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SEPTEMBER 2024

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Spotlight on recent changes to the taxation of capital gains and employee stock options

Caitlin Morin, Toronto

The Government of Canada's announcement in the 2024 federal budget to increase the inclusion rate for capital gains realized after June 24, 2024 came as a surprise to many. Taxpayers who expected to be impacted and their advisors had just over two months from the time of the announcement to consider and implement any planning opportunities that were available in anticipation of the change.

Related measures were also announced in the 2024 federal budget, including a new capital gains incentive for entrepreneurs and a reduction of the employee stock option deduction. In addition, the 2024 federal budget announced that the lifetime capital gains exemption would be increased to apply on up to \$1.25 million – from \$1,016,836 in 2024 – of eligible capital gains for dispositions that occur after June 24, 2024.¹

In June 2024, draft legislation to implement the measures was tabled, and the Department of Finance released two backgrounders. These documents cover the main features of the proposed changes to the capital gains inclusion rate, as well as the reduction of the employee stock option deduction and several other related amendments. In August 2024, revised legislative proposals were released for consultation; final legislation is expected in the fall.²

In this article, we provide a high-level overview of these proposed changes to help you understand their impact on your income tax liability for 2024 and beyond. In next month's edition, we'll take a closer look at how the capital gains proposals will apply in specific situations.

¹ The proposed increase in the lifetime capital gains exemption and the proposed Canadian entrepreneurs' incentive are outside the scope of this article. For details on these measures, refer to [EY Tax Alert 2024 Issue No. 24](#) and [EY Tax Alert 2024 Issue No. 33](#).

² For details on the draft legislative proposals released on August 12, 2024, refer to [EY Tax Alert 2024 Issue No. 42](#) and [EY Tax Alert 2024 Issue No. 45](#).

How is the capital gains inclusion rate changing?

When you sell property, the difference between the adjusted cost base and net proceeds you receive is normally considered a capital gain or loss. Since October 18, 2000, only half of the capital gain or loss realized on the disposition of property was included in calculating a taxpayer's income – therefore, a 50% inclusion rate.

However, the 2024 federal budget and corresponding draft legislation introduced an increase in the capital gains inclusion rate from one-half to two-thirds for corporations and most trusts, and by the same amount on the portion of capital gains realized in the year that exceed \$250,000 for individuals and some trusts for capital gains realized on or after June 25, 2024.³

If you sold or expect to sell property after June 24, 2024, you should be aware of the following details:

- ▶ **\$250,000 threshold** – This threshold operates as an annual capital gains reduction that effectively reduces the inclusion rate to one-half on capital gains, net of any capital losses for the year, up to \$250,000. The \$250,000 reduction can also be applied against employee stock option benefits realized in the year by an individual; however, the total reduction on a combined basis cannot exceed \$250,000 (see “How is the employee stock option deduction changing?” below for further discussion). Any unused portion of the \$250,000 threshold cannot be carried forward.

In addition to individuals, graduated rate estates (GREs) and qualified disability trusts (QDTs) are also eligible for an effective one-half inclusion rate on the first \$250,000 of capital gains realized in the year, provided the gains are not allocated to a beneficiary in the year. The \$250,000 threshold also applies to capital gains brought into income from a capital gains reserve or allocated by a partnership or trust.

Individuals, GREs and QDTs will not be permitted to average capital gains realized over multiple years to remain below the \$250,000 annual threshold to benefit from the lower capital gains inclusion rate. As well, the threshold cannot be shared with or allocated to corporations or other trusts.

- ▶ **Net capital losses** – You may carry net capital losses back three years and forward indefinitely to offset capital gains of other taxation years. A capital loss realized when a different inclusion rate applied can still fully offset an equivalent capital gain realized in a year during which another inclusion rate applied.⁴

If you – or a GRE or QDT – are subject to multiple capital gains inclusion rates in a particular year because the \$250,000 annual threshold has been exceeded, net capital losses from previous years applied in the current year will effectively be applied first to offset capital gains subject to the higher inclusion rate.

Special rules apply in respect of the application of net capital losses in an individual's tax return for their year of death.

