The Joint Committee on Taxation of
The Canadian Bar Association
and
Chartered Professional Accountants of Canada
Chartered Professional Accountants of Canada, 277 Wellington St. W., Toronto ON, Canada M5V3H2
The Canadian Bar Association, 66 Slater St., Suite 1200, Ottawa, ON, Canada K1P 5H1

January 22, 2025

Trevor McGowan
Associate Assistant Deputy Minister
Tax Policy Branch
Department of Finance Canada
90 Elgin Street, Ottawa, ON
K1A 0G5

Dear Mr. McGowan:

Subject: Federal Budget 2024 – Capital Gains Inclusion Rate

We are writing to express our concerns on the uncertainty Canadian taxpayers currently face with respect to the proposals made in the Federal Budget 2024 relating to the increase in the capital gains inclusion rate (the "**Capital Gains Proposals**"). The Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada (the "**Joint Committee**") is an apolitical organization committed to collaborating with the Department of Finance on the improvement of the technical provisions of the *Income Tax Act* (Canada) (the "**Act**"). We have previously provided submissions on the Capital Gains Proposals, dated May 1, 2024, which are enclosed as Appendix A.

Since Parliament was prorogued on January 6, 2025, many members of the tax and broader community have expressed concern regarding the uncertainty faced by taxpayers in dealing with the Capital Gains Proposals.[1] While the proposals have yet to be tabled to Parliament in the form of a bill, the Department of Finance and the Canada Revenue Agency (the "**CRA**") have confirmed that the Act will be administered as though the Capital Gains Proposals were enacted.[2] While such an administrative position is generally consistent with the long-standing practice with respect to proposed legislation with retroactive effect, it

[1] See, for example, C. Irvine and J Tobin, "A Kafkaesque Tax Quagmire: Why We Need to Defer or Abandon the Failed Capital Gains Changes", E-brief. Toronto: C.D. Howe institute. January 17, 2025: https://www.cdhowe.org/publication/a-kafkaesque-tax-quagmire-why-we-need-to-defer-or-abandon-the-failed-capital-gains-changes/ (the "**CD Howe Brief**").
[2] Department of Finance emailed statement dated January 7, 2025, as reported by Investment Executive: https://www.investmentexecutive.com/news/industry-news/finance-confirms-cra-will-administer-capital-gains-tax-changes/ and CRA news release dated January 7, 2025 at https://www.canada.ca/en/revenue-agency/news/newsroom/tax-tips/tax-tips-2025/top-changes-affecting-business-taxes-2025.html

is clear that the current situation is distinguishable from the "norm". The Capital Gains Proposals have not been enacted, and the current political situation raises significant uncertainty as to whether the proposals will ever be enacted.[3] This uncertainty is unlikely to be resolved prior to the time at which many taxpayers will be required to pay tax and/or file tax returns for their 2024 taxation years. As an example, corporations (other than certain CCPCs) with a December 31, 2024 year end are required to pay their tax due for 2024 by February 28, 2025 (see the definition of "balance-due day").

Given the excellent analysis undertaken by others, we have not repeated in detail the practical difficulties of complying with the Capital Gains Proposals here; a publication by the C.D. Howe Institute which provides a comprehensive discussion of the issues is attached hereto as Appendix B. Briefly summarized, Canadian taxpayers have two choices:

- Pay tax (and file tax returns) on the basis of existing legislation, and file an amendment with additional tax payable in the event the Capital Gains Proposals are enacted with retroactive effect; OR
- Pay tax (and file tax returns) on the basis of the Capital Gains Proposals, and file an amendment (or object to their own filing position to preserve their rights in this regard) and apply for a refund in the event the Government announces its intention to not proceed with the Capital Gains Proposals.

Neither alternative is satisfactory for the average Canadian taxpayer. The first exposes the taxpayer to the possibility of interest, and to the additional administrative costs of filing amended tax returns. The second causes the taxpayer to potentially overpay tax, with the resulting adverse cash flow implications, and to bear the additional administrative costs of filing amended tax returns and applying for tax refunds. The administrative burden of either approach on the CRA should also not be underestimated. As pointed out by others, such a situation undermines public confidence in the tax system.

We acknowledge that this is not the first time that proposed amendments to the Act have remained outstanding over a year end, or even in the context of a prorogued Parliament. However, the present situation is different, and in particular far more uncertain than is typically the case, and thus warrants a more tailored approach than the simple application of proposed amendments as if they were law.

Recommendations

Our recommendations are as follows:

- **The Government should announce that the Capital Gains Proposals, if enacted, will only be applicable to gains realized after the relevant bill is introduced to Parliament. In the current circumstance, retroactive application is unfair to Canadians.**
- If the above recommendation is not acted upon, the CRA should provide administrative relief by waiving arrears interest and confirming that penalties should not be applicable[4] – until at least

[3] On January 14, 2025, the Conservative Party publicly announced that, if it forms the next Government, the Capital Gains Proposals will not be enacted: https://www.conservative.ca/the-ndp-liberals-must-cancel-their-lawless-capital-gains-tax-increase/#utm_source=rss&utm_medium=rss&utm_campaign=the-ndp-liberals-must-cancel-their-lawless-capital-gains-tax-increase

[4] The non-application of penalties for filing on the basis of current law should not be viewed as an administrative concession.

the date of the introduction of the relevant bill to Parliament – for taxpayers who pay tax (and file tax returns) on the basis of existing legislation.[5]

- Any future bill respecting the Capital Gains Proposals should be modified with respect to certain of the Joint Committee's recommendations made in its earlier submissions, including with respect to: (i) permitting taxpayers to realize a capital gain through filing of an election, rather than requiring a disposition of property; (ii) the application of the $250,000 threshold to private corporations and trusts; and (iii) the ability to carry forward any unused portion of the annual $250,000 threshold.

