Revenue Agency (CRA) [announced](#) it would administer the proposed changes to the capital gains inclusion rate based on the proposals included in the revised NWMM, citing its “standard practice”.<sup>1</sup> Proactive relief for interest and penalties was announced for corporations and trusts impacted by these changes that have a filing date on or before March 3, 2025. The CRA also indicated that impacted forms would be expected no later than January 31, 2025, to enable tax compliance.

The Liberal Party of Canada has announced that a new leader will be selected on March 9, 2025, following which Prime Minister Justin Trudeau has indicated his intention to resign as Prime Minister. As of the date of this alert, announced leadership candidates have not formally indicated their intentions regarding the capital gains inclusion rate. In contrast, the Conservative Party of Canada, currently forming the official opposition, announced in a letter to Minister of Finance Dominic LeBlanc on January 14, 2025, that they would “never allow [the capital gains changes] to become law.” Furthermore, while a federal election is required no later than October 20, 2025, many are expecting an election to be called in early spring, based on current comments from various political leaders.

The timing of this series of events has left taxpayers with a difficult choice: (1) file based on the proposed law as outlined in the revised NWMM, or (2) file based on current law, contrary to the CRA’s administrative guidance, with a potential amendment in the event the measures ultimately take effect for gains on or after June 25, 2024.

## **A choice for taxpayers: File based on current or proposed law?**

The CRA’s longstanding administrative position, which asks taxpayers to file returns on the basis of draft and proposed legislation,<sup>2</sup> is intended to “ease both the compliance burden on taxpayers and the administrative burden on the CRA.” However, this administrative practice does not extend to situations where there is an increase in benefits or a significant rebate or refund is at stake. Furthermore, the CRA’s longstanding administrative position is that they “generally speaking [...] will not reassess if the initial assessment was correct in law.”<sup>3</sup> It remains to be seen how the administration of the proposed changes, as announced in the January 7, 2025 press release, would affect the potential reassessments for those that choose to file on the basis of current law.

The choices for taxpayers will be subject to further consideration to the extent that taxpayers may have undertaken internal capital gain crystallization transactions before June 25, 2024, including when accompanied with potential tax deferral elections. The fact profiles in these cases will vary and specific tax advice will be required based on the scope of the transactions undertaken.

## **Individuals**

For individuals with capital gains realized on or after June 25, 2024, to the extent that gains are less than \$250,000, an additional capital gains reduction is available equal to one sixth of the total amount of capital gains, resulting in an effective inclusion rate of 50%.<sup>4</sup> In other words, should a taxpayer file on the basis of the proposed law and the changes are not ultimately adopted, while an individual’s tax payable would not change, the presentation on the tax return would change.

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<sup>1</sup> The CRA has longstanding administrative guidance which asks taxpayers to file returns on the basis of draft and proposed legislation announced by the Department of Finance.

<sup>2</sup> The CRA’s administrative position has been stated on various occasions and most recently restated at the 2022 Roundtable at the Canadian Tax Foundation’s annual conference.

<sup>3</sup> Ibid.

<sup>4</sup> The \$250,000 limit on capital gains includes certain stock option benefits which benefit from similar treatment.

Given the number of individuals who report capital gains and that very few were expected to pay more taxes as a result of the proposals,<sup>5</sup> we would hope that the CRA could adopt a practical administrative approach to minimize broad individual reassessments in the event the measures did not pass.

Individuals will be required to file their personal tax return by April 30, 2025, with self-employed individuals filing no later than June 15, 2025. Given that the vast majority of individuals will have no financial effect from the proposed changes, a prudent approach is for individuals to file on the basis of the draft legislation, consistent with the CRA's administrative recommendation. This approach would align taxpayers with the disclosure approach in the forms expected from the CRA in the coming weeks.

