In good company: Earning investment income in your corporation

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When it comes to earning investment income inside your corporation, the amount of taxes paid depends on the type of income earned, such as interest income, Canadian dividends or capital gains. Similarly, the amount you get to keep will depend on how well the corporate tax system is "integrated" with the personal tax rates in your province of residence. This report will examine how investment income that is earned in a private Canadian corporation is taxed and show that, due to a "Retention Advantage" for most types of investment income in the majority of provinces, it may be best to retain after-tax investment income in your corporation.[1]

This report uses 2025 tax rates in effect as of January 31, 2025. More detailed tax information and rates are available in the CIBC Tax Toolkit.

[1] In this report, it is assumed that the shareholder pays tax at the highest marginal tax rate for federal and provincial or territorial purposes. Results may vary significantly if the shareholder pays tax at lower rates.

Based on our analysis, there is a "Retention Advantage" (defined below) for most types of investment income in most provinces and territories. Accordingly, if you do not need funds personally, after-tax corporately-earned interest income, capital gains and dividends should generally be retained in your corporation, with a few exceptions.[2]

In all provinces, the non-taxable portion of capital gains should generally be distributed as tax-free capital dividends as soon as possible, as will be discussed in the section titled "Capital gains and losses."

Background

Our previous report, Bye Bye Bonus, looked at whether to maintain surplus after-tax business income in your corporation or distribute the funds as dividends or a bonus. For small business income, which is active business income up to the small business limit of $500,000 federally and in most provinces and territories ($600,000 in Saskatchewan), there is a significant tax deferral[3] that ranges from 32.5% to 43.3%, depending on the province or territory.

For active business income exceeding the small business limit, the tax deferral is slightly lower and ranges from 17.5% to 27.0%. This means that by leaving after-tax business income in your corporation, there is more money that can be invested than if you were to withdraw the funds from your corporation and invest them personally. If you're a business owner who has left surplus funds in your corporation, now is the time to look at the taxes that arise when the corporate funds are invested and what to do with the funds that remain after taxes are paid on the investment income.

When investment income is earned in your corporation, it is initially taxed at the applicable corporate tax rate. The after-tax income may then be left in your corporation to be reinvested or, alternatively, it may be distributed to you (the shareholder)[4] as a dividend, on which you would pay personal tax.

Since tax is levied at both the corporate and personal levels, 2 mechanisms are available to prevent double taxation: some or all of the initial corporate tax may be refunded[5] to your corporation when a dividend is paid and you may be able to claim a dividend tax credit to reduce taxes payable on the dividend.

Due to these 2 levels of tax (corporate and personal), there is often a difference between the after-tax income that is initially available to the corporation and the amount that will ultimately be left when paid out to you. We will call this the "Retention Advantage."

The Retention Advantage: Deciding whether to retain investment income in your corporation

A Retention Advantage occurs when the after-tax investment income that is available by retaining funds in your corporation is greater than the after-tax income that is available to you once your corporation distributes funds as a dividend and you pay personal tax.

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2 In all provinces and territories, after-tax corporately-earned interest income, capital gains, dividends and foreign income should generally be retained in your corporation, with the following exceptions:

- In the Northwest Territories and Nunavut, interest income, capital gains and non-eligible dividend income should be distributed in the year they are earned.
- In all provinces other than Newfoundland and Labrador, Nova Scotia, Ontario and Quebec, after-tax eligible dividend income should be distributed in the year it is earned.

3 The tax deferral (or tax prepayment) refers to the tax that is deferred to a future year (or paid in advance) if the company pays dividends in the future, and is calculated as the difference between the personal tax and corporate tax on the same income.

4 Throughout this report, it is assumed that you are the sole shareholder of a Canadian-controlled private corporation and that funds would be distributed from your corporation to you as dividends, rather than salary or bonus.

5 Refundable taxes increase the regular corporate tax so that corporate tax is roughly equal to the amount of tax that you would pay if you earned the income personally. Refundable taxes include a portion of tax on "aggregate investment income" (see footnote 6) and the Part IV tax on Canadian dividends (see footnote 8). These refundable taxes are notionally tracked in the Refundable Dividend Tax on Hand (RDTOH) account and are refunded at a rate of $38.33 for every $100 of taxable dividends distributed to shareholders. A corporation may generally recover Part IV tax that it paid on "portfolio dividends" (received from non-connected corporations) by distributing eligible dividends.

When there is a Retention Advantage, it is generally better to retain after-tax investment income in your corporation rather than distribute it in the year it's earned. There will generally be a greater amount for re-investment in your corporation than you would have personally.