- ▶ **Allowable business investment losses (ABILs)** – ABILs are the portion of certain business investment losses that may be deductible against income, such as employment, business and property income.⁵

Unlike the treatment of net capital losses carried forward, ABILs will not be subject to an adjustment to account for the inclusion rate for the taxation year in which the loss is claimed. Business investment losses incurred before June 25, 2024 will be included in computing ABILs at a one-half inclusion rate, even if the ABIL is applied in a period after June 24, 2024.

Similarly, business investment losses incurred after June 24, 2024 will be included in computing ABILs at a two-thirds inclusion rate, even if the amount is carried back to a period before June 25, 2024.

³ The proposed measures do not provide for an annual inflationary adjustment (or indexation) of the \$250,000 threshold.

⁴ This is achieved by having an adjustment factor applied to the net capital losses of other taxation years when used in the current taxation year to be offset against capital gains.

⁵ Generally, a business investment loss is a loss from the disposition to an arm's-length person of shares or debt of a corporation that is a small business corporation at any time in the preceding 12 months. ABILs may be carried back three years and carried forward 10 years, after which time the loss reverts to an ordinary net capital loss, which may be carried forward indefinitely to offset capital gains only.

- ▶ **Principal residence exemption** – The principal residence exemption will continue to be available, allowing for capital gains realized on such dispositions to be exempt from capital gains taxes where all relevant conditions are met.
- ▶ **Québec harmonization** – For Québec income tax purposes, the provincial tax legislation will be harmonized with changes to the taxation of capital gains in the *Income Tax Act* (the Act).

Example of the proposed changes to the capital gains inclusion rate

Sharon is a resident of British Columbia. She purchased a cottage in 2004 for \$200,000. She is the sole owner of the cottage and did not designate the property as a principal residence in any year of ownership.

In 2024, Sharon sells the cottage for \$750,000, resulting in a capital gain of \$550,000. She has no other capital gains and no capital losses for the 2024 taxation year. Her 2024 employment income is \$105,000, and she has no other income and no deductions from income. The only nonrefundable credit she is entitled to claim in 2024 is the basic personal amount.

Here’s how Sharon’s taxable income on the sale of the cottage under the rules for the taxation of capital gains that apply before June 25, 2024 and after June 24, 2024 would be calculated:

| | Cottage is sold before June 25, 2024 | Cottage is sold after June 24, 2024 |
|--|--------------------------------------|--|
| Capital gain | \$550,000 | \$550,000 |
| Capital gain inclusion rate | 50% | <ul style="list-style-type: none"> ▶ 50% on the first \$250,000 ▶ 66.67% on the portion that exceeds \$250,000 |
| Taxable capital gain | \$275,000 | \$325,000 |
| Employment income | \$105,000 | \$105,000 |
| Total income | \$380,000 | \$430,000 |
| Federal and provincial income tax ⁶ | \$153,956 | \$180,706 |
| Effective tax rate | 40.51% | 42.02% |

In the example above, by selling the cottage after the effective date of the increased capital gains inclusion rate, Sharon would have an additional \$50,000 of taxable income. The increase in the capital gains inclusion rate would result in an extra \$26,750 of income tax being payable.

If Sharon owned the cottage jointly with another individual, they would each have access to their \$250,000 threshold.

2024 transitional year

As the new capital gains inclusion rate rules are generally effective on or after June 25, 2024, this results in the need for special rules for taxation years that start before and end on or after June 25, 2024 (i.e., a “straddle year,” such as a typical January 1, 2024 to December 31, 2024 taxation year).⁷

To assess your income tax liability for a taxation year that straddles June 25, 2024, you will need to separately identify capital gains and losses realized before June 25, 2024 (Period 1) and after June 24, 2024

⁶ Federal and provincial income tax was calculated using [EY’s 2024 Personal Tax Calculator](#).

⁷ Special rules that apply to capital gains reserves for taxation years that straddle June 25, 2024, and with respect to partnerships, trusts and mutual fund corporations with fiscal periods that straddle June 25, 2024, are outside of the scope of this article.

(Period 2). Gains and losses from Period 1 and Period 2, respectively, will then be netted against each other to arrive at a net gain or loss for each period.

The annual \$250,000 threshold for individuals, GREs and QDTs is fully available – that is, it is not prorated – in 2024, and it applies only in respect of net capital gains realized in Period 2 less any net capital losses from Period 1.

