

Budget 2023 and changes to the Alternate Minimum Tax

What is Alternate Minimum Tax (“AMT”)?

The AMT is a separate tax system which is designed to ensure that wealthy individuals (including certain trusts) with high gross preferential incomes (such as dividends, capital gains) who might otherwise use various deductions and credits to significantly reduce their tax liability still pay a minimum amount of tax.

AMT operates parallel with the regular tax system and taxpayers subject to AMT are required to compute their annual tax liability under the regular method and the AMT method and must then pay the higher of the two calculated tax amounts.

For instance, AMT could apply where a taxpayer claims the Lifetime Capital Gains Exemption (“LCGE”) on the sale of their Qualified Small Business Shares (“QSBC”) or claims significant deductions from investments such as flow through shares.

AMT paid in a given year in excess of regular tax may be carried forward seven years and can be deducted from the ordinary tax liability that is in excess of AMT liability if certain conditions are met. If these credits are not utilized, then the AMT becomes a permanent tax liability instead of a prepayment of tax.

How is AMT calculated?

The AMT calculation consists of four main elements:

- **AMT Base** – this is the starting point and is determined by adding back certain tax credits and deductions which were allowed under the regular income tax calculation.
- **AMT Exemption** – the exemption is a certain amount subtracted from the AMT base which serves as a threshold, allowing certain income levels to be exempt from the AMT calculation.
- **AMT Rate** – this is a fixed percentage applied to the adjusted AMT base after deducting the AMT exemption. This represents the additional tax owed under the AMT system.
- **AMT Tax Credits** – after calculating the AMT amount, certain non-refundable tax credits are applied to lower the taxpayer’s AMT liability.

Thus, the AMT calculation begins by calculating the AMT base, net of the AMT exemption, and then applying the AMT Rate. The resulting tax is reduced by certain non-refundable tax credits to determine the individual’s AMT for the year.

Proposed changes to the AMT calculation beginning in 2024

Budget 2023 proposes the first major changes to the AMT since its introduction in 1986 with the stated goal of “ensuring the wealthiest Canadians pay their fair share.”

As part of the proposed changes, the rate of AMT is set to increase from the current 15% to 20.5% federally. This aims to ensure that taxpayers subject to AMT pay a higher amount in taxes. Provinces also have AMT, which is generally a percentage of the federal AMT. This article is about the changes to federal AMT and does not deal with the provincial AMT.

Simultaneously, to reduce the impact on middle-income taxpayers, the basic exemption amount available to individuals and certain trusts is proposed to raise from the current \$40,000 to \$173,000 (indexed to inflation annually), thus targeting high income earners more specifically.

In addition to the above, other proposed changes affecting AMT are:

- increasing the capital gain inclusion rate from 80% to 100%;
- increasing the capital gain inclusion rate for donated publicly listed securities from 0% to 30%;

- maintaining the 50% inclusion rate for capital loss carryovers and business investment losses (in other words, the capital gains inclusion rate would increase from 80% to 100%, and the inclusion rate for capital losses and business investment losses would be reduced from 80% to 50%);
- maintaining the inclusion of 30% of gains offset by the LCGE (under the current AMT, the LCGE is not adjusted to reflect the 80% inclusion rate for capital gains);
- denying the entire employee stock option deduction so that stock option benefits are included at 100%;
- increasing from 0% to 30% the stock option benefit associated with donated publicly listed securities;
- disallowing 50% of the deductions for: interest and carrying charges, limited partnership losses of other years, non-capital loss carryovers, employment expenses (other than those incurred to earn commission income), CPP, QPP, and provincial parental insurance plan contributions, moving expenses, child-care expenses, disability supports, workers' compensation and social assistance payments, and guaranteed income supplement payments, northern residents, Canadian armed forces personnel and police;
- reducing most basic minimum tax credits by 50%.

Illustrations

Example 1 – Sale of property not eligible for LCGE

Suppose Jim sells capital property with a fair market value of \$1,000,000 and an adjusted cost base of \$200,000, realizing a capital gain of \$800,000. This is his only income for the year. The table shows the tax calculations:

Description	Regular Tax	Current AMT calculation	New AMT calculation
Taxable Capital Gains	\$ 400,000.00	\$ 400,000.00	\$ 400,000.00
AMT Base			
Capital Gains Inclusion (30%/50%)	\$ -	\$ 240,000.00	\$ 400,000.00
AMT Exemption	n/a	\$ (40,000.00)	\$ (173,000.00)
Adjusted Taxable Income	\$ 400,000.00	\$ 600,000.00	\$ 627,000.00
Tax/AMT Rate	Graduated Rates	15%	20.50%
Taxes payable before tax credits	\$ 107,743.63	\$ 90,000.00	\$ 128,535.00
Basic personal tax credit @ (15% x \$14,139) reduced by 50% under new AMT legislation	\$ (2,120.85)	\$ (2,120.85)	\$ (1,060.43)
Regular Tax/AMT Payable	\$ 105,622.78	\$ 87,879.15	\$ 127,474.58

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In the proposed scenario, the AMT is higher as entire capital gains is included in calculating taxable income and only 50% of basic personal amount tax credit is allowed.