Conversely, if there is a Retention Disadvantage, it is generally better to distribute after-tax investment income from your corporation in the year it's earned rather than retain it in your corporation. There will generally be a greater amount for re-investment personally than you would have in your corporation.

Investment income and the Retention Advantage (Disadvantage)

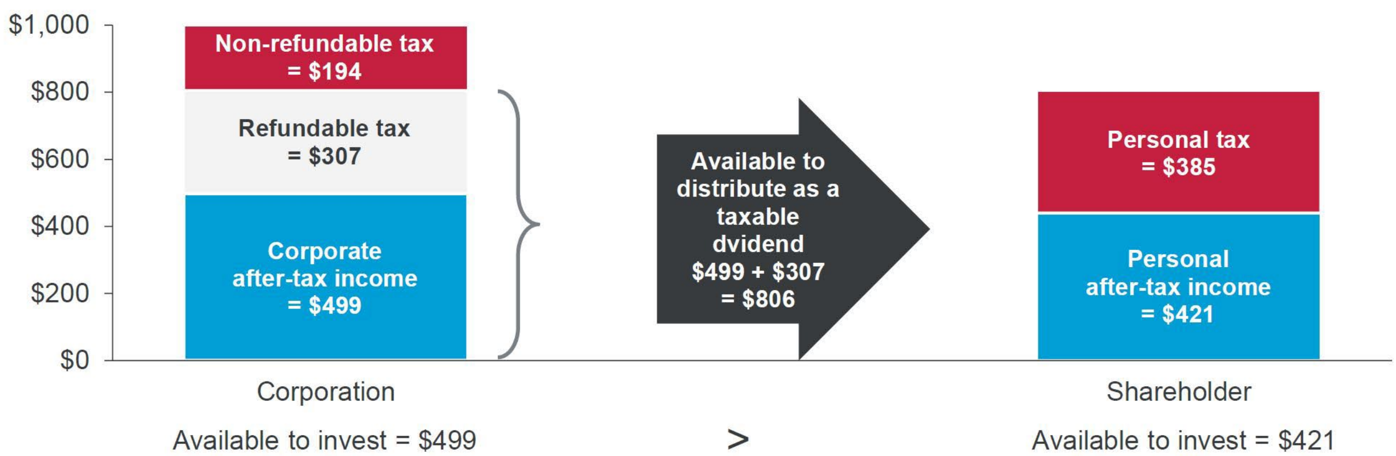
Let's look at the specific details of how some common types of investment income are taxed when earned through your corporation and how the Retention Advantage (Disadvantage) is determined for each type of income.

Interest income

Figure 1 illustrates how $1,000 of interest income would be taxed in Ontario if it was earned through a corporation.[6]

The left bar in Figure 1 illustrates the after-tax income if interest income was earned inside your corporation and retained there (not yet distributed as a dividend), while the bar to the right represents what would happen if the after-tax income was then distributed to you as a dividend.

Figure 1: Interest income earned in a corporation in Ontario



The left bar of Figure 1 shows that non-refundable (federal and Ontario) tax of $194 and refundable tax of $307 would be paid by your corporation when the income was initially earned, leaving $499 available within your corporation for investment. When a taxable dividend is paid, the refundable tax would be returned to your corporation, so that a total of $806 could be distributed to you as a taxable dividend. The right bar of Figure 1 shows that you would pay tax of $385, thus leaving $421 in your hands for investment.

If the after-tax interest income was retained in your corporation, there would be $78 ($499 - $421) of additional funds available for investment, compared to the amount that would be available for you to invest personally if funds were distributed to you. As a result, in Ontario there is a Retention Advantage that amounts to 7.8% of corporately-earned interest income.

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6 The combined federal/provincial corporate tax rate on aggregate investment income (which includes interest income) is 50.17% in Ontario, and ranges from 46.67% to 54.67% across the provinces and territories. This tax rate includes a 30.67% refundable tax (see footnote 5), so that the "non- refundable tax rate" in Ontario is 19.5% (50.17% minus 30.67%). Both the after-tax income and refundable tax may be distributed to shareholders as non-eligible dividends. The highest personal marginal tax rate on non-eligible dividends is 47.74% in Ontario, and ranges from 36.82% to 48.96% across the provinces and territories.