- The Government should take active steps to introduce legislation in Parliament which would govern the administration of proposed legislation in similar situations in the future and reduce delays in the enactment of tax legislation. Consistent with the procedure used in other jurisdictions,[6] we recommend that such legislation mandate that tax legislation be enacted within a specified period of time from the date of announcement, and that the provisional collection of taxes based on proposed legislation be permitted only where such enactment occurs within the specified period.

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We would like to thank you for your consideration of this submission.

Members of the Joint Committee participated in the discussion concerning this submission and contributed to its preparation, including:

- Byron Beswick – KPMG
- Ryan Minor – CPA Canada
- Anu Nijhawan – Bennett Jones LLP
- Carrie Smit – Goodmans LLP

We trust that you will find our comments helpful and would welcome the opportunity to discuss the submission and our concerns with you at your convenience.

Yours truly,

Byron Beswick	Carrie Smit
Chair, Taxation Committee	Chair, Taxation Section
Chartered Professional Accountants of Canada	Canadian Bar Association

CC: The Honourable Dominic LeBlanc, Minister of Finance and Intergovernmental Affairs

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[5] The current CRA administrative relief applies only to arrears interest and penalty relief for corporations and trusts that have a filing due date on or before March 3, 2025, and, even in those cases, the interest relief expires on March 3, 2025.

[6] Brian J. Arnold, Robert D. Brown, F.C.A., Robert Couzin, Stanley E. Edwards, Q.C., Thomas E. McDonnell, Q.C., and Douglas J. Sherbaniuk, Q.C., "The Canadian Budget Process" (1986) 34:5 *Canadian Tax Journal* 989-1094.

APPENDIX A
Joint Committee Submissions dated May 1, 2024 on the Capital Gains Proposals

THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

CHARTERED PROFESSIONAL ACCOUNTANTS CANADA
COMPTABLES PROFESSIONNELS AGRÉÉS CANADA

The Joint Committee on Taxation of
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Chartered Professional Accountants of Canada, 277 Wellington St. W., Toronto ON, Canada M5V3H2
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May 1, 2024

Robert Demeter
Director General
Tax Legislation Division
Tax Policy Branch
Department of Finance Canada
90 Elgin Street, Ottawa, ON
K1A 0G5

Email: Robert.Demeter@fin.gc.ca

Dear Mr. Demeter:

Subject: Federal Budget 2024 – Capital Gains Inclusion Rate

We are enclosing a submission which considers the changes to the *Income Tax Act* (the "Act") which will be required to implement the proposals made in the Federal Budget 2024 relating to the increase in the capital gains inclusion rate. Our objective in this submission is to raise specific issues and concerns along with suggestions and recommendations provided by the Joint Committee regarding the changes. Given the significance of the proposals to ordinary taxpayers, and the short period before the proposals are intended to become effective, we would appreciate your consideration of the issues as soon as possible.

In addition, this submission sets out the most time sensitive and fundamental issues regarding the proposal. The Joint Committee may make further submissions.

Members of the Joint Committee and others in the tax community participated in the discussion concerning this submission and contributed to its preparation, including:

- Anu Nijhawan – Bennett Jones
- John Oakey – CPA Canada
- Carmela Pallotto – KPMG

- Jeffrey Shafer – Blakes
- Carrie Smit – Goodmans LLP

We would like to thank you for your consideration of this submission. We trust that you will find our comments helpful but would welcome the opportunity to discuss the submission and our concerns with you at your convenience.

Yours truly,

Carmela Pallotto

Carmela Pallotto, CPA, CA
Chair, Taxation Committee
Chartered Professional Accountants of Canada

Carrie Smit
Chair, Taxation Section
Canadian Bar Association

Cc: Trevor McGowan, Associate Assistant Deputy Minister

CBA - CPA Canada Joint Committee on Taxation Submission
Federal Budget 2024 - Capital Gains Inclusion Rate

General comment

The 2024 Federal Budget proposed to increase the capital gains inclusion rate from one-half to two-thirds, for dispositions occurring on or after June 25, 2024. As proposed, corporations and trusts will be subject to the higher inclusion rate on all capital gains while individuals will only be subject to this higher inclusion rate on capital gains realized in a year in excess of $250,000. The delayed effective date, which we understand was designed to provide taxpayers sufficient time to plan their affairs, is insufficient and causes a high degree of uncertainty for taxpayers and their advisors.

Specific comments, addressed below, relate to the following categories:

1. Election to Realize a Capital Gain;
2. Effective Date;
3. Grandfathering;
4. Legislative Amendments Required to Avoid Retroactive Effects;
5. Private Corporations and Integration;
6. Trusts; and
7. Carry Forward of Threshold.