The following table illustrates how the inclusion rate is determined for taxation years that straddle June 25, 2024:

| Taxpayer scenario | Transitional inclusion rate |
|--|--|
| Only net capital gains, or only net capital losses, in each of Period 1 and Period 2 | $(1/2 \times A + 2/3 \times B) \div (A + B)^*$ |
| Net capital gains and net capital losses are nil for the year | 2/3 |
| Net capital gains in Period 1 exceed net capital losses in Period 2 | 1/2 |
| Net capital losses in Period 1 exceed net capital gains in Period 2 | 1/2 |
| Net capital gains in Period 2 exceed net capital losses in Period 1 | 2/3 |
| Net capital losses in Period 2 exceed net capital gains in Period 1 | 2/3 |

** A is the taxpayer's net capital gains or net capital losses, as applicable, from dispositions of property in Period 1. B is the taxpayer's net capital gains or the net capital losses, as applicable, from dispositions of property in Period 2.*

Special rules also apply in determining the amount of the net capital gains or net capital losses that arise in each period, which make the rules for the transitional year very complex.

Reach out to your EY or EY Law advisor for assistance in applying these rules to your specific situation. For further details and other information about the proposed changes to the capital gains rules, refer to [EY Tax Alert 2024 Issue No. 33](#), [EY Tax Alert 2024 Issue No. 42](#), and [EY Tax Alert 2024 Issue No. 45](#).

Disposition of taxable Canadian property

Nonresidents are generally subject to Canadian income tax on capital gains realized on the disposition of taxable Canadian property.⁸ To ensure the CRA collects any Canadian taxes resulting from a taxable Canadian property disposition, the nonresident vendor must notify the CRA of the disposition no later than 10 days following the date of disposition, and pay the CRA the required withholding tax (or provide acceptable security).

Where these requirements are met, the CRA will issue a clearance certificate to the nonresident vendor and the purchaser. If a clearance certificate is not obtained, the purchaser is generally required to withhold and remit a portion of the proceeds as tax on behalf of the nonresident.

⁸ For greater certainty, nonresidents are subject to Canadian income tax on Canadian-source income generally. Taxable Canadian property generally includes real property situated in Canada, property used in a business carried on in Canada and interests in certain entities deriving a specified proportion of their value from Canadian real property or resource properties. If you're a nonresident disposing of Canadian property, consult your EY Tax advisor to navigate the complicated rules.

Under draft legislative proposals, the applicable withholding rate for nonresidents disposing of certain types of taxable Canadian property will be increased from 25% to 35% for dispositions that occur after December 31, 2024.

The increased withholding tax is intended to reflect the approximate increase in the combined federal and provincial taxes payable for capital gains subject to the highest marginal personal tax rates.

How is the employee stock option deduction changing?

If you've acquired shares under an employee stock option plan, the excess of the value of the shares on the date you acquired them over the price you paid for them is included in your income from employment as a stock option benefit.

When the corporation is not a Canadian-controlled private corporation (CCPC), the benefit is generally included in your income in the year you acquire the shares. If you've acquired CCPC shares under an employee stock option, the benefit is normally taxed in the year you dispose of or exchange the shares, rather than in the year you acquired them.

Until recently, one-half of the stock option benefit included in income generally qualified for a deduction, provided certain conditions were met.⁹ This resulted in stock options that met the necessary conditions effectively being taxed at the same rate as capital gains, when capital gains were subject to a one-half inclusion rate.

To reflect the proposed increase in the capital gains inclusion rate, draft legislative proposals reduce the employee stock option deduction to one-third of the stock option benefit for stock options exercised after June 24, 2024. In the case of CCPC stock option benefits, the stock option deduction is reduced to one-third where the acquired share is disposed of or exchanged after June 24, 2024.

However, you may be able to claim an increased deduction of one-half of the stock option benefit up to a combined annual limit of \$250,000 for both employee stock options and capital gains. The annual \$250,000 threshold applies only in respect of net capital gains realized and stock options exercised – or, in the case of CCPC options, where the acquired share is disposed of or exchanged – after June 24, 2024.¹⁰

If your total employee stock option benefits and capital gains exceed \$250,000 in a taxation year, you will be able to choose the allocation of the preferential tax treatment – that is, the lower capital gains inclusion rate and higher stock option deduction – between the capital gains and the stock option benefit.