Capital gains and losses

Only 50% of a capital gain is included in your corporation's taxable income. The remaining 50% of the capital gain is not taxed in your corporation and may be distributed as a capital dividend that is completely tax-free to you.[7]

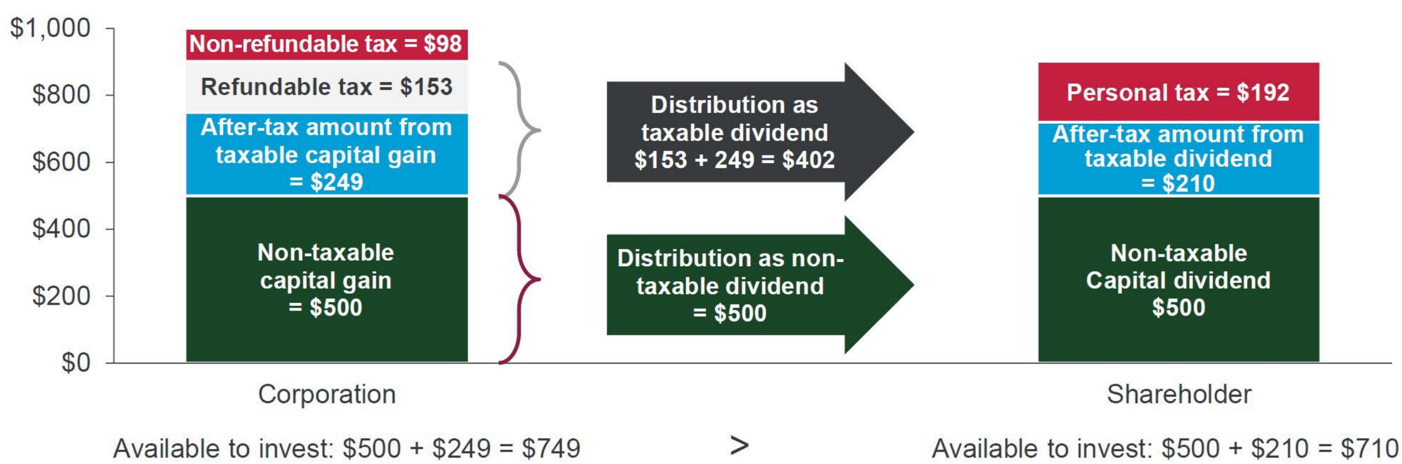
Figure 2 shows how $1,000 of net capital gains would be taxed in Ontario if earned through your corporation.

First we will look at the non-taxable portion of the capital gain, which is shown in the bottom half of Figure 2. 50% of the capital gain ($500) is not taxable in your corporation and may be distributed to you as a capital dividend, on which you would pay no tax. It is important to note that as capital losses are incurred, they may decrease the capital dividends that can be paid until additional capital gains are realized. You may, therefore, wish to pay capital dividends as soon as possible.

Now let's look at the taxable portion of the capital gain, which is the other 50% of the capital gain ($500) shown in the top half of Figure 2. The left bar shows that your corporation would pay non-refundable tax of $98 and refundable tax of $153, leaving $249 after tax that could be invested within your corporation. When a taxable dividend is paid, the refundable tax of $153 would be refunded to your corporation and could be distributed to you, along with the after-tax corporate income of $249. You would, therefore, receive a taxable dividend of $402. The right bar shows that you would pay personal tax of $192, leaving $210 in your hands.

If the $249 of after-tax income (the after-tax portion of the taxable capital gain) was retained in your corporation, there would be a Retention Advantage of $39 (3.9%) compared to the $210 that would be available for you to invest personally if the after-tax income was distributed to you.

Figure 2: $1,000 of net capital gains earned in a corporation in Ontario



Capital losses that are incurred in your corporation offset your corporation's capital gains, resulting in a net capital gain (or loss) in the current year. Any net capital loss can only be claimed within the corporation and cannot be claimed by you personally. If there is an unused net capital loss in the current year, it may either be carried back and applied against your corporation's net capital gains in the prior three taxation years, or may be carried forward and applied against capital gains in any future year. As noted previously, capital losses may limit or eliminate the capital dividends that may be paid.

[7] 50% of net capital gains and losses are added to a corporation's notional Capital Dividend Account (CDA). Dividends may be designated as capital dividends if they do not exceed the balance of the CDA. Net capital losses will decrease the CDA and will, therefore, reduce or eliminate the capital dividends that may be paid. If there is a negative balance in the CDA, net capital gains must be generated to offset the negative balance before capital dividends can be paid. Capital dividends are not taxable to an individual who is resident in Canada.