Election to Realize a Capital Gain

We recommend that taxpayers be provided with the ability to realize a capital gain through filing an election, which would deem designated assets to be disposed of for (up to) fair market value proceeds prior to June 25. This elective process would allow taxpayers to realize capital gains without an actual disposition of assets. This election could be filed separately or with the taxpayer's income tax return for the 2024 tax year. We have set out the following reasons to consider an elective process:

- **No draft legislation has been released.** Taxpayers require a level of certainty when planning their affairs, and there are many considerations that should be taken into account before realizing gains through the sale of assets. There is no draft legislation to guide taxpayers, and the draft legislation when released may differ from what is anticipated. The inclusion of an elective process would mean that taxpayers do not need to rush to sell assets and can wait until legislation is available providing a necessary level of certainty. Requiring taxpayers to plan their affairs and potentially enter into irrevocable transactions without draft legislation is unfair and inappropriate.

- **Gain crystallization transactions are difficult for middle-class taxpayers.** Providing taxpayers with the ability to file an election ensures that all taxpayers have an equal opportunity to crystalize capital gains prior to June 25. Furthermore, absent an election, crystallization transactions are not always possible. Some assets cannot be easily liquidated, such as shares in a private company, real estate, or unvested stock options. For assets that can be sold, such as cottages or publicly-traded securities, the pressure to close a disposition transaction before June

25 may distort pricing and put downward pressure on values, causing unintended market impacts and potentially reducing anticipated tax revenues.

- **Simplicity and efficiency** would be attained by permitting taxpayers to file an election. This would avoid significant costs such as professional fees and selling costs, particularly in situations where the sale is only being undertaken to crystallize the gain and the taxpayer wishes to continue to own the asset. The money spent on these costs could be better utilized in other areas that could contribute to the growth and development of the economy.

- **Revenue target** for the fiscal 2024/25 period would not be negatively impacted by an election and could possibly be increased as more taxpayers would have access to tax planning through the more simplified election process. We also recommend that the election process allow taxpayers to elect a deemed disposition price between tax cost and fair market value to provide maximum flexibility. This flexibility could be subject to guardrails such as minimum or maximum deemed realized gains.

We would also recommend that taxpayers filing an election be allowed to pay the resulting tax liability over a period of time. This is consistent with other transitional rules implemented for previously unanticipated taxes.

If the government decides to implement an elective process, we strongly urge that an announcement be made as soon as possible to prevent a mass sell-off and frantic scramble to obtain professional advice and execute transactions before June 25.

Effective Date

It is our understanding that the June 25 effective date was provided allowing taxpayers 10 weeks from the announcement date to plan for the increase in the capital gains inclusion rate and to facilitate in-progress transactions. However, the 10-week period is insufficient to properly plan for many taxpayers. With no draft legislation to follow, transactions during this 10-week period would be executed with an unfair level of uncertainty. As discussed above, we recommend that an elective process be introduced to deal with this uncertainty. Alternatively, or in addition to this process, we recommend the effective date be moved to January 1, 2025 as this would:

- Provide more time for the Department of Finance to draft legislation and have a public consultation, and for the legislation to be enacted;
- Allow taxpayers, at a minimum, to have draft legislation available when planning their affairs. The draft legislation might even be enacted by January 1 giving a much higher level of certainty;
- Be consistent with the legislative changes announced in the 1987 tax reform when the capital gains rate changed to 2/3 on January 1, 1988 and then changed to 3/4 on January 1, 1990. This would provide both the Department of Finance and taxpayers a higher level of certainty given the precedent set for the previous increase;
- Align with existing reporting systems that provide detailed reporting of purchases and sales of assets, costs and fair market values, such as reports provided by financial institutions;
- Provide taxpayers with sufficient time to properly plan their affairs, particularly for assets that are illiquid or do not have a readily available market; and

- Align with the structure of the Act, which is often based on a taxation year (such as partnership and trust income allocations).

Grandfathering

Many taxpayers entered into binding agreements to sell capital property prior to Budget Day. Such agreements may have conditions to closing which are outside the control of the taxpayer (*e.g.,* regulatory approval) and which preclude the disposition occurring prior to June 25, 2024. Such taxpayers entered into their agreements based on the law existing at the time of the agreement and without any notice of a potential change, and the applicable tax rate is often a key driver of the economics agreed to in the binding agreement.

Consistent with grandfathering provisions that Finance has implemented in the case of other legislative amendments, we recommend that the increased capital gains inclusion rate not apply to "*dispositions of property occurring pursuant to legally binding obligations entered into by the taxpayer in writing before April 16, 2024*".

To the extent there are policy concerns with extending grandfathering relief inappropriately, the grandfathering could be limited, including, for example as follows:

- The grandfathering could apply only to legally binding obligations with a person or partnership with whom the taxpayer was dealing at arm's length;
- There could be a loss of grandfathering status if the binding agreement is significantly modified; and
- The grandfathering could apply only to the extent that the disposition cannot occur prior to June 25 due to conditions outside of the taxpayer's control.

