**Part 2** Earning an income in a corporation

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# Many business owners wonder whether it makes sense to incorporate their business.

## When is the best time to do so? The answer depends on a number of factors, including the type of income earned and the applicable tax rates associated with that income.

Part 2 of the Tax and estate planning for incorporated business owners series, focuses on the tax implications of earning income in a corporation and how you, as an incorporated business owner, may be able to reap the benefits of a possible tax deferral. You should, however, consider developing appropriate investment strategies to not only minimize tax but investment income with the introduction of the new passive investment rules, while still accumulating wealth.

**This is Part 2 of the Tax and estate planning for incorporated business owners series**

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**There can be a great opportunity to access the small business rate and defer tax using a corporation.**

# Earning active business income in a corporation

A corporation is a separate legal entity apart from individuals who own the shares of the company. There are two layers of tax when a corporation earns any income whether it be active business income (ABI) or investment income (both defined below), once at the corporate level and again at the individual level when the after-tax corporate proceeds are flowed out to the individual shareholder as a dividend. The difference is, personal tax can be deferred when the net income is retained in the corporation, which is usually only the case when earning ABI.

In its simplest form, active business income (ABI) is generated by providing a service or selling/ manufacturing a product. ABI generally excludes income earned from investments (although there are exceptions) and other personal service businesses.

The distinction between earning ABI and earning other forms of income is a key determinant in helping you decide whether to incorporate. One of the main advantages of earning ABI in a corporation is the ability to claim the small business deduction (SBD) also, referred to as the small business limit (SBL). The SBD allows a Canadian-controlled private corporation (CCPC) to access a lower tax rate on ABI, up to a certain threshold. In most provinces and territories, the SBD is $500,000.

The federal tax rate on the first $500,000 of ABI is 9% (2024) and each province/ territory applies its own tax rate; the combined (federal and provincial/territorial) tax rate on ABI ranges from 9%-12.2%.

However, if ABI is instead earned personally, a business owner taxed at top personal rates could pay a combined federal and provincial income tax rate between 44.5%-54.8%, depending on their province/territory of residence.

Given the difference between the tax rates applicable to ABI when earned through a corporation and the otherwise top personal income tax rate that may apply, there can be a great opportunity to access the small business rate and defer tax using a corporation. As a result, the corporation can access the low tax rate and retain the after-tax profits allowing the incorporated business owner to benefit from a significant tax deferral. Currently, the tax deferral on ABI ranges between 32.5%-43.3% depending on province/territory of residence. Usually the after-tax profits on ABI can be retained in the company for the long-term until the individual shareholders require an income source from the corporation, in which case a taxable dividend can be paid. This can defer the personal tax impact and spread an otherwise heavy tax liability over time, possibly lowering the combined (corporate and personal) tax bill. However, when the corporation flows out the after-tax profits to the individual shareholder as a non-eligible dividend, personal income tax is payable. In most provinces/territories, the combined corporate and personal income tax rate exceeds the top personal rate, potentially causing a tax cost associated with earning this income in a corporation versus earning personally.

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## Example 1

Holly owns a business in British Columbia and is taxed at the top personal rate of 53.5%. Her business generates $100,000 of ABI. The chart below illustrates the tax deferral opportunity and tax cost associated with earning her business income through a corporation and distributing the after-tax profits now as a non-eligible dividend versus earning the same income personally.

| Ticker | Earn business income personally | Earn business income through the Corporation |
|---|---|---|
| Corporate active business income | – | $100,000 |
| Corporate Tax | – | $11,000[1] |
| After-tax income paid out as a non-eligible dividend | – | $89,000[2] |
| Total Personal Income | $100,000[3] | $89,000[2] |
| Personal Taxes Payable | $53,500[4] | $43,512[4] |
| Total Tax on Business Income | $53,500 | $54,512[5] |
| **Tax Deferral by Incorporating** | **$42,500[6]** | |
| **Tax cost by Incorporating** | **($1,012)[7]** | |

## Planning point: The available tax deferral allows you to pay tax in the future when you may be in a lower tax bracket or tax rates fall.

The chart above highlights the impact of the tax deferral as a key tax planning opportunity available if Holly incorporates her business. First, if Holly can retain the after-tax business profits inside the corporation and not have it flowed out to her as a dividend; she is able to defer $42,500 of income tax annually. This is measured by the difference between total taxes payable assuming she earned the income personally less the corporate taxes paid on the income earned through the corporation.

