

Federal Budget 2024: New AMT Discourages Individuals Leveraging Investments



WESTWARD'S VIEWPOINT

The media frenzy over the federal budget's announcement to increase the capital gains inclusion rate may have distracted attention from the AMT changes that could also impact personal financial planning.

In most cases, AMT has historically applied some additional tax to large **one-time** capital gains with the likelihood that the AMT will be recovered within the seven year carry forward recovery period.

The budget's AMT changes effective January 1, 2024 now tax a portion of **recurring** deductions and in particular 50% of otherwise deductible interest expense on investment loans.

Individuals with recurring deductible interest must start income tax planning now for 2024 and beyond.

Start by having your tax advisor model 2023 taxable income under the 2024 AMT rules. For variable rate loan interest, do a second model at half the 2023 interest expense to evaluate a future "best case" scenario when interest rates stabilize.

If AMT applies, obtain tax advice about options to restructure income sources to reduce or eliminate AMT. Increasing employment bonuses and reducing dividends may alleviate AMT for some taxpayers.

In some cases, AMT may require restructuring individual debt as corporate debt or simply paying down individual debt.

Westward clients with individual loans secured by life insurance policies must evaluate the suitability of the leverage going forward under the new AMT. We will be contacting our clients and their tax advisors to assist with the AMT evaluation.



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WHAT IS AMT?

Alternative Minimum Tax ("AMT") has been around since 1986¹. Federal AMT recalculates an individual's federal income tax² by:

1. Adjusting taxable income by removing specified tax preferences from the usual taxable income calculation ("ATI"), and
2. Substituting marginal tax brackets and tax rates with a flat tax rate on ATI above a specified threshold.

Federal AMT = 15% x (ATI - \$40,000) – eligible tax credits

The taxpayer pays the higher of federal AMT and federal tax otherwise payable. If federal AMT applies, provincial AMT is calculated as a percentage of the federal AMT in excess of tax otherwise payable and added to provincial tax otherwise payable³.

AMT paid in excess of tax otherwise payable can be recovered in the following seven years to the extent that regular tax exceeds AMT.

AMT does not apply in the year of death.

BUDGET CHANGES TO AMT

Effective January 1, 2024, the AMT formula is changed to:

Federal AMT = 20.5% x (ATI - \$173,000) – 50% of eligible tax credits⁴

Significant ATI Components	Regular Tax	AMT Pre-2024	AMT Post-2023
1. Taxable portion of capital gains on:			
a) donations of publicly listed shares	0%	0%	30%
b) donations of other property	50%	50%	100%
c) all other capital gains <\$250,000	50%	80%	100%
d) all other capital gains >\$250,000	67%	80%	100%
2. Dividends			
a) Taxable portion	Gross-up	Actual	Actual
b) Dividend tax credit	Allowed	None	None
3. Taxable portion of employment bonuses			
	100%	100%	100%
4. Interest expense allowed			
	100%	100%	50%
5. Donation tax credit allowed			
	100%	100%	80%

In summary, the substantive impacts of the new AMT:

- increase the tax exempt income threshold from \$40,000 to \$173,000,
- increase the flat federal tax rate from 15% to 20.5%,
- increase the portion of capital gains subject to tax,
- reduce the deductibility of interest by 50%, and
- reduce the donation tax credit by 20%.

1. The AMT rules are in sections 120.2 and 127.5 to 127.55 of the *Income Tax Act*.

2. "Individuals" includes most trusts and estates with some exceptions and most trusts cannot claim the income threshold exemption. The Budget eliminates AMT for estates.

3. For example, provincial AMT rates as a % of federal AMT in excess of federal tax otherwise payable are 33.7% in BC, 35.0% in AB and 33.67% plus surtax in ON. Quebec has its own AMT regime and intends to follow the federal AMT changes.

4. Some eligible tax credits retain partial or full tax preference.

