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Revised AMT Rules — Review Your Tax Plans Now

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Individuals and certain trusts may have to pay more tax beginning in 2024 as a result of the significant changes to the alternative minimum tax (AMT) rules. Finance recently released draft legislation to enact these AMT changes that were first proposed in the 2023 federal budget. Although the draft legislation generally follows the budget proposals, it also includes some unexpected changes, such as a proposal to increase to 100% the AMT inclusion rate for capital gains on donations of property other than publicly listed securities (from 50%). In addition, Finance's proposals also expand the types of trusts that will not be subject to the AMT rules, to include graduated rate estates, trusts with classes of their units traded on a designated stock exchange, certain investment funds and others. The draft legislation, which was released on August 4, 2023, is proposed to apply for taxation years that begin after 2023. Finance is accepting comments on the draft legislation until September 8, 2023.

Following the release of this draft legislation, individuals and trusts should determine whether they may be affected by the revised AMT rules and model the potential impact on loss utilization, stock option benefits, capital gains (including the lifetime capital gains exemption), utilization of AMT carryovers and charitable giving.

Background
AMT is a parallel tax calculation that allows fewer deductions, exemptions and tax credits than the regular income tax rules. This calculation applies a flat tax rate instead of a progressive rate structure and provides a basic exemption generally to individuals only.

Individuals and trusts must pay AMT or regular tax, whichever is higher. Additional tax paid due to AMT may generally be carried forward for seven years and credited against regular tax to the extent regular tax exceeds AMT in those years.

The 2023 federal budget announced several changes to the calculation of AMT, including measures to broaden the base on which the tax is calculated and increase the AMT rate to 20.5% (from 15%). In addition, the budget provided that the basic AMT exemption, available for individuals, would be equal to the start of the fourth federal tax bracket which is expected to be $173,000 based on anticipated indexation for 2024 (rather than $40,000 under the existing rules).

The budget broadened the AMT base by further limiting tax preferences (i.e., exemptions, deductions, and credits), including to increase the AMT capital gains inclusion rate to 100% (from 80%). In addition, the budget specified that capital loss carryforwards would apply at a 50% rate, and 100% of employee stock option benefits would be included in the AMT base. Under these proposals, allowable business investment losses (ABILs) would be determined in the same manner as under the regular rules (i.e., an ABIL is equal to 50% of a business investment loss). No changes were proposed to the inclusion rate for capital gains eligible for the lifetime capital gains exemption, which would remain at 30%.

The budget also included 30% of capital gains on donations of publicly listed securities in the AMT base. The 30% inclusion rate would also apply to related employee stock option benefits to the extent that a deduction is available because the underlying securities are publicly listed securities that have been donated.

In addition, the budget broadened the base by disallowing 50% of certain deductions and expenses, including non-capital loss carryovers, and deductions for limited partnership losses of other years, among several other deductions. The budget also provided that only 50% of non-refundable tax credits would be allowed to reduce the AMT, subject to limited exceptions.

The budget further noted that the government would continue to examine whether additional types of trusts should be exempt from AMT. The budget stated that the changes would come into force for taxation years that begin after 2023.

For more information, see *TaxNewsFlash-Canada* 2023-17, "2023 Federal Budget Highlights".

Additional changes to AMT base and exemption

In addition to the changes proposed in the 2023 federal budget, the draft legislation increases the AMT inclusion rate for capital gains on donations of property other than publicly listed securities to 100% (from 50%). For example, as a result of this change, individuals and trusts would have to include 100% of the capital gain on a donation of land or private company shares in the AMT base, whereas only 50% of the gain has to be included under the existing rules.

The draft legislation also increases the AMT inclusion rate for gains from listed personal property and capital gains allocated by trusts to beneficiaries to 100% (from 80%). To match the increased AMT inclusion rate for capital gains allocated by trusts, the draft legislation allows trusts to deduct 100% of capital gains allocated to beneficiaries from their AMT base (rather than 80% under the existing rules).

The draft legislation further specifies that non-refundable tax credits for AMT purposes, which will be 50% deductible, now include the pension tax credit, disability tax credit transferred from a dependant, certain tax credits transferred from a spouse (or common-law partner) and tuition tax credit transferred from a child or grandchild.

In addition, the draft legislation specifies that qualified disability trusts will be eligible for the basic AMT exemption.

For a summary of the draft changes to the AMT base, see the table in the Appendix.

