



Canadian Entrepreneurs' Incentive

The 2024 federal Budget introduced the Canadian Entrepreneurs' Incentive, which provides an additional (partial) capital gains deduction for individuals. The incentive is intended to give relief to "innovators", particularly those in the tech and farming business sectors. The deduction applies to dispositions that occur on or after January 1, 2025.

New and Expanded Capital Gains Tax Relief for 2024

The incentive allows an individual who disposes of "qualifying Canadian entrepreneur incentive property" to claim a deduction that reduces the capital gains inclusion rate to $\frac{1}{2}$ of the regular inclusion rate, up to a maximum of \$2,000,000 in capital gains (or \$1,333,333 in taxable capital gains) during their lifetime. Since the inclusion rate for a taxable capital gain is $\frac{2}{3}$ of a capital gain, this deduction will result in a net inclusion rate for the taxable capital gain of $\frac{1}{3}$ of the capital gain (i.e., $\frac{1}{2}$ of $\frac{2}{3}$).

The lifetime deduction limit begins to apply to a maximum of \$266,667 of taxable capital gains commencing in the 2025 taxation year, with additional \$266,667 increments

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In 2024, the federal government introduced three new capital gains exemptions that may be relied upon when selling shares of your business. The first is the Canadian Entrepreneurs' Incentive, which can provide some capital gains tax relief. The other two, more niche, exemptions can apply on the sale of shares to an employee ownership trust or workers' cooperative. These three measures have not been enacted into law at the time of writing. This article discusses in brief all three of these new exemptions.

being added each subsequent year, before ultimately reaching the lifetime limit of \$1,333,333 of taxable capital gains in the 2029 taxation year.

EXAMPLE

Marina, an entrepreneur, founded a fintech start-up several years ago, and decides to accept an offer to sell her company to a large fintech company, which will use its resources to scale-up their technology. Marina earns \$2 million in capital gains on this sale.

Marina has already used the increased lifetime capital gains exemption of \$1.25 million when she sold some of her business shares to a business partner.

Currently, she would pay tax on \$1 million — or 50% of her \$2 million in capital gains.

When the Canadian Entrepreneurs' Incentive is fully implemented, Marina would only pay tax on 33% of the \$2 million — \$667,000. The incentive reduces her taxable income by \$333,000 when selling her business.

A "qualifying Canadian entrepreneur incentive property" of an individual is property that:

- a) at the time of the disposition of the property, is a qualified farm or fishing property or a "qualified small business corporation share" determined as if the test regarding all or substantially all of the corporation's assets being used "principally in an active business carried on primarily in Canada" by the corporation or a related corporation did not apply to an "excluded business";

- b) throughout the 24-month period immediately before the disposition, is a property that meets the below conditions:

- (i) if the property was a share of a corporation, the individual owned at least 5% of the issued and outstanding shares with full voting rights of the corporation,
- (ii) if the property was an interest in a partnership, the individual's specified proportion of the partnership for its most recent fiscal period was 5% or more, and
- (iii) for other property, the fair market value of the individual's interest in the property was not less than 5% of the total fair market value of the property; and

- c) is an interest in a business in the activities of which the individual was actively engaged on a regular, continuous, and substantial basis for a total period of at least three years.

The deduction in a taxation year is limited to the amount of net taxable capital gains in the year from dispositions of qualifying Canadian entrepreneur incentive property, subject to the lifetime limit that applies as of that year:

- for 2025, \$266,667,
- for 2026, \$533,333,
- for 2027, \$800,000,
- for 2028, \$1,066,667, and
- for 2029 and subsequent years, \$1,333,333.

Each year's limit is reduced to the extent the deduction was claimed in previous years. A taxable capital gain from a disposition of qualifying Canadian entrepreneur incentive property that is eligible and claimed under the regular lifetime capital gains deduction cannot be "doubled up" and also

claimed under the Canadian Entrepreneurs' Incentive.

Employee Ownership Trusts

There is a new exemption for up to \$10 million in capital gains realized on the sale of a business to an employee ownership trust ("EOT"), subject to certain conditions, applicable to qualifying dispositions of shares that occur between January 1, 2024 and December 31, 2026.

An EOT is a form of employee ownership where a trust holds shares of a corporation for the benefit of the corporation's employees. EOTs may be used to facilitate the purchase of a business by its employees without requiring the employees to pay directly to acquire the shares. For business owners, an EOT provides the owner of a qualifying small business an additional tax-efficient option for succession planning or disposing of their business.

The exemption is available to an individual (other than a trust) on the sale of shares to an EOT where the following conditions are met:

- The individual, a personal trust of which the individual is a beneficiary, or a partnership in which the individual is a member, disposes of shares of a corporation (other than a professional corporation).
- The transaction is a "qualifying business transfer" in which the trust acquiring the shares is not already an EOT, or a similar trust with employee beneficiaries.
- Throughout the 24 months immediately prior to the qualifying business transfer,
 - the transferred shares were exclusively owned by the individual claiming the ex-

emption, a related person, or a partnership in which the individual is a member, and

- over 50% of the fair market value of the corporation's assets were used principally in an active business.
- At any time prior to the qualifying business transfer, the individual (or their spouse or common-law partner) has been actively engaged in the qualifying business on a regular and continuous basis for a minimum period of 24 months.
- Immediately after the qualifying business transfer, at least 90% of the beneficiaries of the EOT are resident in Canada.

If multiple individuals dispose of shares to an EOT as part of a qualifying business transfer and meet the conditions described above, they may each claim the exemption, but the total exemption claimed cannot exceed \$10 million. The individuals will have to determine how to allocate the exemption between themselves.

If a "disqualifying event" occurs within 36 months after the qualifying business transfer, the exemption will not be available. Where the individual has already claimed the exemption, it would be retroactively denied. A disqualifying event is where an EOT loses its status as an EOT, or if less than 50% of the fair market value of the qualifying business' shares is attributable to assets used principally in an active business at the beginning of two consecutive taxation years of the corporation.

If the disqualifying event occurs more than 36 months after a qualifying business transfer, the EOT will be deemed to realize a capital gain equal to the total amount of exempt capital gains.

Worker Cooperatives

Concurrent with the introduction of the \$10 million capital gains deduction for qualifying business transfers to EOTs, the Department of Finance expanded the deduction to cover dispositions of shares to a corporation that is a worker cooperative in certain types of worker cooperative “conversions”.

The \$10 million deduction is available for dispositions of shares by individuals (other than trusts) in 2024, 2025, and 2026. However, the gains are eligible for a maximum 10-year reserve where proceeds are due after the year of the disposition, which means that the exemption could apply after 2026 in respect of the portion of gains deferred under the reserve. The reserve requires a minimum of 10% of the gain included in income over the 10 years, with each year’s reserve dependent upon the amount of proceeds due after that year.

A “qualifying cooperative conversion” is a disposition by an individual of subject shares in a subject

corporation to a purchaser corporation that meets certain conditions including the following:

- immediately before the disposition, all or substantially all of the fair market value of the assets of the subject corporation (normally meaning 90% or more) is attributable to assets that are used principally in an active business carried on by the subject corporation or a wholly-owned corporation;
- at the time of the disposition, the individual deals at arm’s length with the purchaser corporation, the purchaser corporation acquires control of the subject corporation, and the purchaser corporation is a “worker cooperative”; and
- at all times after the disposition, the individual deals at arm’s length with the purchaser corporation and subject corporation, and does not retain any right or influence that, if exercised, would allow the individual to control, directly or indirectly in any manner whatever, the purchaser corporation or subject corporation.