Legislative Amendments Required to Avoid Retroactive Effects

The Budget proposals indicate that the increase in the capital gains inclusion rate is to apply to capital gains realized on or after June 25, 2024. We understand that the policy is that capital gains in respect of dispositions of capital property prior to June 25 (**Pre-June 25 Dispositions**) remain subject to the one-half inclusion rate. Members of the Joint Committee have identified several provisions of the Act which will require amendment/clarification to ensure that capital gains realized in respect of Pre-June 25 Dispositions are not inadvertently included in income at the higher inclusion rate. While this is not a comprehensive list, the identified areas include:

- **Capital Gains Reserve** – Various taxpayers have claimed capital gains reserves under subparagraph 40(1)(a)(iii) for Pre-June 25 Dispositions. Subparagraph 40(1)(a)(ii) requires such prior year reserves to be included in computing the taxpayer’s gain for its 2024 taxation year. Any such inclusion which relates to a Pre-June 25 Disposition should be subject to the pre-June 25 one-half inclusion rate. As an alternative, an elective mechanism could be included to permit a taxpayer to bring any prior year reserve into income in 2024 as a Pre-June 25 Disposition.

- **Hybrid Surplus** – Where a taxpayer receives a dividend from a foreign affiliate, paragraph 113(1)(a.1) currently permits the taxpayer a deduction for one-half of a dividend prescribed to have been paid out of hybrid surplus. We assume that the reference to one-half will be altered to one-third for hybrid surplus resulting from capital gains realized by foreign affiliates in respect of dispositions after June 24, 2024. The amendments to paragraph 113(1)(a.1) should include, however, a continuance of the one-half deduction rate for hybrid surplus resulting from capital gains realized by foreign affiliates in respect of Pre-June 25 Dispositions, irrespective of the year such hybrid surplus is repatriated in the form of a dividend. As an alternative to amending paragraph 113(1)(a.1), consideration could be given to creating a new category of hybrid surplus for capital gains realized after June 24, 2024 with a new paragraph 113(1)(a.2) added to provide a deduction for one-third of a dividend prescribed to have been paid from this new category of "post-June 24, 2024" hybrid surplus.

- **Stock Options** – Taxpayers may have exercised stock options granted by Canadian controlled private corporations (**CCPCs**) prior to June 25, 2024. Paragraph 110(1)(d.1) currently provides for a 50% deduction of the section 7 option benefit where certain conditions are satisfied, including that the acquired shares are held for two years. The Budget proposals include an amendment to the 50% rate to be one-third (subject to the $250,000 threshold). The amendments to paragraph 110(1)(d.1) should include, however, a continuation of the 50% deduction rate for CCPC options exercised prior to June 25, 2024, irrespective of the year in which the acquired shares are disposed of.

- **Allocations of Capital Gains of Trusts and Partnerships** – A capital gain recognized by a trust or a partnership prior to June 25, 2024 should retain its status as a capital gain from a Pre-June 25 Disposition when allocated to beneficiaries or members, notwithstanding that this allocation will occur at the end of the fiscal period of the trust or partnership.

- **Mutual Fund Trusts** – Consequential changes will be required to the capital gains refund mechanism for 2024.

Private Corporations and Integration

Incorporation is the normal form of business organization in Canada, allowing for limited liability and facilitating raising capital. As discussed in detail in the Joint Committee's October 2, 2017 submission regarding the taxation of private companies, due to under-integration there is actually no material tax saving to earning active business income or aggregate investment income in a private corporation. Many middle-class Canadian individuals and small business owners indirectly own and operate their businesses through private corporations, including restaurants owners, tech entrepreneurs, doctors, and farmers. Assets accumulated within these corporations are typically used to expand business operations or support the individuals through retirement. In particular, many of these individuals do not have employment pensions to rely on during retirement but rather accumulate investments in their corporations in order to fund what may be 20+ years of retirement.

The $250,000 annual safe harbour granted to individuals allows Canadians to pay tax at a lower rate on a base amount of annual capital gains, reflecting that the purpose of the proposal is increased taxation on only the wealthiest Canadians (the 0.13%). However, with no proposed threshold provided to corporations, many ordinary Canadians who operate their businesses indirectly through private corporations will unfairly lose access to the $250,000 safe harbour. This result does not align with the government's policy intent. There is currently under-integration on capital gains realized by private corporations in every province and territory. Not extending the threshold to private corporations will result in a further increase of under-integration on capital gains between 9.24% and 15.13%.

In order to properly align the government's policy, we believe it is imperative that the rules be drafted to allow Canadian individuals the ability to share their annual $250,000 safe harbour with a private corporation of which they are a (direct or indirect) shareholder. The sharing or transfer of the threshold could be based on the proportionate common share ownership of the private corporation or otherwise. Restrictions could be put in place to ensure double counting would be avoided (similar to the current sharing of the small business deduction limit). Alternatively, the rules could be drafted to allocate a capital gain from a private corporation to individual shareholders, allowing the individuals to utilize their own $250,000 threshold. The Joint Committee would be happy to work with Finance to structure and draft a rule that allows individuals who indirectly hold their assets in a private corporation to fairly benefit from the $250,000 threshold.

