THE GLOBE AND MAIL

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TAX MATTERS

How to claim the lifetime capital gains exemption and its much bigger sibling

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED NOVEMBER 12, 2026

I've been in Mexico the past few days. Last night we ate at a café and, as we were leaving, the waiter said "buenas noches," to which I replied: "Yes, they were very good nachos – a few too many jalapenos, but good otherwise."

That's when I learned that "good nachos" (buenos nachos) and "good night" are similar in Spanish. It's the same with the lifetime capital gains exemption, and the new Canada Growth Incentive. Similar – but different. Let me explain.

The LCGE

Let's start with an old friend. The lifetime capital gains exemption (LCGE) lets you shelter up to $1,275,000 of capital gains in 2026 (now indexed to inflation) when you sell qualified small business corporation shares. Qualified farm and fishing property can also qualify.

But the shares have to pass some tests. At the time of sale, the company must be a Canadian-controlled private corporation (CCPC) with all or substantially all (think 90 per cent) of its assets used in an active business carried on primarily in Canada. For the 24 months before the sale, more than 50 per cent of the assets must have met that test, and you, or a related person, must have owned the shares. Also, a cumulative net investment loss, or CNIL, can reduce your available exemption.

The CGI

Last week's federal budget introduced the Canada Growth Incentive (CGI), which exempts up to $15-million of capital gains. Here's the kicker: the limit applies per individual, per business. That's right, you could claim it more than once, on each qualifying company you invest in. The LCGE, by contrast, caps out at $1,275,000 in your lifetime.

The rules for the CGI are different, though. The shares must be newly issued by a CCPC on or after Nov. 5, 2026, and before 2037, solely for cash or for employment services. Shares you already own won't qualify. You must be at least 18 when you acquire the shares,

must hold them for at least 36 months, and own them personally or through a partnership. The LCGE is more flexible here.

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For the CGI, the company and related corporations can't exceed $100-million in carrying value at the time shares are issued. Substantially all its assets must be used (or intended for use within 36 months) in a qualifying business at issuance, at least 50 per cent throughout your ownership, and substantially all again when you sell. Unlike the LCGE, the company can be public by then if it's listed on a designated Canadian exchange.

Sorry, but not all businesses are eligible for the CGI. Consulting and professional practices, franchises, and sectors such as agriculture, fishing, forestry, mining, financial services, real estate, food and accommodation, and arts and entertainment are excluded. Again, the LCGE is more flexible here.

Can you claim both exemptions? Not generally on the same disposition; claiming the CGI on a corporation's shares will limit your LCGE on that disposition, and vice versa. The exception is a sale to an employee ownership trust or worker co-operative, where both can be claimed. You could, however, claim the LCGE on one company and the CGI on another.

Let's consider these ideas.

Pay employees in shares. CGI shares can be issued for employment services, which makes equity a powerful recruiting tool. For arm's-length employees of a CCPC, the employment benefit (the shares' value at issuance) isn't taxed until the shares are sold. Ideally, issue shares early while values are low. These shares can also qualify for the LCGE.

Purify the company. Surplus cash and investments can disqualify your company under both regimes. There are ways to "purify" a company by moving excess assets to a holding company (get the help of a tax pro). Do this well before any sale, since the LCGE's 50-per cent test looks back 24 months and the CGI's applies throughout ownership.

Opinion: As year-end approaches, business owners should consider these ideas to save tax

Plan for AMT. Both exemptions put 30 per cent of the exempt gain into your adjusted taxable income for alternative minimum tax, or AMT. On a full $15-million CGI claim, that's $4.5-million. After the 2026 federal AMT exemption of $181,440 (for 2026), you could face about $885,000 in federal AMT at 20.5 per cent, before credits and provincial tax. Consider spreading the gain over several years using a capital gains reserve, realizing fully taxed income like salary in the year of sale to reduce AMT, and planning income over the next seven years so you can recover AMT paid.

Multiply across the family. Each family member, 18 or older, who subscribes for shares can have their own $15-million CGI limit. Anti-multiplication rules may be coming, so wait for draft legislation before doing anything. And using a family trust can allow you to use the LCGE of multiple family members.

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