For Québec income tax purposes, the provincial tax legislation will be harmonized with changes to the taxation of employee stock options in the Act, such that where the one-half deduction rate applies, it will be reduced to one-third of the amount of the benefit. In addition, the one-third deduction will be calculated on the portion of the benefit that exceeds the combined annual limit of \$250,000 for both stock options and capital gains.¹¹

What's next?

If you're looking to sell your investments, or if your employer has granted you stock options, make sure you understand how the proposed changes to the taxation of capital gains and employee stock options apply to your situation.

If you would like to understand the potential implications of these measures in greater detail, please reach out to your EY or EY Law advisor.

⁹ Generally, if the exercise price is no less than the fair market value of the shares at the date the option is granted, and certain additional conditions are met, you can claim the deduction. These rules are modified in the case of CCPC stock options. As well, recent amendments generally limit the availability of the stock option deduction to an annual maximum of \$200,000 of stock option grants that vest in a calendar year, subject to certain exceptions.

¹⁰ To the extent these net capital gains are not offset by a net capital loss incurred before June 25, 2024.

¹¹ For Québec income tax purposes, the rate of the employee stock option deduction is generally one-quarter. However, a one-half deduction is available in limited circumstances. The one-quarter deduction rate will not be changed.

Court grants relief for an individual who did not consent to being named a director

*Vikram Sandhu and Jeanne Posey, Vancouver
Ikenouye v FTA Logistics Inc. et al, 2024 ONSC 3476*

In *Ikenouye v FTA Logistics Inc.*, the Ontario Superior Court of Justice was asked to consider whether Ms. Ikenouye, the applicant, was appointed as a director of a corporation (A Co) without her consent.

The court referenced subsection 250(2) of Ontario's *Business Corporations Act* (BCA), which allows the court to grant an order to rectify a corporation's records if certain conditions are met, as well as section 97 of the *Courts of Justice Act*, which allows the court to grant declaratory relief in certain circumstances.¹²

The court focused on the election and appointment of directors of a corporation, which is governed by section 119 of the BCA.

Facts and issue

In October 2019, the applicant received a collection letter from the the CRA regarding the respondent's unpaid taxes. The applicant was the daughter of the respondent's sole shareholder and, upon receipt of the letter, informed her father she had received it with the expectation that he would address it.

The applicant took no further action since she was not aware that she was a director of A Co on the basis that she had never, to her knowledge, been appointed.

In July 2023, shortly before her father's death, the CRA contacted the applicant again about the amounts A Co owed in taxes, roughly \$30,000. At this time, the applicant discovered she was listed as a director of A Co and requested her legal counsel file a Notice of Change to remove her from the role.

ServiceOntario indicated that a Notice of Change could not be filed because it would leave A Co without a director. The applicant's only option to avoid the \$30,000 liability was to seek an order to rectify A Co's registers and records, which would remove her as a director on the grounds that she had never consented to the appointment.

The court was asked to consider whether the applicant was appointed as a director without her consent.

Court decision and analysis

In general, if a corporation has failed to remit source deductions, the director listed – in this case, the applicant – is jointly and severally, or solidarily, liable together with the corporation to pay the outstanding amount and any interest and penalties relating to it under section 227.1 of the *Income Tax Act*.

The court was ultimately tasked with determining whether the applicant was truly a director of A Co, and hence potentially liable under *Income Tax Act* section 227.1. This determination was based on whether the applicant was in fact appointed without her consent, contrary to the requirement for a director to provide written consent to their appointment set out in subsection 119(9) of the BCA. If so, the court had to determine if she would be eligible to apply for rectification under subsection 250(1) of the BCA.

BCA subsection 250(2) allows the court to grant a rectification order if the name of a person has been wrongly entered or retained in a corporation's registers or other records. Subsection 250(1) permits the aggrieved person to apply to the court for an order to rectify the records.

The applicant argued that she was wrongly listed in the corporate records and had not consented to being named as a director of A Co. Thus, the applicant applied to the court for an order that the registers and records be rectified to remove her as a director.