Trusts

The $250,000 safe harbour granted to individuals was not proposed to be extended to trusts. This inability for trusts to access the safe harbour threshold will have a negative impact on routine estate planning situations. Examples of the trusts that would be negatively impacted are as follows:

- **Graduated Rate Estate (GRE)** – The administration of an estate typically results in the retention of capital gains in the GRE. This could be a result of planning or due to necessity. Without access to the safe harbour threshold, the increase in the capital gains inclusion rate would result in higher taxes for the estate, which will ultimately affect the beneficiaries, including those in the middle class. We recommend that a GRE should be afforded its own $250,000 threshold to minimize the impact on individual taxpayers.

- **Qualified Disability Trust (QDT) and Henson Trust** – QDTs and Henson trusts are set-up to provide indefinite help for individuals with disabilities. The exclusion of the safe harbour threshold will subject any undistributed capital gains to the increased inclusion rate. We recommend that a QDT and Henson trust should each be afforded their own $250,000 threshold. To avoid duplication of the threshold, the trust and the disabled beneficiary could share the $250,000 threshold.

- **Alter Ego (AE) or Joint Spousal/Partner Trusts (JSP)** - Upon death of the beneficiary or the last surviving spouse beneficiary, the capital gains realized are taxed in the trust. Without the benefit of the safe harbour threshold, the trust would be subject to the increased capital gains inclusion rate. We recommend that AE and JSP trusts should be afforded their own $250,000 threshold. To avoid duplication of the threshold, the trust and the settlor could share the $250,000 threshold.

Given that these trusts are routinely used by many taxpayers to administer or protect their estates or even help manage assets for disabled beneficiaries, we believe that these exceptions align with the government's overall policy.

Carry Forward of Threshold

The $250,000 annual threshold is a meaningful measure to ensure that middle class Canadians are not impacted as heavily by the increase to the capital gains inclusion rate. However, an annual "use-it-or-lose-it" threshold is not well matched to the reality of how this segment of the population often realizes capital gains. For many people, investment portfolios can be stable for long periods of time, without generating material annual capital gains (until, perhaps, larger dispositions are undertaken as individuals enter retirement). Many Canadians also have significant portions of their wealth tied up in large long-term assets, such as small businesses, family farms, real estate, or inherited property. These assets are much more likely to generate very large one-time gains, rather than annual smaller amounts. This is particularly the case where there is a disposition of assets to fund retirement or the deemed disposition of assets realized on an individual's death.

To address the above, we recommend that Canadians be permitted to carry forward unused safe habour amounts. Such a carryforward could be indefinite, but consideration can also be given to time limitations and limitations on the portion of the annual safe harbour available for carryforward.

Finally, to ensure that the $250,000 threshold remains relevant to Canadians, we recommend that the amount be indexed going forward.

APPENDIX B
C.D Howe Brief

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E-BRIEF

January 17, 2025

FISCAL AND TAX POLICY

A Kafkaesque Tax Quagmire: Why We Need to Defer or Abandon the Failed Capital Gains Changes

by John Tobin and Carl Irvine

- The federal government's proposed increase to the capital gains inclusion rate has created a nightmarish scenario for taxpayers.
- The Canada Revenue Agency has been administering the changes since June 25, 2024, as though the proposal is law, even though the government failed to enact the proposal into legislation before Parliament was prorogued.
- With the likelihood of a spring election, taxpayers face a choice: pay at the higher rate now and struggle to recoup overpayments if the measure dies, or follow existing law and risk interest and penalties should it eventually pass.
- The proposed rules affect not only individuals with large gains but also trusts, corporations, and non-residents, creating complex reporting requirements under an uncertain legal framework. Software updates, tax slips, and filing instructions are already being tailored to legislation that does not yet exist. This administrative limbo erodes public confidence in the tax system, as taxpayers and tax preparers struggle with a rule that might never be legally enacted.
- The government should abandon the proposed increase. If it will not, it should delay the effective date to at least January 1, 2025, to spare taxpayers the gamble of filing 2024 returns under a measure that may never pass.
- This deferral would reduce needless compliance costs. If the government insists on retroactive application, the CRA should provide relief by waiving interest and penalties for taxpayers who file under current rules. Canadians deserve a predictable tax system, not one that forces them to hedge bets on unpassed legislation.

In the April 2024 federal budget, the government announced a proposed increase in the portion of realized capital gains that would be included in income for tax purposes (the "capital gains inclusion rate" or CGIR). Specifically, the proposals would increase the CGIR from 50 percent to 66 2/3 percent for capital gains realized on or after June 25, 2024.[1] An unprecedented feature of the

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The views expressed here are those of the authors and are not attributable to their respective organizations. The authors wish to thank Bill Robson, Alexandre Laurin, Daniel Schwanen, Colin Busby, Jeffrey Trossman, Kevin Wark, Shawn Porter, John Oakey, Nick Pantaleo, Don Drummond and anonymous reviewers for helpful feedback on previous versions of the paper, and James Fleming for editing the paper. The authors retain responsibility for any errors and the views expressed.