Canadian dividends

Canadian dividends are typically classified as either eligible or non-eligible. Eligible dividends result from income that was subject to a high rate of tax in the corporation (such as active business income that is not eligible for the small business deduction) and are most commonly received from Canadian publicly-traded companies or mutual funds (including ETFs) that hold Canadian dividend-paying equities. An enhanced dividend tax credit is available to an individual who receives eligible dividends to compensate for the high rate of tax that was paid when income was initially earned in a corporation. Non-eligible dividends would typically be received from a private Canadian corporation that paid tax on its corporate income at the low, small business rate. Because tax is paid at a low rate in the corporation, a lower dividend tax credit is available to an individual for non-eligible dividends.

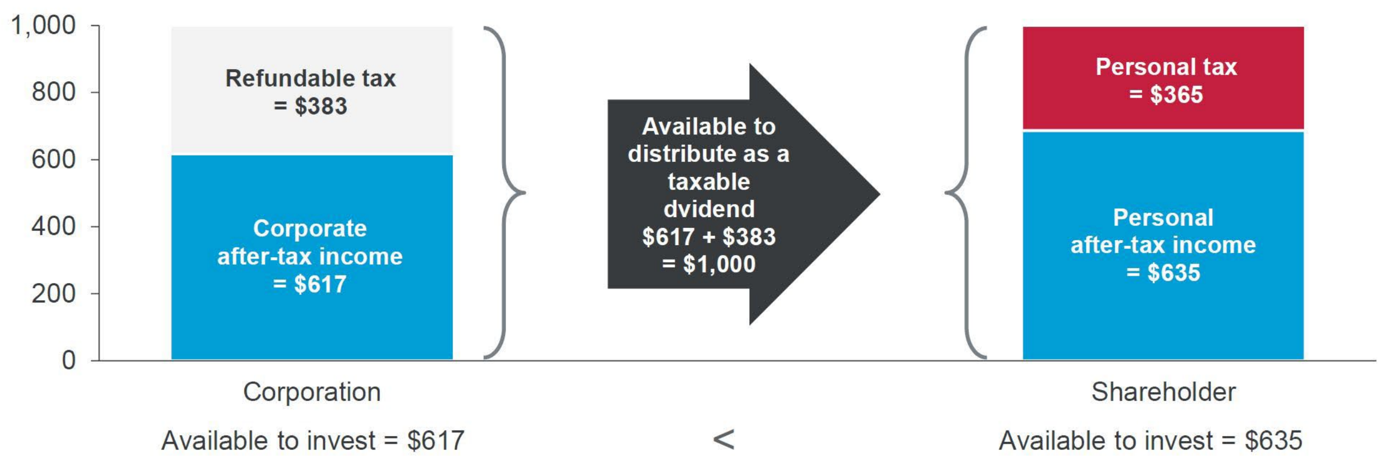
Eligible dividends

Let's look at how $1,000 of eligible dividend income would be taxed if it was earned through your corporation in B.C., as illustrated in Figure 3.[8]

The left bar in Figure 3 shows that refundable tax of $383 would be paid by your corporation, leaving $617 in your corporation to be invested. When a taxable dividend is paid, the refundable tax would be refunded to your corporation so that a total of $1,000 could be distributed to you as a taxable dividend. The right bar in Figure 3 shows that you would pay tax of $365 on the dividend, leaving $635 to be invested personally.

You would have $617 available to invest when funds remain in your corporation. In comparison, you would have $635 available for personal investment after distributing funds from your corporation. Consequently, there is a Retention Disadvantage of $18 (1.8%) when eligible dividend income is retained in your corporation.

Figure 3: Canadian eligible dividend income earned in a corporation in B.C.



Non-eligible dividends

Non-eligible dividends are taxed in exactly the same way as eligible dividends in your corporation; however, personal taxation differs. You would pay a higher rate of personal tax on non-eligible dividends that are distributed to you since there is a lower gross-up and tax credit mechanism than for eligible dividends, which have a higher gross-up and enhanced dividend tax credit.

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[8] A Canadian-controlled private corporation pays federal tax of 38 1/3% (under Part IV of the *Income Tax Act* on dividends that it receives from a non-connected Canadian corporation. There is no provincial corporate tax on Canadian dividends. The "Part IV tax" is fully refundable (see footnote 5). Both the after-tax income and refunded tax may be distributed to the shareholder, either as eligible or non-eligible dividends, according to the type of dividends originally earned. The highest personal marginal tax rate on eligible dividends is 36.54% in B.C. (and the highest rate ranges from 28.33% to 46.20% across the provinces and territories.) The highest personal marginal tax rate on non-eligible dividends is 48.89% in B.C. (and the highest rate ranges from 36.82% to 48.96% across the provinces and territories.)