¹² R.S.O. 1990, c. B.16.

In the present case, A Co was not able to rectify its records as it was not operational at the time, nor did it respond to the proceedings. As such, the applicant would be required to obtain declaratory relief declaring that the applicant was never a director of the corporation pursuant to section 97 of the *Courts of Justice Act*.¹³

The applicant was appointed a director of A Co without her consent

The applicant filed a Notice of Change with the Court dated August 22, 2023. The document indicated that the applicant's father had appointed both her and her stepsister as directors on November 1, 2006.

In a connected case, *Bunton v FTA Logistics Inc. and Ikenouye*, 2020 ONSC 5463, in which TB, the applicant's stepsister was also appointed a director of FTA without her consent, TB sought similar relief and through a similar procedure was successful in being removed as a director and in rectifying registers and records.

In *Bunton*, the court noted "there must be something more than the mere appearance of an individual's name in the list of directors as evidence of consent to the appointment or election to that position.... Consent in writing is required before the appointment of a director becomes effective...."

While the issues were the same in *Bunton* and the present case, in *Bunton* the applicant and her father remained listed as directors after TB was removed as a director, which did not result in a vacant board of directors as it would have in the present case.

The court found that the applicant was never a director of A Co since there was no evidence or documents, such as articles of incorporation or minutes of any shareholder meetings, that indicated her acceptance of the appointment. This proved the applicant neither consented in writing nor engaged in such a role.

The court granted a declaration that the applicant was never a director of A Co, with orders that A Co and the applicant's father's estate rectify A Co's register and records.

Lessons learned

Corporations are advised to ensure they have sufficient documents and records to support the appointment of directors. Also, directors should be reminded that they can be liable for certain tax liabilities of a corporation pursuant to *Income Tax Act* section 227.1. While the BCA contains some relieving provisions for incorrectly appointed directors, a court order is required to rectify a corporation's records.

Consistent with many other recent cases, it can't be overstated how important it is to maintain correct and clear written documents.

Publications and articles

Tax Alerts - Canada

[Tax Alert 2024 No. 37 - Entry-into-force date set for Canada's Digital Services Tax Act](#)

[Tax Alert 2024 No. 38 - CRA announces a change in position with respect to Regulation 105 withholding tax on subcontractor fees](#)

[Tax Alert 2024 No. 39 - CBSA issues its trade compliance verification list update](#)

[Tax Alert 2024 No. 40 - Amendments to treatment of concessional loans impact SR&ED claims](#)

[Tax Alert 2024 No. 41 - Canada imposes provisional duties on imports of high protein content pea protein from China](#)

[Tax Alert 2024 No. 42 - Finance releases draft legislation for 2024 budget and other measures](#)

¹³ R.S.O. 1990 c. C.43.

[Tax Alert 2024 No. 43 - CBSA announces transition period and a new process for pre-CARM customs adjustments](#)

[Tax Alert 2024 No. 44 - Proposed modifications to the enhanced trust reporting requirements and post-mortem tax planning by a trust](#)

[Tax Alert 2024 No. 45 - Finance releases revised legislative details to implement changes to increase the capital gains inclusion rate](#)

[Tax Alert 2024 No. 46 - Canada proposes the undertaxed profits rule and further amends the GMTA](#)

Additional resources

[Digital services tax - 2024 jurisdiction activity summary](#)

An updated version of EY's DST jurisdiction activity summary is now available. The summary outlines the status, scope, rate, thresholds, exclusions and effective dates for 24 jurisdictions. It also includes links to relevant EY Global Tax Alerts and EY contact details.

EY's activity summary provides the latest information correct as of April 1, 2024.

[EY Climate Cash and Tax Barometer 2022](#)

The EY Climate Cash and Tax Barometer analyzes spending by governments and businesses on policies designed to forward climate goals.

Expanded Green Tax Tracker now available

The EY [Green Tax Tracker](#) provides an overview of the sustainability incentives, carbon pricing regimes and other environmental taxes in effect in an ever-growing number of jurisdictions.