For individuals who are financially affected by the increase, there are two alternatives:

- **File on the basis of the existing legislation, and file an amendment in the event the changes are enacted.** Manual adjustments to the tax return may be required to ensure correct disclosure, which could result in post assessment questions from the CRA. This approach may result in interest should the changes be enacted.
- **File on the basis of the proposed legislation, and file an amendment in the event the changes are not enacted.** Interest could be mitigated by either paying the proposed tax and requesting a refund, or alternatively, paying the proposed tax in the 2025 instalment account and applying it against 2025 individual instalments, to the extent these are otherwise required. This approach may result in delays in obtaining refunds.

## Corporations

For corporations with capital gains realized on or after June 25, 2024, there is no \$250,000 exemption to effectively implement the existing inclusion rate, and all gains will be subject to the higher inclusion rate.

Corporations are required to file their corporate tax returns within six months of their fiscal year ends. As a result, corporations with taxation years ending between June 25, 2024, and July 17, 2024, have already had a filing deadline which includes potential capital gains. The number of corporations affected grows by the day.

As a result, all corporations with capital gains have the same alternatives facing affected individuals, as noted above. Calendar year taxpayers will not need to make the decision regarding the presentation of gains realized on or after June 25, 2024, on their tax returns until June 30, 2025, however tax payments are typically due by February 28, 2025, thus requiring more immediate consideration of the amount of tax to be paid. Corporations wishing to manage exposure to interest may choose to pay on the basis of the higher inclusion rate by February 28, 2025, and determine their filing approach when more information is known.

In addition, there are various corporate tax attributes which are computed with direct or indirect reference to the taxable capital gains realized. For example, the balance in a corporation's non-eligible refundable dividend tax on hand (NERDTH) may change a corporation's dividend refund resulting from the payment of a taxable dividend, and in turn, the amount of Part IV tax payable by the recipient of a taxable dividend from a connected corporation.

Corporations paying a capital dividend must also decide whether to make a payment based on the existing inclusion rate, or the new inclusion rate. Should a capital dividend be paid based on the existing inclusion rate, in the event the legislation is ultimately enacted, there is a risk of an excessive capital dividend, giving rise to Part III tax at 60% of the excess. Therefore, a conservative approach would be to pay the capital dividend based on the lower inclusion rate, with a subsequent capital dividend once there is legislative certainty. Alternatively, taxpayers may choose to pay a higher capital dividend based on the

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<sup>5</sup> Budget 2024 estimated that 40,000 individuals would have higher tax payable as a result of the changes, largely given the \$250,000 mechanism. For context, the CRA indicated that approximately 3.7 million individual taxpayers reported a taxable capital gain in 2021, based on the Income Statistics 2023 (2021 tax year).

lower inclusion rate and require shareholders to proactively concur to an election pursuant to subsection 184(4) of the *Income Tax Act*<sup>6</sup> which has the effect of recharacterizing the excess amount of the capital dividend to a taxable dividend.

Corporations which are claiming the small business deduction will need to consider the impact of the proposed legislation on their adjusted aggregate investment income, which includes taxable capital gains. To the extent that the prior year adjusted aggregate investment income of an associated group exceeds \$50,000, the available small business deduction will be reduced, and is completely eliminated at \$150,000. Therefore, choices made in 2024 filings may, for some taxpayers, impact determinations in the subsequent years which may necessitate amendments.

Finally, the NWMM contains other corresponding adjustments, including the impact on debt forgiveness calculations, the amount of depreciable basis in the event of an acquisition from a related party that has realized a capital gain, and certain rules involving the tax consequences of transactions with foreign affiliates, including the determination of foreign accrual property income (FAPI). This would extend to the calculation of surplus pools and may impact the ultimate disclosure on broader compliance such as T1134s.

## **Trusts and partnerships**

Trusts and partnerships have accelerated filing deadlines, to enable unitholders, beneficiaries or partners, as the case may be, to report the capital gains in their respective returns by their filing deadlines. Generally speaking, for calendar year end trusts and partnerships, this will result in a March 31, 2025, filing deadline for many.