Let's consider how $1,000 of non-eligible dividend income would be taxed if it was earned through your corporation in B.C.

As with eligible dividends, your corporation would pay refundable tax of $383, leaving $617 in your corporation to be invested. When a taxable dividend is paid, the refundable tax would be refunded to your corporation so that a total of $1,000 could be distributed to you as a taxable dividend. You would pay tax of $489 on the non-eligible dividend, leaving $511 to be invested personally.

While you would have $617 available to invest when funds remain in your corporation, in comparison you would have only $511 available for personal investment after distributing funds from your corporation. Consequently, there is a $106 (10.6%) Retention Advantage when non-eligible dividend income is retained in your corporation.

Foreign income that has foreign withholding tax

Foreign income is taxed in the same way as interest income except for one key difference: a lower portion of the corporate tax is refundable when foreign withholding tax applies to the foreign income. For example, a 15% US withholding tax generally applies when a US corporation pays dividends to non-residents of the US.[9]

Figure 4 illustrates how $1,000 of US dividends would be taxed in Ontario if they were earned through a corporation.

The left bar in Figure 4 illustrates the after-tax income if US dividends were earned inside your corporation and retained there (not yet distributed as a dividend), while the bar to the right represents what would happen if the after-tax income was then distributed to you as a dividend. If you compare this to the treatment for interest income that is illustrated in Figure 1, you will see that it is the same but a lower portion of the corporate tax is refundable.

Figure 4: US dividends earned in a corporation in Ontario

The left bar of Figure 4 shows that non-refundable (federal and Ontario) tax of $314 and refundable tax of $188 would be paid by your corporation when the income was initially earned, leaving $498 available within your corporation for investment. When a taxable dividend is paid, the refundable tax would be returned to your corporation, so that a total of $686 could be distributed to you as a taxable dividend. The right bar of Figure 4 shows that you would pay tax of $328, thus leaving $358 in your hands for investment.

If the after-tax interest income was retained in your corporation, there would be $140 ($498 - $358) of additional funds available for investment, compared to the amount that would be available for you to invest personally if funds were distributed to you. As a result, in Ontario there is a Retention Advantage that amounts to 14.0% of corporately-earned foreign income when a 15% foreign withholding tax applies.

[9] Canada generally allows a foreign tax credit for foreign withholding taxes up to 15%, which reduces the Canadian tax payable.

The tax cost on foreign income

Although there is a benefit to retaining after-tax foreign income in a corporation, it may be better not to earn foreign income in your corporation in the first place due to the tax cost that is described below.

Until this point, we have only considered the Retention Advantage (or Disadvantage), which fundamentally assumes that after-tax business income is left in your corporation as capital for investment. For some types of income, however, there is a substantial, permanent tax cost[10] when income is earned in a corporation rather than personally, making it more expensive to earn income through a corporation in the first place.

For example, you may have noticed that when $1,000 of US dividends are earned through your corporation in Ontario, only $358 would remain in your hands after tax. This means that combined corporate and personal taxes amount to $642, which is 64.2% of the $1,000 of foreign dividends. If, instead, you earned $1,000 of foreign dividends personally, you would only pay tax of $536. Consequently there is a tax cost of $106 or 10.6% (meaning you pay an extra 10.6% of income in taxes when income is earned through your corporation).[11] It may, therefore, be more tax effective to hold foreign investments that pay interest or dividends personally, rather than in your corporation.

One exception, however, may be for US securities. If you are not a US person (such as a US citizen or green card holder) and your worldwide estate exceeds USD$13.99 million,[12] you may face a US estate tax liability if you die owning US situs property, including shares of US corporations. Holding these securities within your Canadian corporation may provide protection from US estate tax that could arise if you hold the securities personally upon your death. Given that US federal estate tax rates range from 18% to 40% of the fair market value of your US situs assets, it may be worthwhile to pay higher tax on the US income and avoid the more punitive US estate tax. You should consult with Canadian and US tax professionals to determine how taxes may apply in your circumstances.

Return of capital

A return of capital (ROC) most frequently occurs when a mutual fund makes a distribution in excess of its income. When your corporation receives an ROC, there is no immediate tax payable; however, unlike the non-taxable portion of a capital gain, the ROC cannot be distributed tax-free from your corporation to you. Instead, the ROC amount is deducted from the adjusted cost base of the investment and may give rise to a capital gain (or decreased capital loss) when the investment is sold in your corporation. Treatment of the capital gain (or loss) is described in the section of this report titled “Capital gains and losses” above.