In Holly's case, this represents a tax deferral of 42.5%. Furthermore, Holly will pay more overall tax if she decides to distribute all of the after-tax business profits to herself as a dividend. Her total tax cost in this case is $1,012, calculated as the difference between the taxes she would have paid personally $53,500 and taxes paid by earning income through the corporation and flowing the after-tax proceeds to her as a non-eligible dividend $54,512. If Holly required the cash flow, she would be better off earning the income personally since more tax is paid by incorporating.

1. Total Federal / B.C. Small business rate = 11.0%.
2. Non-eligible dividend
3. $100,000 of ABI
4. Based on 2024 top marginal tax rates for B.C.
5. Corporate tax $11,000 plus personal tax $43,512 on dividend.
6. Tax deferral-personal tax $53,500 (if income earned personally) less corporate taxes paid $11,000.
7. Tax cost-difference between personal tax $53,500 (if income earned personally) less the combined corporate and personal tax $54,512 (if income earned through the corporation).

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The tax deferral benefit is not unique for B.C. - in fact, the benefit is available in all provinces/ territories. As a result, it may make the most sense to incorporate if your business is going to earn higher profits and you are able to retain some or all of the profits inside the corporation for a longer period of time. Below is a summary of the tax deferral and tax savings/(cost) by province/territory. Also, more detailed information is available in Mackenzie's 2024 publication TE1040 "Income in a Corporation".

| Province/territory | Small business rate[8] | Income earned personally[9] | Tax deferral | Tax savings / (cost)[10] |
|---|---|---|---|---|
| B.C | 11.00% | 53.50% | 42.50% | (1.00%) |
| Alberta | 11.00% | 48.00% | 37.00% | (0.70%) |
| Saskatchewan | 10.50% | 47.50% | 37.00% | 0.40% |
| Manitoba | 9.00% | 50.40% | 41.40% | (1.10%) |
| Ontario | 12.20% | 53.53% | 41.33% | (0.60%) |
| Quebec | 12.20% | 53.30% | 41.10% | (1.70%) |
| New Brunswick | 11.50% | 52.50% | 41.00% | (0.50%) |
| Nova Scotia | 11.50% | 54.00% | 42.50% | (0.20%) |
| PEI | 10.00% | 51.75% | 41.75% | (1.10%) |
| Newfoundland | 11.50% | 54.80% | 43.30% | 0.00% |
| Yukon | 9.00% | 48.00% | 39.00% | (1.10%) |
| NWT | 11.00% | 47.05% | 36.05% | 3.30% |
| Nunavut | 12.00% | 44.50% | 32.50% | (0.80%) |

* Rates as of July 2024
8. The small business rate applies to the first $500,000 federally and in most provinces/territories, except Saskatchewan the SBL is $600,000.
9. Assumes individual is in the top marginal tax bracket in their province/territory of residence.
10. Represents the total tax savings / (cost) of earning ABI through a corporation, and then flowing all after-tax profits out to the individual shareholder in the form of a non-eligible dividend vs. the shareholder earning ABI personally.

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# Earning investment income in a corporation

Incorporated business owners often use the after-tax profits from their active business to purchase income generating investments (investing passively), such as a rental property or mutual fund portfolio just to name a few. The income generated from passive investments is generally referred to as investment income which is taxed at higher rates compared to ABI. However, investment income such as interest, rent, royalties, taxable capital gains/losses, and foreign income (including foreign dividends) is generally referred to as aggregate investment income (AII). To complicate matters further, dividends received from Canadian corporations are not considered AII and are taxed differently. These dividends are subject to what is known as Part IV tax. The taxation of Canadian dividends is discussed below.

In the past, it was advantageous to establish a corporation for the sole purpose of earning investment income. However, as a result of corporate and personal tax rate changes over the past several years, the tax deferral and savings associated with earning investment income in a corporation has, for most provinces and territories, been eliminated. Generally, there is now a tax cost associated with earning investment income through a corporation versus personally. (See Mackenzie's 2024 publication TE1040 "Income in a Corporation" for more information).

While many individuals may not establish corporations with the sole intent of earning investment income, incorporated business owners who take advantage of the significant tax deferral when earning ABI through their corporation may use excess corporate cash to purchase passive income producing investments. When assets exceed what is required to operate the business, many incorporated business owners purchase investment portfolios within their active business corporations to further generate wealth. However, if the intent is to one day sell the shares and benefit from the LCGE you may want to reorganize the share structure first, as excessive passive assets could cause the shares to disqualify for the exemption.

