

Tax filings in uncertain times: Reporting impact of prorogation on proposed two-thirds capital gains inclusion rate

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On Jan. 6th, 2025, Justin Trudeau publicly announced that he will be resigning as the Prime Minister of Canada. On the advice of the Prime Minister, the Governor General of Canada has consequently prorogued, or suspended, Parliament until March 24, 2025.

Uncertainty of a prorogation

Neither of Parliament's two houses sits during a prorogation and any bills that were being debated or studied before prorogation cease to exist. Subject to limited exceptions, this means that draft legislation, such as the legislation increasing the capital gains rate, must be reintroduced as if it had never existed when a new parliamentary session begins. By proroguing Parliament, the Liberal Party of Canada is able to avoid a confidence vote until March 24th, buying themselves more time to run a leadership race.

Capital gains rate changes

In April 2024, the federal government announced an increase to the capital gains inclusion rate (the portion of a capital gain that is included in income for tax purposes) from one-half to two-thirds, effective June 25th, 2024. As a result, many taxpayers implemented pre-June 25th tax planning to crystallize gains and permit them to take advantage of the lower inclusion rate. See a summary of the [changes and tax strategies](#).

On Sept. 23, 2024, the government tabled a notice of [Ways and Means motion](#) to introduce the bill that increased the capital gains inclusion rate for capital gains realized after June 24, 2024 (Capital Gains Draft Legislation). If the Capital Gains Draft Legislation is enacted (as currently proposed) into law when Parliament resumes, it would remain effective as of June 25, 2024 (the date provided for in the original proposals). However, there is a reasonable basis to believe that the current government will fall shortly after prorogation and a new election will follow. A Liberal government under new leadership may also [maintain the one-half inclusion rate](#).

If the Liberal government is replaced by a Conservative government (or a Liberal government under new leadership), it is possible these proposals will never be enacted. Taxpayers have been left with little guidance on how to report their capital gains on their 2024 tax returns by the April 30th filing deadline (or June 30th for Corporations with December 31 fiscal year ends). As a result of this legislative limbo, taxpayers are now left with the following two options:

OPTION 1: Prepare their tax returns using the increased capital gains inclusion rate of two-thirds and (as a result) over-pay taxes in the event that the one-half inclusion rate prevails; or

- Taxpayers could file an amended return and seek a refund if the capital gains rate remains one-half, but the refund would not be issued immediately leaving taxpayers out of pocket for undetermined amounts of time.

OPTION 2: Prepare their tax returns using the one-half inclusion rate but face non-deductible interest and possible penalties if the Capital Gains Draft Legislation is implemented and receives Royal Assent after March 24th, 2025.

Administration by CRA

Despite Parliament's prorogation and the fact that the Capital Gains Draft Legislation has not been enacted into law, the Canada Revenue Agency (CRA) [has indicated](#) that it is going to administer the two-thirds inclusion rate: "consistent with standard practice, the CRA is administering the changes to the capital gains inclusion rate effective June 25, 2024, based on the proposals included in the [Notice of Ways and Means Motion] tabled September 23, 2024. For all taxpayers, the new inclusion rate will apply to capital gains realized on or after June 25, 2024."

Interest and penalties

According to Chapter 12.3.5 of the CRA's Income Tax Audit Manual (Audit Manual), if proposed legislation is not beneficial to a taxpayer, the CRA cannot require a taxpayer to file on the basis of the proposed legislation. In such cases, the CRA must inform the taxpayer that they are responsible to apply the legislation according to the enacted legislation after Royal Assent, and that they may be subject to interest (and possibly penalties) on amounts owing.

The Audit Manual states:

Proposed amendments have no legal effect until they receive royal assent and, as a result, cannot be imposed on the taxpayer. However, as the amendments are generally applied retroactively after royal assent, the taxpayer is responsible for applying the legislation according to the amended legislation after royal assent.

For example, an amendment is effective on the date it is announced, March 31, 2015, but it does not receive royal assent until February 29, 2016. Without the taxpayer's consent, the auditor cannot assess the taxpayer on an amendment-related issue until at least February 29, 2016. However, after royal assent, the

taxpayer's consent is not required and the taxpayer is assessed from the date of announcement. (12.3.4)

...

If the taxpayer does not agree to pay the amendment-related assessment now, send a letter to the taxpayer at the end of the audit. The letter should inform the taxpayer that penalty and interest, if they apply, are applied on any outstanding taxes payable after the date of royal assent. (12.3.11)

...

If an amendment to the ITA is not in the taxpayer's favour, there is no legal basis for an assessment relating to it until the amendment receives royal assent. (12.3.13)

Pursuant to the Audit Manual, penalties are applied from the date of Royal Assent. If applied, late filing penalties are equal to 5 per cent of the balance owing, plus an additional 1 per cent for each full month filed after the due date, to a maximum of 12 months.

With respect to interest rates, if a taxpayer selects Option 2 (prepares tax returns using the one-half capital gains inclusion rate) the interest rate charged by the CRA on overdue taxes is 8 per cent (Q1, 2025). This is higher than the amount a taxpayer would receive as refund interest if they selected Option 1 and reported a two-thirds capital gains rate and subsequently filed an amended return if the capital gains rate remains at one-half. The refund interest rate, if applied, is 4 per cent for corporate taxpayers and 6 per cent for individuals and trusts (Q1, 2025) and is taxable to the recipient.

Given that returns and taxes may be due for corporations and trusts before the updated tax forms are released on Jan. 31st, 2025 (expected date), the CRA has stated that arrears interest and penalty relief, if applicable, will be provided for those corporations and trusts impacted by the Capital Gains Draft Legislation that have a filing due date on or before March 3, 2025. The [interest relief](#) will expire on March 3, 2025.

For more information on this topic, please contact any of the authors or key contacts listed below.

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