



In good company: Earning investment income in your corporation

March 2021

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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 an “Investment 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 in 2021.¹

Based on our analysis, there is an “Investment Advantage” (defined below) for most types of investment income in 2021. 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](#)³, 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 deferral⁴ that ranges from 32.5% to 42.5% in 2021, 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% in 2021. 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)⁵ as a dividend, on which you would pay personal tax.

Since tax is levied at both the corporate and personal levels, two mechanisms are available to prevent double taxation: some or all of the initial corporate tax may be refunded⁶ 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 two 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 “Investment Advantage.”



¹ Tax rates in this report were provided by Tax Templates Inc. and reflect rates for the 2021 calendar year, as of February 1, 2021. 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.

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

- In all provinces and territories other than Newfoundland and Labrador, Nova Scotia, Ontario and Quebec, after-tax eligible dividend income should be distributed to you in the year it is earned
- In the Northwest Territories and Nunavut, all investment income that is not foreign income subject to withholding tax, should be distributed to you in the year it is earned.

³ The report “Bye Bye Bonus” is available online at cibc.com/content/dam/personal_banking/advice_centre/tax-savings/jg-dividends-bonus-en.pdf.

⁴ 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, rather than paying salary (or bonus) in the current year.

⁵ 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.

⁶ Refundable taxes increase the corporate tax so that it is about 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 7) and the Part IV tax on Canadian dividends (see footnote 9). 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.

Figure 1: Interest income earned in a corporation in Ontario in 2021



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

An Investment 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. When there is an Investment Advantage, it is generally better to retain after-tax investment income in your corporation since there will be a greater amount for re-investment in your corporation than you would have personally. Conversely, if there is an Investment Disadvantage, less after-tax investment income is available for investment within your corporation, so the after-tax investment income should generally be distributed as dividends in the year it is earned and you should invest the after-tax funds personally.

Investment income and the Investment 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 Investment 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 in 2021 if it was earned through a corporation.⁷

The left bar in Figure 1 illustrates the after-tax income if interest income was earned inside your corporation and retained there (i.e. 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.

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.

⁷ In 2021, 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 6), so that the "non-refundable tax rate" in Ontario for 2021 is 19.5% (50.17% - 30.67%). Both the after-tax income and refundable tax may be distributed to shareholders as non-eligible dividends. In 2021, the highest personal marginal tax rate on non-eligible dividends is 47.74% in Ontario, and ranges from 36.82% to 48.89% across the provinces and territories.

If the after-tax interest income was retained in your corporation, there would be \$78 (i.e. \$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 in 2021, there is an Investment Advantage that amounts to 7.8% of corporately-earned interest income.

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.⁸

Figure 2 shows how \$1,000 of net capital gains would be taxed in Ontario in 2021 if earned through your corporation.