In its most recent guidance for trusts and partnerships, the CRA directed taxpayers to separately identify capital gains and losses realized before June 25, 2024 (Period 1) and those realized on or after June 25, 2024 (Period 2) when reporting capital gains in the returns. The identification of the gains between each period is achieved by providing additional information on the T3 or T5013 slips which are issued to the unitholders, beneficiaries or partners.<sup>7</sup>

While partnerships do not pay income tax, certain trusts may choose to pay tax as opposed to making distributions to their unitholders or beneficiaries. To the extent that income is distributed to unitholders or beneficiaries, filing in accordance with the current law, as opposed to the proposed changes, can in some cases have an impact on the income reported by other taxpayers. As a result, many partnerships and trusts may choose to file on the basis of the proposed rules, consistent with the CRA's administrative position, to leave the decision to the ultimate taxpayer. This may be done, notwithstanding that proposed tax measures are only enforceable in the event that Parliament actually passes the legislation in the same form as the NWMM.

## **Mutual fund trusts and publicly listed partnerships**

Publicly listed investment trusts and partnerships are required to make a disclosure of the breakdown of their taxable income on a central website, CDS Innovations, no later than 60 days after the end of the taxation year,<sup>8</sup> to enable the filing of trust returns and information slips to unitholders. This year's deadline is March 3, 2025, given that March 1 is on a Saturday.

In the event a fund files on the basis of the proposed legislation, it must determine whether to calculate its taxable capital gains by period using the actual allocation method or an elective method based on the number of days in each period resulting in a deemed allocation.<sup>9</sup> The choice will not only impact the fund's taxable income, but will impact the allocation between periods which is disclosed to unitholders.

Finally, should a fund file on the basis of the proposed legislation and the legislation does not ultimately pass, there may be circumstances where the capital gains allocated to beneficiaries may change, which may occur in situations where the fund

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<sup>6</sup> *Income Tax Act* (Canada), RSC 1985, c. 1 (5th Supp.) as amended (hereinafter the "Act").

<sup>7</sup> Trusts will report in Code 52 (gains from dispositions occurring before June 25, 2024) and Code 53 (gains from dispositions occurring on or after June 25, 2024).

<sup>8</sup> Regulations 204.1 and 229.1.

<sup>9</sup> Proposed subsection 104(21.4).

may have certain combinations of expenses or loss carryforwards. This would require the fund to refile their tax returns and reissue the T3 slips.

## Dispositions of taxable Canadian property

Where certain Canadian property is disposed of by a non-resident of Canada, the non-resident is required to notify the tax authorities of the disposition, and purchaser is obligated to withhold and remit certain amounts to the CRA to ensure the ultimate collection of potential taxes payable by the non-resident. This process applies to the disposition of Canadian real or immovable property, equity instruments of certain entities which derive their value from real property, Canadian resource properties or timber resource properties, and is administered through section 116 of the Act.

Historically, the withholding obligation has been set at 25%, with an additional 12.875% for properties located in Quebec. The withholding obligation of 25% approximated the income tax applicable for an individual at a notional 50% marginal rate multiplied by a 50% capital gains inclusion rate.

The NWMM increased the withholding amount from 25% to 35% for dispositions realized on or after **January 1, 2025**. For further alignment, Revenu Québec has proposed to increase its withholding tax rate from 12.875% to 17.167%. To the extent there is a withholding requirement, purchasers would be advised to continue to withhold at the proposed rates to manage their liability. While the withholdings are ultimately refunded upon the filing of the Canadian returns, this can introduce a cash flow burden. This may require additional negotiation of the terms of escrow arrangements in the context of comfort letters.

## Stock option changes and payroll impacts

The NWMM confirms that the tax treatment for holders of stock options will be dependent on when the underlying option is exercised, or in the case of a Canadian-controlled private corporation (CCPC) share, when the share is disposed of or exchanged.

