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Tax Alert – Canada

Federal government announces deferred implementation date of the capital gains inclusion rate change

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 31 January 2025, in the midst of mounting pressures from the tax and broader community, the Minister of Finance and Intergovernmental Affairs announced the deferral of the effective date for the proposed capital gains inclusion rate change. More specifically, the federal government intends to introduce legislation to defer – from 25 June 2024 to 1 January 2026 – the date on which the proposed capital gains inclusion rate will increase from one-half to two-thirds on capital gains exceeding $250,000 annually for individuals and on all capital gains realized by corporations and most types of trusts.

The proposed capital gains inclusion rate increase effective 25 June 2024 was included in the 23 September 2024 notice of ways and means motion (September NWMM), which "died" on the Order Paper when Parliament was prorogued on 6 January 2025. For more information, see EY Tax Alert 2025 Issue No. 2, *Impact of prorogation on outstanding income tax proposals*.

On the same day, following the federal government's decision, the Canada Revenue Agency (CRA) announced that it has reverted to administering the currently enacted one-half capital gains inclusion rate. Consequently, unless an exemption applies, all capital gains realized before 1 January 2026 will be subject to the one-half inclusion rate.

The Department of Finance news release also confirmed that the proposed implementation date for the increase in the lifetime capital gains exemption (LCGE) to $1.25 million, effective as of 25 June 2024, and the introduction of the Canadian entrepreneurs' incentive, effective starting in the 2025 taxation year, would not change. The CRA announced that it will continue to administer the proposed increase to the LCGE for dispositions that occur after 24 June 2024.

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CRA guidance on the administration of the proposed capital gains changes

The CRA has provided the following guidance for taxpayers with respect to filing returns.

Individuals and trusts

The CRA will issue updated forms reflecting the one-half capital gains inclusion rate in the coming weeks.

Relief from late-filing penalties and arrears interest will be granted until 2 June 2025 for impacted T1 individual filers and until 1 May 2025 for impacted T3 trust filers.

Corporations

Until further notice, corporations can continue to use existing forms and tax software to file using the one-half inclusion rate.

For those corporations that followed the CRA's guidance to file based on the proposed increase to the inclusion rate effective 25 June 2024, the CRA will coordinate corrective reassessments to reverse the application of the two-thirds inclusion rate.

Other considerations

Various other issues are stemming from the federal government's deferral decision, including the following:

Employee stock option deduction

Consequential on the increase in the inclusion rate for capital gains, proposed amendments were included in the September NWMM to reduce the employee stock option deduction from one-half to one-third of the stock option taxable benefit realized after 24 June 2024. The proposed amendments allowed eligible individuals to claim a deduction of one-half the stock option taxable benefit up to a combined annual limit of $250,000 for both employee stock options and capital gains.

Although not specifically mentioned in the Department of Finance news release or the CRA announcement, we anticipate that the deferral will apply to all consequential changes included in the September NWMM, including the reduction in the employee stock option deduction. We are awaiting confirmation or clarification from the Department of Finance on this point.

Taxable Canadian property

The September NWMM also proposed to increase the applicable withholding tax rate for nonresidents disposing of certain types of taxable Canadian property (TCP) from 25% to 35% for dispositions of TCP that occur on or after 1 January 2025. The increased withholding tax rate was intended to reflect the approximate increase in the highest marginal combined federal and provincial tax rate on capital gains.

At this time, the pending issue awaiting clarification from the Department of Finance is whether the increased withholding tax rate will continue to apply to dispositions that occur after 2024, or if it will be postponed to better align with the effective date of the capital gains inclusion rate increase.

Information slips

Additional areas of uncertainty include whether payers who already have issued information slips based on the proposed increase to the capital gains inclusion rate — or the proposed reduction to the employee stock option deduction — effective 25 June 2024 will be required to amend those slips. Potential impacted information slips include the Form T4, *Statement of Remuneration Paid*; Form T5, *Statement of Investment Income*; Form T3, *Statement of Trust Income Allocations and Designations*; and Form T5013, *Statement of Partnership Income*.

No indication has been provided by the CRA as of yet on that point.

Quebec

Quebec previously announced that it would harmonize with the proposed increase to the capital gains inclusion rate as well as to the reduction in the employee stock option deduction, subject to certain exceptions.

On 3 February 2025, the Quebec Department of Finance announced in Information Bulletin 2025-1, *Harmonization of the Québec tax system with certain measures announced by the Government of Canada and other measure*, that Quebec will harmonize with the federal government's deferral of the effective date of the capital gains inclusion rate increase and with the maintenance of the implementation date for the increase in the LCGE and the introduction of the Canadian entrepreneurs' incentive. The deferral is also announced to apply to related Quebec particularities for which harmonization was previously announced in separate information bulletins (e.g., the reduction in the employee stock option deduction), although no further details were announced.

In addition, at the time of writing, no guidance on how the deferral will be administered by Revenu Québec (e.g., in terms of penalties and interest relief) has been announced.

We will continue to monitor for the release of any additional administrative guidance.

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