[EY's Worldwide Personal Tax and Immigration Guide 2023-24](#)

Governments worldwide continue to reform their tax codes at a historically rapid rate. Taxpayers need a current guide, such as the Worldwide Personal Tax and Immigration Guide, in such a shifting tax landscape, especially if they are contemplating new markets. The content is straightforward. Chapter by chapter, from Albania to Zimbabwe, we summarize personal tax systems and immigration rules in more than 150 jurisdictions. The content is current as of September 1, 2023, with exceptions noted.

[EY's Worldwide Capital and Fixed Assets Guide 2024](#)

Capital expenditures represent one of the largest items on a company's balance sheet. This guide helps you reference key tax factors needed to better understand the complex rules relating to tax relief on capital expenditures in 30 jurisdictions and territories.

[EY's Worldwide Estate and Inheritance Tax Guide 2024](#)

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[Worldwide VAT, GST and Sales Tax Guide 2024](#)

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[Worldwide R&D Incentives Reference Guide 2024](#)

The Worldwide R&D Incentives Reference Guide offers taxpayers the information necessary to identify and leverage opportunities to benefit from available incentives, especially relevant if they are contemplating new or expanded investments in R&D, innovation and sustainability.

[Worldwide Transfer Pricing Reference Guide 2022-23](#)

This publication is designed to help international tax executives identify transfer pricing rules, practices and approaches.

The information included in the guide covers 123 jurisdictions. It is meant to provide an overview for the covered jurisdictions regarding their transfer pricing tax laws, regulations and rulings; OECD Guidelines treatment; documentation requirements; transfer pricing returns and related-party disclosures; transfer pricing documentation and disclosure timelines; BEPS Action 13 requirements; transfer pricing methods; benchmarking requirements; transfer pricing penalties and relief from penalties; statutes of limitations on transfer pricing assessments; possibility of transfer pricing scrutiny and related audits by the tax authorities; and opportunities for advance pricing agreements (APAs).

The content for the guide is updated as of June 30, 2023.

[EY Center for Board Matters](#)

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EY TradeFlash

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[EY TradeWatch Issue 2, 2024](#)

EY TradeWatch provides information about customs and international trade developments to help you develop strategies to manage duty costs and the risks of global trade, to improve trade compliance and to increase the operational effectiveness of international supply chains.

Websites

[EY Law LLP](#)

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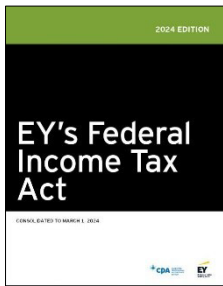
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[Online tax calculators and rates](#)

Frequently referred to by financial planning columnists, our mobile-friendly calculators on ey.com/ca let you compare the combined federal and provincial 2023 and 2024 personal tax bills in each province and territory. The site also includes an RRSP savings calculator and personal tax rates and credits for all income levels. Our corporate tax-planning tools include federal and provincial tax rates for small business rate income, manufacturing and processing rate income, general rate income and investment income.

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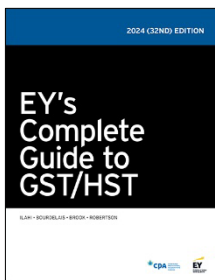


[EY's Federal Income Tax Act, 2024 Edition](#)

Editors: Albert Anelli, Janette Pantry, and Linda Tang

Now available.

Included with this edition: interactive online features and purpose notes for selected provisions. Purchase of a print book includes access to an online updated and searchable copy of the federal *Income Tax Act* as well as the pdf eBook. Consolidated to March 1, 2024, this edition contains amendments and proposals, including December 20, 2023 legislative proposals [2023 fall economic statement measures], Bill C-59, *Fall Economic Statement Implementation Act, 2023*, August 4, 2023 legislative proposals [budget 2023 and other proposals and technical amendments], and Bill C-47 (2023, c. 26), *Budget Implementation Act, 2023, No. 1*.



[EY's Complete Guide to GST/HST, 2024 \(32nd\) Edition](#)

Editors: Jadys Bourdelais, Thomas Brook, Sania Ilahi, David Douglas Robertson

Available October 2024.

Canada's leading guide on GST/HST, including GST/HST commentary and legislation, as well as a GST-QST comparison. Written in plain language by a team of EY indirect tax professionals, the guide is consolidated to July 1, 2024 and updated to reflect the latest changes to legislation and CRA policy.

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