Capital Gains Exemptions for Small Businesses

One of the initiatives that make starting a small business in Canada so attractive is the existence of the *Lifetime Capital Gains Exemption* (LCGE). Essentially what the LCGE does is allow Canadian residents to receive certain capital gains tax-free, up to a lifetime limit of $750,000. This means that LCGE-eligible individuals can save tens, if not hundreds of thousands of dollars on their lifetime tax bill.

Entrepreneurs should be aware of the LCGE and how to utilize it when they are starting their business. There are a number of criteria that must be satisfied in order to allow an individual to claim the LCGE. Planning for the LCGE in advance is important to ensure that you will be able to meet these criteria.

In order to claim the LCGE, you must first realize a capital gain. A capital gain occurs when you dispose of an asset whose value has increased since you acquired it.

Currently, 50% of capital gains are taxable. This means that if you buy shares in a company for $100 and sell them for $200, you will be taxed on 50% of this gain, or on $50. The amount of tax you pay depends on your marginal tax bracket. However, if your asset sale qualifies for the LCGE, you will pay no tax on that sale.

The LCGE is only available for dispositions of certain types of property, though for tech entrepreneurs, only one type is relevant: shares in a qualified small business corporation (QSBC). In order for a sale of shares to qualify for the LCGE as a QSBC, the following requirements must be met:

- At the time of sale, it was a share of the capital stock of a small business corporation and was owned by you, your spouse or common-law partner, or a partnership of which you were a member

- In the 24 months before the sale, it was a share of a Canadian-controlled private corporation (CPCC) and more than 50% of the fair market value of the assets of the corporation were used mainly in an active business carried on primarily in Canada

- In the 24 months before the sale, no one other than you, a partnership of which you were a member, or a person related to you owned the share

In order to qualify as a Canadian-controlled private corporation, a corporation must meet the following requirements:

- It is not controlled directly or indirectly by one or more non-resident person, by a public corporation, or by a corporation that sells shares on a stock exchange outside of Canada. If the three classes of stock holders listed above were owned by one person, that person would not have a controlling stake in the corporation

- No class of shares is listed on a stock exchange

- The corporation is resident in Canada

Understanding these requirements and structuring your corporation in a way that you can comply with them can save you a tremendous amount of money later in life. There are a number of tax-planning advantages associated with having your own corporation, of which the LCGE is one. Speaking to a lawyer and an accountant who specializes in tax matters early on in your businesses' life can help you ensure that you will be able to make use of these tax advantages when the time comes.