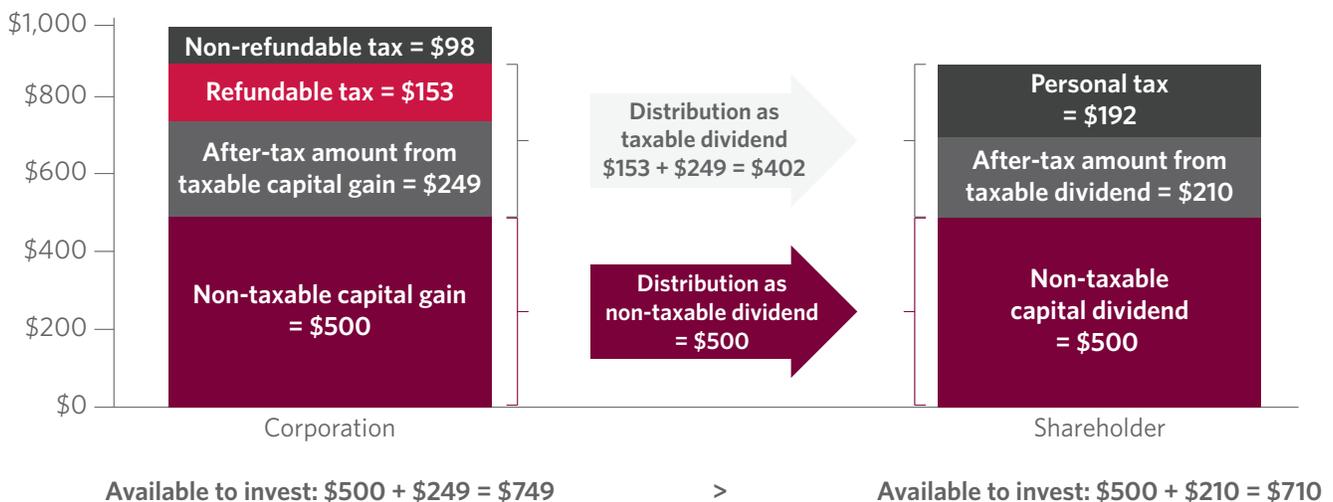
First we will look at the non-taxable portion of the capital gain, which is shown in the bottom half of Figure 2. 50% of the capital gain (\$500) is not taxable in your corporation and may be distributed to you as a capital dividend, on which you would pay no tax. It is important to note that as capital 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 an Investment 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.

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.

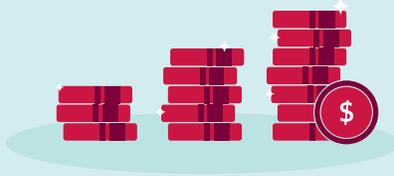
Figure 2: \$1,000 of net capital gains earned in a corporation in Ontario in 2021



⁸ 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.



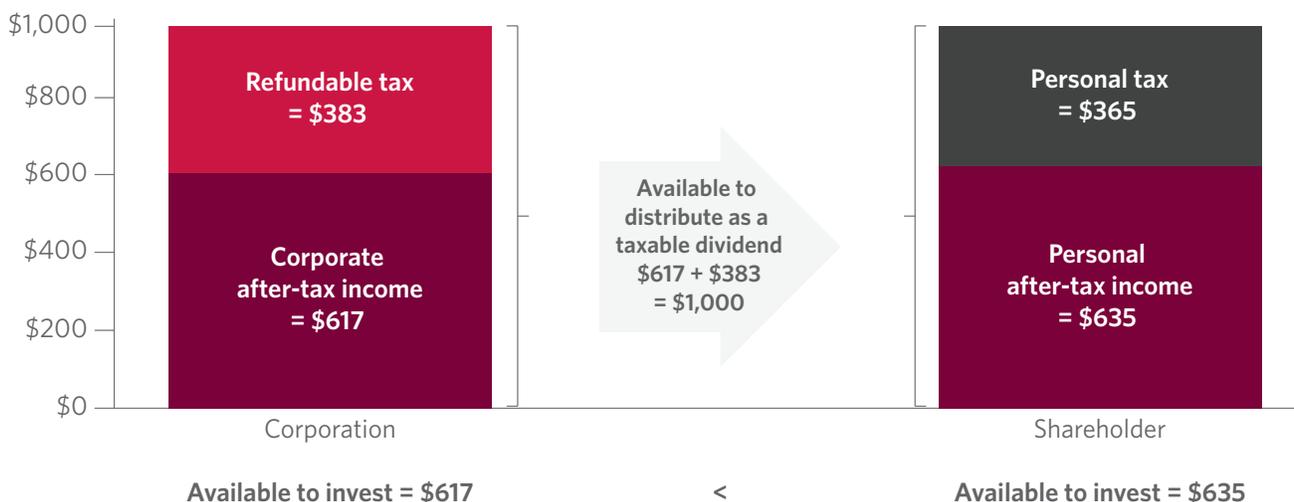
Eligible dividends

Let's look at how \$1,000 of eligible dividend income would be taxed if it was earned through your corporation in B.C. in 2021, as illustrated in Figure 3.⁹