KPMG observations
Due to the significant changes to the AMT rules, individuals and trusts that intend to make substantial charitable donations after 2023 may have to pay more tax. As a result, these taxpayers should revisit whether they may be affected and consider the structuring of their charitable giving. In particular, these taxpayers should evaluate the impact of the decrease in the deductibility of non-refundable tax credits (which includes the donations tax credit) for AMT purposes, as well as the increases to the AMT inclusion rates for:

- Capital gains on donations of property other than publicly listed securities
- Capital gains on donations of publicly listed securities
- Employee stock option benefits to the extent that a deduction is available because the underlying securities are publicly listed securities that have been donated.

Excluded trusts

The draft legislation also expands the types of trusts that will be excluded from the AMT rules for taxation years beginning after 2023. Specifically, the following trusts will also be excluded from the AMT rules if they are (throughout the taxation year):

- A graduated rate estate
- A trust governed by any of the following types of plans:

- A deferred profit-sharing plan
- A pooled registered pension plan
- A registered education savings plan
- A registered pension plan
- A registered retirement income fund
- A registered retirement savings plan
- A tax-free savings account
- An employee profit sharing plan
- A registered supplementary unemployment benefit plan
- A first home savings account

- A trust where all (or some) of the classes of its units are traded on a designated stock exchange
- An investment fund as defined in subsection 251.2(1) of the *Income Tax Act* (unless the trust is an investment fund as part of a transaction or series of transactions where one of the main purposes is to avoid AMT)
- A trust that meets all the following conditions:
  - All the trust's beneficiaries are exempt from AMT (or are trusts where all their beneficiaries are exempt from AMT)
  - The trust's trustee(s) may only add beneficiaries that are exempt from AMT (or are trusts where all their beneficiaries are exempt from AMT)
  - All the trust's interests are fixed interests
  - The trust is irrevocable
- A trust that is otherwise exempt from Part I tax
- A communal religious organization.

We can help

The draft revised AMT rules are complex, and your KPMG adviser can help you determine whether you are affected by these proposals and how they may apply to your unique situation. For more details on these rules, contact your KPMG adviser.

Appendix

Summary of Draft Changes to AMT Base on August 4, 2023

Items Affecting AMT Base	Draft AMT Rules	Existing AMT Rules
Capital gains	Include 100%	Include 80%
Gains from listed personal property	Include 100%	Include 80%
Capital loss carryforwards	Deduct 50%	Deduct 80%
Allowable business investment losses	Deduct 50% of business investment losses (BILs)	Deduct 80% of BILs
Employee stock option benefits to the extent that a deduction is available	Include 100%	Include 80%
Capital gains on donations of publicly listed securities	Include 30%	No inclusion
Employee stock option benefits to the extent that a deduction is available because the underlying securities are publicly listed securities that have been donated	Include 30%	No inclusion
Capital gains on donations of property other than publicly listed securities	Include 100%	Include 50%
Capital gains allocated by trusts to beneficiaries	Include 100%	Include 80%
Trust deduction for capital gains allocated to beneficiaries	Deduct 100%	Deduct 80%
Certain employment expenses	Deduct 50%	Deduct 100%
Deductions for Canada Pension Plan (CPP)/Quebec Pension Plan contributions on self-employed earnings, enhanced CPP contributions and Quebec parental insurance plan self-employed premiums	Deduct 50%	Deduct 100%
Moving expenses	Deduct 50%	Deduct 100%
Child care expenses	Deduct 50%	Deduct 100%
Disability supports deduction	Deduct 50%	Deduct 100%
Deduction for workers' compensation payments	Deduct 50%	No deduction
Deduction for social assistance payments	Deduct 50%	No deduction
Deduction for Guaranteed Income Supplement and Allowance payments	Deduct 50%	No deduction
Deduction for Canadian Forces and police for designated international missions	Deduct 50%	No deduction

Appendix Cont'd

Summary of Draft Changes to AMT Base on August 4, 2023

Items Affecting AMT Base	Draft AMT Rules	Existing AMT Rules
Interest and financing expenses incurred to earn income from property Note that this does not affect other existing AMT provisions that continue to apply to limit the deduction of interest and financing expenses for specific purposes (i.e., rental property, film property, resource property and tax shelters)	Deduct 50%	Deduct 100%
Deduction for limited partnership losses of other years	Deduct 50%	Deduct 100%
Non-capital loss carryovers	Deduct 50%	Deduct 100%
Northern Residents deduction	Deduct 50%	Deduct 100%
Non-refundable tax credits (subject to limited exceptions) Note that the donations tax credit is a non-refundable tax credit	Credit 50%	Credit 100% No credit for pension tax credit, disability tax credit transferred from a dependant, certain tax credits transferred from a spouse (or common-law partner) and tuition tax credit transferred from a child or grandchild