1 This effective date differed from the approach taken in the late 1980s, the last time the CGIR was increased, when the increased CGIR applied only as of January 1 of the next following year.

proposal was to apply the higher CGIR to individuals only to the extent their gains realized in a particular year exceed $250,000. In contrast, for all other taxpayers, namely corporations and trusts, the higher CGIR applies to all realized gains.[2]

The detailed legislation for the proposed increase in the CGIR was not included with the budget materials (suggesting this controversial measure was inserted late in the budget preparation process), nor was this proposed change included in the first budget implementation bill, which received Royal Assent in June 2024. While detailed draft legislation was later released (and that draft legislation includes over 40 pages of complex consequential changes), and a Notice of Ways and Means Motion (NWMM) was adopted in the House of Commons in September 2024 approving the measure, no bill has ever been tabled in (much less, approved by) Parliament to give effect to the CGIR increase.

With the recent proroguing of Parliament until March 24, 2025, it is clear the proposals will not be enacted into law before many taxpayers must calculate and pay their income tax liabilities for periods affected by the proposed CGIR increase. Furthermore, tax reporting slips will have to be issued and tax preparers will be in the advanced stages of preparing trust, personal and corporate tax returns before Parliament resumes. Meanwhile, the Canada Revenue Agency (CRA) has said it will administer the *Income Tax Act* (ITA) as though the proposals were in effect. This has left Canadian taxpayers in a bizarre and menacingly complex situation – having to decide how to file their taxes in the face of a political proposal that may never become law.

The best solution to this problem would be for the government to drop the proposals altogether. If it cannot or will not drop them, it should delay their effective date until January 1, 2025, at the earliest. Although Parliament is prorogued, the government is still active and it has the ability to announce that the measure will not proceed.

Complex Tax Conundrum, Compliance Nightmare

We are sympathetic to the staff of the CRA and the Ministry of Finance staff who are caught in politics. The Minister of Revenue's decision to enforce the proposals, communicated by the CRA on January 8, 2025, is consistent with a long-standing practice for dealing with proposed legislation with retroactive effect.[3] As noted above, a NWMM was approved in September 2024, but no bill has been presented to Parliament. In more normal times, taxpayers could have high confidence that unenacted retroactive legislation will eventually be enacted and they would voluntarily comply. In light of the overall context, these are not normal times. Prorogation means that any bill to implement the CGIR increase will have to be introduced in the next session of Parliament. It is evident that there is a high likelihood of a spring election and a change of government before enactment of any such bill, and hence a significant likelihood that the capital gains tax changes will never occur.

In this environment, do taxpayers voluntarily report gains at the higher rate now and risk overpaying their taxes if the changes never occur, or do they report under current law and then risk being reassessed and subject to punitive interest on unpaid taxes if the changes are subsequently legislated?

One complicating aspect of this is "legislative authority." The capital gains proposals are not currently law. The law as it exists today is clear. One-half of realized capital gains are included in income for tax purposes, not

2 The proposed measure therefore strangely introduces a new disconnect between the taxation of investment income earned personally rather than through a holding company.

3 https://www.canada.ca/en/revenue-agency/news/newsroom/tax-tips/tax-tips-2025/top-changes-affecting-business-taxes-2025.html.

66 2/3 percent. The increased CGIR will become law only when the relevant legislation passes Parliament and receives Royal Assent. Indeed, it cannot be otherwise. The bedrock principle that taxation may be imposed only by Parliament and not by executive fiat is a fundamental principal of Anglo-Canadian constitutional law dating back to the Magna Carta. But, if they are passed in their current form, they will have retroactive application. So, at least for the moment, compliance with the proposed rules is "voluntary." Such retroactive application would make the tax applicable to 2024 gains and would make the tax payable retroactively.

Another complicating aspect is that there are other rules that are currently law. Trusts (including mutual funds, segregated funds and ETFs) are required to make a return in "prescribed form" and recently announced T3 filing requirements for electronic filing, which "prescribe the reporting requirements" for electronic filing, require a trust to report its various types of pre-June 25, 2024, and post-June 24, 2024, capital gains in separate boxes.[4] This seems to indicate for trusts that are required to file electronically, that CRA will require them to provide the relevant information about when gains were realized (regardless of whether the capital gains rules are enacted effective for dispositions in 2024). We expect that financial institutions will provide whatever information is prescribed. Taxpayers may therefore see many different (and new) boxes on their reporting slips.

Tax reporting software approved by the CRA and used by many tax preparers may not have functionality to be overridden in order to avoid voluntarily paying tax based on the proposed changes. Second, as noted, numerous consequential changes to the ITA flow from the proposed CGIR increase.

While the CGIR increase is presented by supporters of the proposals as an issue only for those few taxpayers who realized more than $250,000 in capital gains, this is simply incorrect, and in fact the measure has much broader application (Mintz 2025). The impact is likely to be visited on hundreds of thousands or even millions of Canadians who, as the familiar phrase goes, risk being "caught in the cogs of a remote, irrational, and soulless bureaucracy" when trying to recover overpaid taxes or fighting interest on retroactively imposed taxes. If slips are produced that report higher gains based on the expectation that the CGIR changes will be enacted for 2024 gains and they are not, how will the CRA unscramble that egg?