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 an Investment 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. in 2021



⁹ Federal tax of 381/3% is levied under Part IV of the Income Tax Act on dividends that a Canadian private corporation receives from another non-connected Canadian corporation. There is no provincial corporate tax on Canadian dividends. The "Part IV tax" is fully refundable (see footnote 6). 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. In 2021, the highest personal marginal tax rate on eligible dividends is 36.54% in B.C. (and the highest rate ranges from 28.33% to 42.61% across the provinces and territories.) The highest personal marginal tax rate on non-eligible dividends in 2021 is 48.89% in B.C. (and the highest rate ranges from 36.82% to 48.89% across the provinces and territories.)

Non-eligible dividends

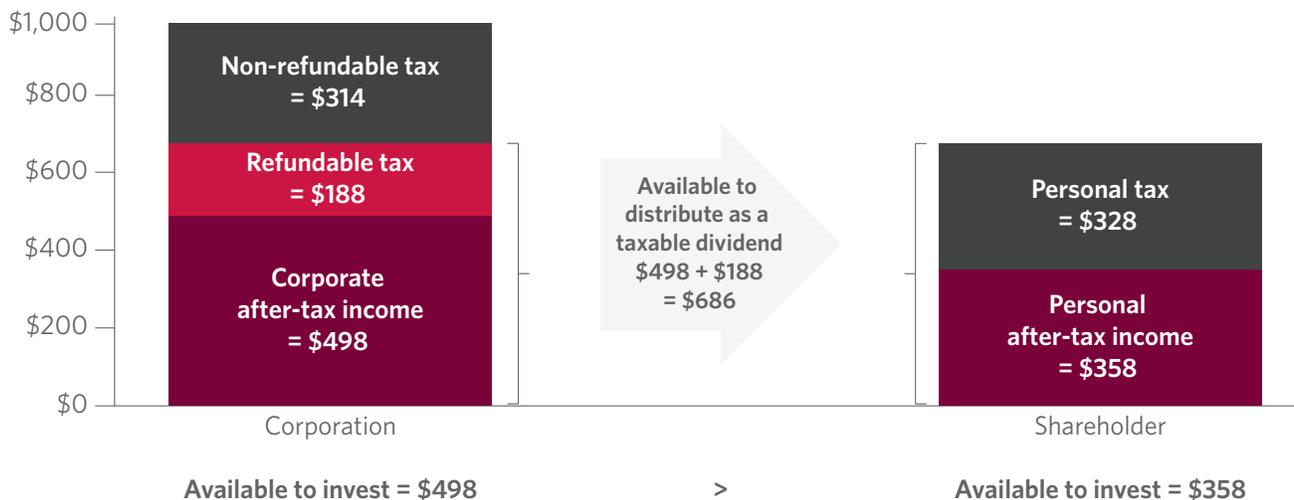
Corporate taxation of non-eligible dividends is exactly the same as eligible dividends; however, personal taxation differs. You would pay a higher rate of personal tax on non-eligible dividends that are distributed to you since there is a lower gross-up and tax credit mechanism than for eligible dividends,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

Let's consider how \$1,000 of non-eligible dividend income would be taxed if it was earned through your corporation in B.C. in 2021.

As with eligible dividends, 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. 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%) Investment Advantage when non-eligible dividend income is retained in your corporation.

Figure 4: U.S. dividends earned in a corporation in Ontario in 2021



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% U.S. withholding tax generally applies when a U.S. corporation pays dividends to non-residents of the United States.¹⁰

Figure 4 illustrates how \$1,000 of U.S. dividends would be taxed in Ontario in 2021 if they were earned through a corporation.

The left bar in Figure 4 illustrates the after-tax income if U.S. dividends were earned inside your corporation and retained there (i.e. 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.

¹⁰ Canada generally allows a foreign tax credit for foreign withholding taxes up to 15%, which reduces the Canadian tax payable.