¹ The start of the fourth bracket at \$173,000 in 2024 implies an estimated indexation factor of 4.58% for 2024. For consistency, this factor is used to index all the brackets including basic personal amount for 2024 in the calculations.

² As per footnote above, the following are the federal tax brackets for 2024:

Tax Bracket	Taxable Income Range	Tax Rate
First	-	55,803 15.00%
Second	55,803	111,605 20.50%
Third	111,605	173,007 26.00%
Fourth	173,007	246,469 29.00%
Fifth	246,469	- 33.00%

³ The graduated tax and AMT payable calculations are approximate and only include the basic personal amount tax credit.

Example 2 – Sale of property eligible for LCGE

Suppose Jim sells the shares of his private corporation resulting in a capital gain of \$800,000. The shares are determined to be QSBC shares and Jim has never claimed LCGE before. The table below shows the tax calculations:

Description	Regular Tax	Current AMT calculation	New AMT calculation
Taxable Capital Gains	\$ 400,000.00	\$ 400,000.00	\$ 400,000.00
AMT Base			
Capital Gains Inclusion (30%/30%)	\$ -	\$ 240,000.00	\$ 240,000.00
LCGE	\$ (400,000.00)	\$ (400,000.00)	\$ (400,000.00)
AMT Exemption	n/a	\$ (40,000.00)	\$ (173,000.00)
Adjusted Taxable Income	\$ -	\$ 200,000.00	\$ 67,000.00
Tax/AMT Rate	Graduated Rates	15%	20.50%
Taxes payable before tax credits	\$ -	\$ 30,000.00	\$ 13,735.00
Basic personal tax credit @ (15% x \$14,139) reduced by 50% under new AMT legislation	\$ (2,120.85)	\$ (2,120.85)	\$ (1,060.43)
Regular Tax/AMT Payable	\$ -	\$ 27,879.15	\$ 12,674.58

Under current AMT rules, 30% of capital gains eligible for the lifetime capital gains exemption are included in the AMT base. The government proposes to maintain this treatment resulting in Jim paying lower AMT.

Example 3 – Donations

In continuation of example 1, let's assume Jim makes a charitable donation worth \$400,000. The table below shows the tax calculations:

Description	Regular Tax	Current AMT calculation	New AMT calculation
Taxable Capital Gains	\$ 400,000.00	\$ 400,000.00	\$ 400,000.00
AMT Base			
Capital Gains Inclusion (30%/50%)	\$ -	\$ 240,000.00	\$ 400,000.00
AMT Exemption	n/a	\$ (40,000.00)	\$ (173,000.00)
Adjusted Taxable Income	\$ 400,000.00	\$ 600,000.00	\$ 627,000.00
Tax/AMT Rate	Graduated Rates	15%	20.50%
Tax/AMT before reduction of tax credits	\$ 107,743.63	\$ 90,000.00	\$ 128,535.00
Tax Credits			
Personal Tax Credit	\$ (2,120.85)	\$ (2,120.85)	\$ (1,060.43)
Donation Tax Credit	\$ (94,104.00)	\$ (94,104.00)	\$ (47,052.00)
Regular Tax/AMT Payable	\$ 11,518.78	\$ -	\$ 80,422.58

Under the proposed rules, Jim would be subject to AMT, however, no AMT under the current rules. This result is due to the higher capital gain inclusion in the AMT base, the increase in the AMT rate, and the 50% reduction in the AMT tax credits.

Example 4 – Donation of publicly listed securities

Suppose Jim has \$500,000 of employment income and publicly listed securities worth FMV of \$1,200,000 and ACB of \$400,000 resulting in an accrued capital gain of \$800,000. He then donates these securities to a charity. The table below shows the tax calculations:

Description	Regular Tax	Current AMT calculation	New AMT calculation
Employment Income	\$ 500,000.00	\$ 500,000.00	\$ 500,000.00
Capital gain on donated publicly listed shares (30% x \$800,000)	\$ -	\$ -	\$ 240,000.00
AMT Exemption	n/a	\$ (40,000.00)	\$ (173,000.00)
Adjusted Taxable Income	\$ 500,000.00	\$ 460,000.00	\$ 567,000.00
Tax/AMT Rate	Graduated Rates	15%	20.50%
Tax/AMT before reduction of tax credits	\$ 138,623.00	\$ 69,000.00	\$ 116,235.00
Tax Credits			
Personal Tax Credit	\$ (2,120.85)	\$ (2,120.85)	\$ (1,060.43)
Donation Tax Credit	\$ (119,584.00)	\$ (119,584.00)	\$ (59,792.00)
Regular Tax/AMT Payable	\$ 16,918.15	\$ -	\$ 55,382.58

The inclusion of 30% of the capital gain on donated publicly listed securities and the reduction of the AMT tax credits by 50% results in higher AMT under the proposed measures.

Conclusion

The federal AMT payable under the proposed rules may be significantly higher than the current rules, even though the basic exemption will be increased, it is expected that it will affect very few taxpayers as whole, however, we expect this will affect several of our clients.

Individuals impacted by the changes may need to devise an effective plan in case they are unable to recover the AMT paid in the seven carryforward years. One strategy to mitigate the implications could be to potentially transfer the assets to a corporation as AMT is not applicable to corporations. The proposals, if passed into law, would come into effect beginning in 2024.

July 2023

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