The Retention Advantage (Disadvantage)

Figure 5 shows the Retention Advantage (Disadvantage) as a percentage of investment income for each of the provinces and territories.

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10 The tax cost refers to the additional tax that is incurred if the income is earned in a corporation and distributed as dividends, rather than earning the income personally.

11 In all provinces, there is a tax cost for foreign income that has a 15% withholding tax, which ranges from 9.6% to 14.6%.The concept of “tax cost” is more fully described in our report, Bye Bye Bonus.

12 In 2025, the maximum US estate tax exemption that can be claimed by a Canadian is USD$13.99 million, or USD$26.98 million if all assets are left to a surviving spouse upon death. Under the Canada-US tax treaty, however, the exemption, must be pro-rated based on the proportion of US situs property to worldwide assets. The Tax Cuts and Jobs Act, which became effective on January 1, 2018, effectively doubled the US estate tax exemption for deaths between 2018 through 2025. After that time, unless permanent legislation is enacted, the exemption will return to the pre-2018 regime in 2026, indexed to inflation.

Figure 5: Retention Advantage (Disadvantage) of retaining various types of investment income in a corporation, by province or territory[13]

Province or Territory	Interest	Capital gains	Eligible dividends	Non-eligible dividends	Foreign income[14]
AB	4.9%	2.4%	(4.0%)	4.0%	11.7%
BC	8.4%	4.2%	(1.8%)	10.6%	14.5%
MB	6.7%	3.3%	(0.6%)	8.3%	13.0%
NB	6.5%	3.3%	(5.9%)	8.5%	12.2%
NL	8.0%	4.0%	7.9%	10.6%	13.1%
NS	7.6%	3.8%	3.3%	9.9%	13.1%
NT	(1.0%)	(0.5%)	(10.0%)	(1.5%)	6.5%
NU	(0.4%)	(0.2%)	(5.3%)	(0.5%)	7.0%
ON	7.8%	3.9%	1.0%	9.4%	14.0%
PE	7.0%	3.5%	(1.8%)	9.6%	12.0%
QC	8.5%	4.3%	1.8%	10.4%	14.6%
SK	2.4%	1.2%	(8.7%)	3.0%	9.4%
YT	4.6%	2.3%	(9.4%)	5.7%	11.2%

Source: Tax Templates Inc.

Simply stated, when you retain after-tax investment income in your corporation, the Retention Advantage (Disadvantage) shows how much more (or less) you'd have in your corporation than personally.[15]

When there is a Retention Advantage (positive value), you'd generally have a higher amount available in your corporation than personally, so after-tax investment income should be retained in your corporation for re-investment provided that you do not need the funds for personal use. The larger the Retention Advantage, the larger the benefit from leaving after-tax investment income in your corporation for re-investment.

When there is a Retention Disadvantage (negative value), you'd generally have a lower amount available in your corporation than personally, so after-tax investment income should be distributed as dividends to you in the year it is earned. The larger the Retention Disadvantage, the larger the benefit from distributing after-tax investment income from your corporation and re-investing personally.

Due to the Retention Advantage for most types of investment income, it may be beneficial to retain the after-tax income in your corporation when you don't need funds for personal use.

Finally, although it is not reflected in Figure 5, the non-taxable portion of capital gains should generally be distributed as capital dividends on a timely basis, to prevent future capital losses from reducing the tax-free capital dividends that may be paid.

[13] It is assumed that the shareholder pays tax at the highest personal marginal tax rate.

[14] It is assumed that 15% foreign withholding tax applies.

[15] It is assumed that that after-tax income is retained in your corporation, rather than being distributed to you (as the shareholder) as dividends. The Retention Advantage shows the additional funds (as a percentage of investment income) that would be available in your corporation, compared to the amount that would be available to you personally. Conversely, the Retention Disadvantage shows how much less would be available in your corporation than to you personally.

A final consideration when deciding whether to accumulate income within your corporation

The federal SBD Limit is decreased for CCPCs with over $50,000 of "adjusted aggregate investment income" (AAII) in the previous year. The SBD Limit is reduced by $5 for each $1 of AAII that exceeded $50,000 in the previous year. It will reach zero once $150,000 of AAII is earned in the previous year. Additional information is available in our report, The CCPC tax rules. This may affect the amount of tax paid by the corporation on its business income and by the shareholder on dividends that come from this income.

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