

## Tax benefits of being a CCPC as a Canadian startup company

NOVEMBER 13, 2024 5 MIN READ



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A Canadian company that qualifies as a “Canadian-controlled private corporation” (CCPC) under the *Income Tax Act* (the Act) is eligible to receive certain benefits and preferential tax treatment relative to what other Canadian business organizations may be entitled to receive. Emerging and high growth companies and their employees can significantly benefit from maintaining CCPC status.

In this article we outline some of the primary tax benefits of maintaining CCPC status. Note that this list is not exhaustive, and you should consult with your tax and legal advisors to determine whether your company is a CCPC and whether the benefits described below apply to you or your company. It can also be helpful to speak with your tax and legal advisors about strategies for acquiring or maintaining CCPC status.

Very generally, for a company to qualify as a CCPC under the Act, the company cannot be controlled, directly or indirectly, by non-residents or public corporations.

### Tax benefits

The primary benefits of being a CCPC for startups can be divided into three categories: tax credits and grants; tax planning on an exit; and the treatment of employee stock options.

#### Tax credits and grants

CCPCs are eligible for the small business deduction (SBD), which reduces the federal corporate tax rate for CCPCs from 28% (after the federal tax abatement) to 9% on up to \$500,000 of active business income.

CCPCs can also be eligible for the enhanced refundable scientific research and experimental development (SR&ED) investment tax credit rate of 35%, which is 20% higher than the basic non-refundable investment tax credit rate. The enhanced SR&ED credit is earned on qualified expenditures up to a limit of \$3 million per year and is refundable, which typically translates into the CCPC receiving the equivalent of approximately \$1-1.5 million per annum of non-dilutive funding. For startups building out their minimum viable product, or even later stage companies scaling and refining their business, the enhanced refundable SR&ED credit can be very valuable.

There are also other tax credits and grants available to CCPCs that are not discussed in this article. Reach out to your tax and legal advisors for more information.

## Tax planning on an exit

Shares of a CCPC can be considered “qualified small business corporation shares” under the Act. As such, shareholders may be able to use their lifetime capital gains exemption upon the sale of their shares to make certain proceeds tax-exempt at disposition. In other words, under certain circumstances, shareholders of a CCPC whose shares qualify as small business corporation shares can exempt part of the proceeds from the sale of their shares from capital gains tax. The lifetime capital gains exemption is currently \$1.25 million for dispositions that occur on or after June 25, 2024; the exemption is expected to increase further in subsequent years and indexation for inflation will resume in 2026.

While the 2024 Canadian Federal Budget (the 2024 Budget) increased the capital gains inclusion rate from 50% to 66 2/3% for capital gains realized for individuals on or after June 25, 2024 for capital gains exceeding \$250,000, the 2024 Budget also introduced a “Canadian Entrepreneurs’ Incentive,” which proposes an additional incentive for eligible investors in certain sectors who own at least 5% of the shares of a CCPC and who have worked at the CCPC as their principal place of employment for at least three years at any time since its founding. This incentive reduces the capital gain inclusion rate from 50% to 33.3% up to a lifetime maximum of \$2 million and applies to dispositions of qualified small business corporation shares that occur after January 1, 2025. The \$2 million limit will be phased in at \$400,000 per year beginning on January 1, 2025, before reaching \$2 million on January 1, 2029. Certain businesses, including professional corporations, are specifically excluded from the application of these rules.

## Employee stock options — tax beneficial treatment

Very generally, when an employee exercises a stock option to acquire shares of their employer, the employee will realize a taxable employment benefit in an amount equal to the excess of the fair market value of the shares received upon exercise of the option over the exercise price paid under the option (the Stock Option Benefit). Where the employer is a CCPC at the time the stock option is issued to an arm’s length employee, the taxation of the Stock Option Benefit arising on the exercise of the option is deferred until the year in which the employee disposes of the shares. In contrast, the Stock Option Benefit realized on the exercise of a non-CCPC option would be taxable in the year of exercise of the option. This distinction is important as it defers taxation of the Stock Option Benefit in the hands of the employee to the year of sale of the underlying shares when there is likely to be liquidity. In addition, unlike the Stock Option Benefit realized on the exercise of a non-CCPC option (which is subject to withholding at source), there is no requirement imposed on the employer to withhold taxes on the exercise of CCPC stock options. This eliminates what can be a significant administrative and monetary tax burden on the employees. Of course, the employees will be required to pay the tax resulting from the Stock Option Benefit when they file their tax return in April of the year following the year of sale of the shares.

If the company was a CCPC at the time of the option award, an employee who exercises their options and holds the underlying shares for two or more years after the exercise may be entitled to claim a deduction of 50% of the Stock Option Benefit even where the options were issued with a strike price that was lower than the fair market value of the shares at the time of the award (i.e. the option award was “in the money”). As a result of the increase in the inclusion rate for capital gains under the 2024 Budget, the employee stock option deduction has correspondingly changed. To align with these new changes, employees may still deduct 50% of the Stock Option Benefit up to a total of \$250,000 (combined with the new limit for

capital gains inclusion), but any taxable benefit in excess of this amount will only be subject to a deduction at a rate of 33 1/3%.

Together, these tax benefits provide meaningful value to qualifying startups and their employees and provide an incentive to incorporate and build your business in Canada. If you have any questions about incorporating a startup in Canada or how these tax benefits might apply to the unique circumstances of your business, please reach out to our team.