Employers have an obligation to withhold taxes when amounts are paid based on prescribed amounts, including the determination of stock option benefits. Employers may reduce withholdings for the portion that is deductible pursuant to paragraphs 110(1)(d) or 110(1)(d.01) of the Act. Given that the deductible portion has been reduced from 50% to one third, employers may withhold at the higher amount for any relevant transactions that occur on or after June 25, 2024.

Employers may choose to withhold at the existing stock option inclusion rate as opposed to the proposed stock option inclusion rate which has various advantages and disadvantages. This topic was described in detail in our [alert](#) dated May 6, 2024 and further discussion was provided in our [document](#) dated November 12, 2024.

Regardless of the withholding approach, the T4s issued by the employer must specify the period when the stock option benefit was realized. These T4s are required to be filed no later than February 28, 2025.

## Financial reporting impacts

Corporations measure current and deferred assets and liabilities, including those arising from capital gains, based on rates which are substantively enacted for generally accepted accounting principles (GAAP) purposes. Substantive enactment requires that legislative changes have passed Third Reading in the House of Commons where a minority government is present.

While the NWMM was tabled in the House of Commons, it did not result in legislation that received Third Reading. Therefore, the changes are not considered substantively enacted for GAAP purposes as of December 31, 2024. The eventual timeline for achieving this is unclear.

## Other tax measures

While the focus of many in the tax community is on the proposed changes to the capital gains inclusion rate, numerous tax measures were included in draft legislation released on August 12, 2024. In addition, the government announced certain proposed tax measures in the 2024 Fall Economic Statement, generally prospectively from December 16, 2024.

The more notable and broadly applicable items include:

- **An increase to the lifetime capital gains exemption to \$1,250,000** for gains realized on or after June 25, 2024, on the disposition of qualified small business corporation shares and qualified farm and fishing property. Given that this proposal was included in the NWMM, it is reasonable that taxpayers should apply this increase consistent with their approach on the capital gains inclusion rate. However, even though filing on the basis of this proposal aligns with CRA's administrative practice, given that this is a net benefit, a more conservative approach is to exclude the impact of the higher deduction in computing the taxable income at the individual level.
- **The Canadian Entrepreneurs Incentive**, which would further reduce the inclusion rate to one third on a lifetime maximum of \$2 million in eligible capital gains realized after 2024.
- **Proposed amendments to the *Global Minimum Tax Act (GMTA)***, including the implementation of the undertaxed profits rule (UTPR) for taxation years that begin on or after December 31, 2024. Note that the financial reporting impacts discussed above may affect (and distort) annual effective tax rate determinations under the GMTA if, for example, capital gains inclusion rate increases were to become law.
- The introduction of **certain exemptions from the Excessive Interest and Financing Expenses Limitations (EIFEL) rules** for certain regulated utility providers and owners of purpose-built housing units. These changes would take effect concurrently with the introduction of the EIFEL rules.
- **Accelerated capital cost allowance for purpose-built rental buildings** that began construction on or after April 16, 2024, and before January 1, 2031, and become available for use before January 1, 2036.
- **Immediate expensing for certain productivity-enhancing assets**, including those in Class 44, Class 46 and Class 50 for assets acquired on or after April 16, 2024, and before January 1, 2027.
- An **extension of the capital cost allowance accelerated investment incentives**, effective January 1, 2025.
- **Proposed enhancements and reforms to the Scientific Research and Experimental Development (SR&ED) program** effective for taxation years that begin on or after December 16, 2024.

Finally, on December 30, 2024, the Minister of Finance announced an extension of the deadline for charitable donations which would be eligible for credit on 2024 individual tax returns to February 28, 2025.

## How can Deloitte help?

Deloitte professionals will continue to monitor the legislative process and additional details for the changes to the capital gains inclusion rate.

Additional details regarding Budget 2024 can be found in our [Budget Alert](#), with additional details regarding the Fall Economic Statement found [here](#).



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