The proposals have further implications that exacerbate the dilemma caused by the uncertainty of potential passage. The increased CGIR also affects non-residents who sell certain Canadian real estate or resource properties (including shares and other interest that derive their value from such property), and their counterparties. One consequential change increases the withholding rate under section 116 of the ITA for foreign sellers of Canadian real estate or resource properties from 25 percent to 35 percent effective January 1, 2025. But without that higher rate having been enacted in law, on what legal basis could counterparties withhold at that rate?[5] At what rate should tax be withheld and remitted to the CRA during this protracted period of limbo, the rate currently required in law, or the proposed higher rate? A Canadian who purchases real property from a non-resident today, in compliance with existing law, could potentially be liable for failing to withhold at the proposed rate, as well as

4 See https://www.canada.ca/en/revenue-agency/services/e-services/filing-information-returns-electronically-t4-t5-other-types-returns-overview/upcoming-year-t619/t3-2025.html.

5 We note that while subsection 227(1) of the ITA protects taxpayers who withhold in compliance or intended compliance with the ITA, it is unclear how it would apply here where the higher withholding tax is clearly not contemplated by the ITA. It is worth nothing that the effective date for the higher withholding rate is January 1, 2025, not June 25, 2024. This suggests that the Department of Finance was aware of the difficulties of imposing withholding requirements in the absence of legislative authority and expected (hoped?) that the proposals would be enacted before this provision came into effect precisely to avoid these problems.

to interest and penalties. How can we punish people who comply with the law? And would a foreign tax authority deny a foreign tax credit for taxes that are effectively paid on a voluntary basis? What kind of a message does this chaotic situation send to potential foreign (and Canadian) investors in Canadian real estate or resource properties?

Some have called for administrative relief. The Minister of Revenue has authority to alleviate hardship in the form of fairness. In the absence of any announcement by the government authorities that they plan to defer on these proposals, the Minister of Revenue should exercise her administrative authority to ensure the fair and proper administration of the ITA by announcing that interest and penalties will not apply to any taxpayers who file based on the existing legislation until 90 days after Royal Assent, and that taxpayers who withhold under section 116 based on the current law are not prejudiced The CRA has already announced some relief by deferring interest and penalties on tax filings by corporations and trusts until March 3, 2025.

The CRA's general practice of administering the tax system on the basis of a NWMM may be practical and reasonable when a government has solid support in Parliament (i.e., a majority government,[6] or a minority with a supply arrangement ensuring Parliamentary support) or in respect of proposed legislation containing remedial or uncontroversial technical or "housekeeping" fixes which have high likelihood of being enacted by the next government if not the current one. That is plainly not the case with respect to the highly controversial CGIR proposals.[7] Taxpayers face a substantive (and controversial) change to the tax system advanced by an unpopular government that tried – and failed – to get it passed before prorogation. The degree of uncertainty is beyond normal and taxpayers risk facing serious consequences whatever they do. If they voluntarily pay tax based on the proposed changes, they will be faced with onerous compliance costs in refiling and seeking recovery of overpaid taxes if the measure never becomes law. If instead they file based on current law, they face potentially onerous compliance and interest costs if the measure ultimately is adopted as proposed. Either way, a large number of taxpayers will be faced with inappropriate uncertainty and costs.

Learning from History

Generally, in normal circumstances, it is prudent for taxpayers and the CRA to voluntarily act as if unenacted legislative proposals will be enacted. However, as Michael Lukyniuk, a former Principal Clerk of the House of Commons, observed in a 2011 article in the Canadian Parliamentary Review, "[t]his practice is not supported by any statutory authority but is simply a convention known as the 'provisional implementation of taxation'. Fundamentally, the system is voluntary" (Lukyniuk 2011).

This issue is not new, but it is serious when it arises. Indeed, in the mid 1980s the Mulroney Government acknowledged that the practice of administering proposed tax law without any legislative basis was problematic. In a Discussion Paper released in 1985, the Department of Finance observed that:

6 Note that under accounting rules, during a minority government, proposals are not treated as "substantively enacted" until they have passed third reading. This presumably reflects the uncertainty surrounding tax legislation under a minority government.

7 Some argue that the delays in enacting this legislation lay with the government, which "mismanaged" the proposals by introducing a mid-year implementation date with no "transitional" relief; separating the legislation from "An *Act* to implement certain provisions of the budget tabled in Parliament on April 16, 2024" for what appeared to be political reasons; and allowing the fall session to effectively be shut down by not acceding to a legitimate House procedural request for information on an unrelated matter.

> [T]he absence of statutory authority presents a range of problems – difficulties of enforcement for tax collectors and of compliance for the taxpayer. A number of taxpayers have questioned the propriety and, indeed, the legality of a government seeking compliance with a voluntary system… No taxpayer can be compelled to pay a provisional tax. Taxpayers who provisionally pay taxes do so voluntarily and are under no obligation to comply until the law is passed. It is also inimical to our system of justice and to the Charter of Rights for a taxpayer to be made liable to any offence, criminal or otherwise, for failure to pay a provisional tax. (Canada 1985a.)

Those concerns have not gone away. Indeed, modern tax practitioners will appreciate the timeless lament made in a commentary in respect of the Discussion Paper by leading practitioners of the mid 1980s to the effect that:

> Long delays between a budget and the introduction of implementing legislation, as well as in the enactment of tax changes, have sometimes involved the introduction of new amendments before the previous year's amendments have been disposed of. These delays have led to uncertainty and confusion for taxpayers and for the officials of Revenue Canada who are responsible for administering the tax system. (Arnold et al. 1986.)