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 (i.e. \$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 in 2021, there is an Investment Advantage that amounts to 14.0% of corporately-earned foreign income when a 15% foreign withholding tax applies.



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 Investment 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 cost¹¹ 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 U.S. dividends are earned through your corporation in Ontario in 2021, 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% (i.e. you pay an extra 10.6% of income in taxes when income is earned through your corporation).¹² 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 U.S. securities. If you are not a U.S. person (such as a U.S. citizen or green card holder) and your worldwide estate exceeds US\$11.7 million,¹³ you may face a U.S. estate tax liability if you die owning U.S. situs property, including shares of U.S. corporations. Holding these securities within your Canadian corporation may provide protection from U.S. estate tax that could arise if you hold the securities personally upon your death. Given that U.S. federal estate tax rates for 2021 range from 18% to 40% of the fair market value of your U.S. situs assets, it may be worthwhile to pay higher tax on the U.S. income and avoid the more punitive U.S. estate tax. You should consult with Canadian and U.S. tax professionals to determine how taxes may apply in your particular circumstances.

¹¹ 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.

¹² In all provinces in 2021, there is a tax cost for foreign income that has a 15% withholding tax, which ranges from 9.61% to 14.15%. The concept of "tax cost" is more fully described in our report, Bye Bye Bonus (see footnote 3).

¹³ In 2021, the maximum U.S. estate tax exemption that can be claimed by a Canadian is US\$11.7 million, or US\$23.4 million if all assets are left to a surviving spouse upon death. Under the Canada-U.S. tax treaty, however, the exemption, must be pro-rated based on the proportion of U.S. situs property to worldwide assets. President Biden has proposed decreasing the U.S. estate tax exemption to US\$3.5 million and increasing the highest estate tax rate to 45%.

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 a 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 will 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.

Figure 5: Investment Advantage (or Disadvantage) of retaining various types of investment income in a corporation in 2021, by province or territory¹⁴

Province or Territory	Interest	Capital gains	Eligible dividends	Non-eligible dividends	Foreign income ¹⁵
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%	(0.5%)	8.3%	13.0%
NB	7.2%	3.6%	(4.8%)	9.4%	12.8%
NL	4.7%	2.4%	4.3%	6.3%	10.3%
NS	7.6%	3.8%	3.2%	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	5.8%	2.9%	(4.1%)	7.9%	10.8%
QC	8.0%	4.0%	1.8%	9.7%	14.2%
SK	3.2%	1.6%	(8.7%)	4.0%	10.0%
YT	4.6%	2.3%	(9.4%)	5.7%	11.2%

Source: Tax Templates Inc., as at December 2020.

The Investment Advantage (or Investment Disadvantage)

Figure 5 shows the Investment Advantage (or Disadvantage) as a percentage of investment income for each of the provinces and territories in 2021.

Simply stated, when you retain after-tax investment income in your corporation, the Investment Advantage (or Investment Disadvantage) shows how much more (or less) you'd have in your corporation than personally.¹⁶ When

¹⁴ It is assumed that the shareholder pays tax at the highest personal marginal tax rate.

¹⁵ It is assumed that 15% foreign withholding tax applies.

¹⁶ 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 Investment 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 Investment Disadvantage shows how much less would be available in your corporation than to you personally.

there is an Investment Advantage (positive value), you'd have a higher amount available in your corporation, 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 Investment Advantage, the larger the benefit from leaving after-tax investment income in your corporation for re-investment.

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

Due to the Investment 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.

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" (AAIL) in the previous year. The SBD Limit is reduced by \$5 for each \$1 of AAIL that exceeded \$50,000 in the previous year. It will reach zero once \$150,000 of AAIL is earned in the previous year. Additional information is available in our report, [The CCPC tax rules](#).¹⁷

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¹⁷ The report "The CCPC tax rules" is available online at cibc.com/content/dam/small_business/day_to_day_banking/advice_centre/pdfs/business_reports/private-corporation-tax-changes-en.pdf.

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