



A Brief Overview of the Lifetime Capital Gains Exemption

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Since it was first introduced in 1984, the lifetime capital gains exemption has been subject to many changes. Currently, the exemption allows a taxpayer to shelter from tax the capital gain from the sale of their farm or fishing property, or shares in a qualifying business. Obviously, the ability to receive a six-figure sum free of tax means that the capital gains exemption can be an extremely lucrative tax planning tool for those who can benefit from it. Thus, if you are a farmer or business owner, this exemption could be very valuable

to you in the future. This article will provide you with a general overview of the basic rules of the lifetime capital gains exemption.

Small Business Corporation Shares

If you sell shares in a small business corporation, you may be able to shelter up to nearly \$1 million worth of capital gains from tax. You can claim a lifetime capital gains exemption of \$971,190 (in 2023) in respect of capital gains realized on the disposition of qualified small business corporation shares. The dollar amount is indexed to inflation annually. Since the capital gains inclusion rate is 50%, the current lifetime exemption for taxable capital gains is \$485,595 (i.e., 50% of \$971,190).

In order for a share to be a “qualified small business corporation share”, the following criteria must be met:

- The shares must be shares of a Canadian-controlled small business corporation which, at the time of disposition, uses 90% or more of its assets either directly in an active business carried on in Canada or as a holding company for such a corporation. The 90% measurement is based

on the fair market value of all assets at the time of disposition.

- The shares must be owned by the taxpayer, the taxpayer's spouse or common-law partner, or a partnership related to the taxpayer.
- The shares must not have been owned by anyone other than the taxpayer or a related person during the 24 months preceding disposition. The death of the individual does not mitigate the 24-month requirement.
- Throughout the 24-month holding period, at least 50% of the assets of the corporation must have been used principally in an active business, or to finance a "connected" active business.

While these criteria may appear simple at a glance, many of the terms mentioned have their own technical criteria that must be met in order for a share to be a qualified small business corporation share. Simply put, it's complicated. To ascertain whether the shares of your corporation will qualify, it is recommended that you seek professional guidance.

Exemption for Gains From Qualified Farm or Fishing Property

If you are in the business of farming or fishing, this section is relevant for you. Gains on qualified farm or fishing property qualify for an exemption limit of \$1 million. When the indexed dollar amount discussed above eventually exceeds \$1 million, the exemption for farming or fishing property will be the higher amount. Since the capital gains inclusion rate is 50%, the current lifetime exemption for taxable capital gains is \$500,000 (50% of \$1 million) for the disposal of qualified farm or fishing property.

"Qualified farm or fishing property" comprises real property or a fishing vessel used in the course of carrying on the business of farming or fishing in Canada, a share of the capital stock

of a family farm or fishing corporation, an interest in a family farm or fishing partnership, and Class 14.1 depreciable property used in the course of carrying on the business of farming or fishing in Canada. The property must meet several criteria for the owners of the property, the users of the property, and the use of the particular property.

In order to qualify for the exemption at a particular time, the property must be owned at that time by the individual, the spouse or common-law partner of the individual, or a family farm or fishing partnership in which the individual or their spouse or common-law partner has an interest. Furthermore, the property must be used in the course of carrying on a farming or fishing business in Canada by the following eligible users:

- the individual;
- if the individual is a personal trust, a beneficiary of the trust that is entitled to receive any income or capital of the trust;
- a spouse, common-law partner, child, or parent of the individual referred to in (i) or the beneficiary referred to in (ii);
- a family farm or fishing corporation, a share of which is owned by any individual referred to in (i) through (iii); or
- a family farm or fishing partnership, an interest in which is owned by any individual referred to in (i) through (iii).

In the case of real or immovable property or a fishing vessel, the property or vessel must have been used principally in the course of carrying on a farming or fishing business. Class 14.1 depreciable property of a farming or fishing business may qualify as qualified farm property or fishing property of an individual if the property was used by the eligible users of qualified farm or fishing property referred to in (i) through (v) (above).

There are two separate rules for determining whether property is considered to be used in the course of carrying on a farming or fishing business in Canada. The first is a general rule requiring the following two-part test be met:

- (1) Throughout the 24-month period preceding the particular time (e.g., the time of disposition), the property must have been owned by the individual, the individual's spouse or common-law partner, child, or parent, or by a partnership an interest in which is a family farm or fishing partnership interest of the individual or the individual's spouse or common-law partner. If the individual is a personal trust, the property must be owned as such by the individual from whom the trust acquired the property, or a spouse or common-law partner, child, or parent of the individual, or a personal trust from which the individual or a child or parent of the individual acquired the property.
- (2) During a period of at least two years during which the property was owned by a qualified owner, the gross revenue of a qualified owner ("Operator") from the farming or fishing business carried on in Canada, in which the property was principally used, exceeded the Operator's income from all other sources in the year. In order to satisfy this requirement, the property must have been owned by a qualified owner for a period of at least 24 months throughout which it was used by a family farm or fishing corporation or a family farm or fishing partnership (specifically, a corporation referred to in (iv) or a partnership referred to in (v) (above)) in the carrying on of the business of farming or fishing in Canada. Additionally, throughout that period the individual referred to in (i), a beneficiary of a personal trust referred to in (ii), or a person referred to in (iii) (above), must have been actively engaged on a regular and continuous basis in the farming or fishing business.

The second rule determines whether a share of the capital stock of a family farm or fishing corporation owned by an individual at a particular time

will qualify as a qualified farm or fishing property. Under this rule, two tests must be met for such a share to qualify:

- (1) Throughout any 24-month period ending before that time, more than 50% of the fair market value of the property owned by the corporation must be attributable to any combination of the following types of property:
 - (i) property that has been used principally in the course of a Canadian farming or fishing business by:
 - (a) the corporation,
 - (b) the individual,
 - (c) if the individual is a personal trust, a beneficiary of the trust,
 - (d) a spouse, common-law partner, child, or parent of the individual or beneficiary of the trust,
 - (e) a related corporation, a share of which is a share in the capital stock of a family farm or fishing corporation of an individual referred to in (b) through (d), or
 - (f) a partnership, an interest in which was an interest in a family farm or fishing partnership of an individual referred to in (b) through (d);

(Individuals described in (b) through (d) must have been actively engaged in the farming or fishing business on a regular and continuous basis.)
 - (ii) shares or indebtedness of one or more corporations, all or substantially all (90% or more) of the fair market value of the assets of which are properties referred to in (i), (ii), or (iii); or
 - (iii) an interest or indebtedness in one or more partnerships, all or substantially all of the fair market value assets of which are properties described in (i), (ii), or (iii).

- (2) At the time of disposition, all or substantially all (90% or more) of the fair market value of the property owned by the corporation must be attributable to properties described in (i), (ii), and (iii).

A similar test determines whether a partnership interest will qualify as qualified farm or fishing property of an individual. Therefore, in order for the partnership interest to qualify at the time of disposition, throughout any period of at least 24 months before that time, more than 50% of the fair market value of its property must have been attributable to any combination of the properties described in (i) through (iii) (in (1) above).

How Can I Utilize the Capital Gains Exemption?

As you can see, the rules can be very complex, and this was only a general overview regarding eligibility. There are additional complex rules and calculations in determining how much you can benefit from the exemption. Generally, the exemption of course requires incurring a capital gain, which would require you to sell or dispose of your farming or business assets or shares. Generally, when selling a business, the exemption is only one piece of the tax planning puzzle. You should seek professional tax advice if you want to know more.