To address those concerns, the Discussion Paper proposed legislation which would have provided a foundation for administering proposed tax changes prior to their enactment. The concept of specific legislative support for so-called provisional taxation (i.e., collection of taxes for a period before adoption of definitive legislation) is hardly novel. In the UK, the *Provisional Collection of Taxes Act 1968*[8] specifically authorizes provisional taxation for a limited period of time in certain circumstances. Interestingly, one of the events that may terminate the authority to collect taxes not supported by definitive legislation is the prorogation of Parliament.

In Canada, a statute like the UK one was never enacted. The 1985 draft required that the proposed measure receive first reading in the House of Commons before it could be administered and then imposed a tight timeline for the Minister of Finance to advance the relevant legislation. If it was not enacted within 180 sitting days of introduction, the authority to administer such proposed tax legislation would be *void ab initio*.

This proposal was considered by the House of Commons Standing Committee on Procedure and Organization (the "Standing Committee"), which published a report making a number of recommendations (Canada 1985b). First, it recommended that that taxes should not be collected until implementing legislation had been enacted. Second, it recommended that the authority to administer proposed legislation be limited to those taxation measures which, if not immediately implemented, would result in great loss of revenue for the government. Third, it recommended that the provisional authority to administer proposed legislation be effective for only 120 calendar days from the date on which it received first reading. If the proposed bill was not enacted within that period, the proposed legislation would be considered *void ab initio*. They further recommended that, in that instance, any tax collected by the government based on the proposed legislation that was not enacted in a timely fashion should be returned to taxpayers.

These ideas, however, bore no fruit. So we are left in a situation where the CRA will be administering a tax proposal that has no legal effect and which the CRA has no current authority to enforce while telling Canadians to voluntarily overpay their taxes.

It is interesting to compare the current circumstances to those set forth in the recommendations of the Standing Committee (albeit that were never enacted). The CGIR proposals are not intended to prevent a great loss

8 See https://www.legislation.gov.uk/ukpga/1968/2/contents

of revenue for the government or otherwise protect the integrity of the tax system; in contrast, they give rise to a tax increase. They were not enacted within 120 days of receiving first reading (indeed, they have not even received first reading – no bill was ever introduced to give effect to the proposals). Finally, there is real concern about the ability of the CRA to efficiently refund any excess tax paid by Canadians who chose to file voluntarily on the basis of the proposals if the required legislation never passes. How will the CRA identify those taxpayers in order to reassess them to ensure they only pay the taxes they actually owe? Are they going to reassess everyone who reported capital gains? Will Canadians be forced to seek out their own refunds? Will taxpayers need to protectively file notices of objection to their initial tax assessments, potentially flooding the CRA with a mountain of objections? If investment funds issue slips based on the higher inclusion rate, how will the CRA address the mismatch in reported gains?

Conclusion: Abandon the Proposals – or at Least Defer Them

The uncertainty about the CGIR proposals forces stakeholders to bet on potential outcomes. Having to make such a bet undermines the government's credibility and public confidence in the tax system. As noted above, in normal times, the likelihood of passage of introduced tax legislative changes is close to 100 percent, so it is prudent for taxpayers to fully comply with proposals and for CRA to "provisionally" administer on that basis. As that likelihood drops off, taxpayers will need to decide whether they are better off to file based on the law as it exists on the filing deadline. If they bet correctly, they will have nothing further to do. If they bet incorrectly, they will have to refile and either (i) report more income and pay interest or (ii) claim a refund and receive some partial interest, depending on the direction of the political outcome they bet upon.

Frustratingly, while the prorogation and resulting legislative limbo for the capital gains changes were not foreseeable, the likelihood that the proposals would be unworkable was evident right after the 2024 budget (Robson 2024). With time, moreover, it has become clearer that the changes would affect far more taxpayers than the government claimed, raise less tax revenue than anticipated, and will hurt Canadian investment and incomes (Mintz 2025, Laurin and Dahir 2024).

The most prudent step at this point would be for the government to announce that it will abandon the proposals entirely. Interestingly, the hoped-for spike in government revenues for 2024 may turn out to be realized even if the measure is abandoned, as many taxpayers prematurely realized gains (at the 50 percent CGIR) before the June 2024 effective date. If the government will not abandon the proposal, it should announce that the changes will take effect for dispositions on or after January 1, 2025, at the earliest, thereby preventing the chaotic situation now facing taxpayers for 2024 (with further deferrals for section 116 withholding until such proposals are enacted). Postponing the effective date would give everyone a chance to see whether Parliament ultimately enacts the capital gains taxation proposals in their current form during 2025 (and long before 2025 returns are due). Canadians would not have to bet on the outcome of an election and the policies of an unknown future government when they file their 2024 taxes this spring. Postponing would also eliminate the complications investments funds and other taxpayers face in reporting split tax periods before and after an arbitrary date last June.

Taxpayers need certainty and should not have to bet on political outcomes with retroactive effect. The government should drop or delay changes to capital gains changes now.

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