Whether an individual establishes a corporation for the purpose of holding an investment portfolio, or an incorporated business owner accumulates passive assets inside their corporation, it is important to understand how investment income generated from passive investments are taxed inside a corporation and how this tax can impact the investment choices an incorporated business owner makes for their corporate portfolio.

Tax rules were introduced in 2018 which may impact the incorporated business owner's ability to claim the SBD when passive investment income exceeds a new threshold. (More on this below.)

There are two significant differences in the way corporate investment income is taxed compared to corporate ABI. First, investment income is generally not eligible for the SBD. As a result, investment income earned in a corporation is taxed at higher corporate income tax rates; which usually exceed the top combined personal tax rates (except in British Columbia, Alberta, Ontario, Quebec, Newfoundland, and Nova Scotia), before factoring in refundable tax. The second difference is that investment income may be subject to "refundable tax." Refundable tax is a "prepayment" of tax payable when investment income is initially earned and can be refunded to the corporation when taxable dividends are paid out to shareholders. Refundable tax is a mechanism under Canadian tax law which attempts to create perfect integration in the tax system. Under the theory of integration, there should be no difference between earning income through a corporation and paying it out to the individual shareholder as a dividend versus earning the income personally.

Under the new regime, there is now two RDTOH accounts referred to as the non-eligible RDTOH and eligible RDTOH accounts. Generally, the non-eligible RDTOH account includes 30.67% of AII earned in the corporation plus Part IV tax on non-eligible dividends from Canadian connected corporations (more on the new RDTOH accounts below). The non-eligible RDTOH can only be refunded if a non-eligible dividend is paid. The new eligible RDTOH only accumulates Part IV tax (discussed below) paid on Canadian portfolio dividends and certain dividends from Canadian connected corporations, which can be refunded when eligible dividend is paid, or when non-eligible dividend is paid and the non-eligible RDTOH pool has been fully exhausted. Generally, both the non-eligible RDTOH account and the eligible RDTOH account, generate a refund of 38.33 cents to the corporation for every $1 of taxable dividends paid to shareholders.

Investment income subject to refundable tax generally eliminates an opportunity to benefit from a tax deferral when earning investment income and retaining that income in the corporation unlike the advantageous tax deferral available when earning ABI. Additionally, in all provinces/territories, there is usually a tax cost associated with earning investment income in a corporation and paying the investment profits out as a taxable dividend. As a result, there is generally no tax incentive to establish a corporation for the sole purpose of earning investment income. More detailed information is available by province/territory in Mackenzie's 2024 publication TE1040 "Income in a Corporation".

For incorporated business owners who accumulate profits in their corporation and create investment portfolios, the tax implications on their investments will depend on the type of income earned. This is best illustrated by way of an example.

**For incorporated business owners who accumulate profits in their corporation and create investment portfolios, the tax implications on their investments will depend on the type of income earned.**

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## Example 2

Let's assume Holly incorporated her active business and took advantage of the significant tax deferral by accumulating profits in her corporation. Using the accumulated profits, she has created an investment portfolio which generated $10,000 of investment income in 2024. She continues to be a resident of B.C and is taxed at the top personal tax rate.

### The following chart compares the tax implications of earning $10,000 of investment income as:

- Interest and foreign income
- Eligible portfolio dividends or
- Capital gains.

### Investment Income in a CCPC: BC (2024)

| Ticker | Interest and foreign income | Eligible portfolio dividends | Capital gains |
|---|---|---|---|
| Investment Income | $10,000 | $10,000 | $10,000 |
| Non-taxable portion – CDA | – | – | $3,333 |
| Taxable portion | $10,000 | $10,000 | $6,667[11] |
| Tax Rate (BC) | 50.70% | 38.33% | 50.70% |
| Corporate Tax | $5,070 | $3,833 | $3,380 |
| **Net income before refundable tax** | **$4,930** | **$6,167** | **$6,620** |
| Refundable Tax Rate | 30.67% | 100% | 30.67% |
| Refundable Tax ($) | $(3,067) | $(3,833) | $(2,045) |
| **Available for distribution to individual shareholder** | | | |
| **Taxable distribution** | **$7,997** | **$10,000** | **$5,332** |
| **Non-taxable distribution** | **$ –** | **$ –** | **$3,333** |
| **Individual shareholder** | | | |
| Non-taxable CDA distribution | $ – | $ – | $3,333 |
| Taxable non-eligible dividend | $7,997 | | $5,332 |
| Personal Tax Rate | 48.89% | | 48.89% |
| Personal Tax | $3,910 | | $2,607 |
| **Total Net proceeds to shareholder** | **$4,087** | | **$6,058** |
| Taxable eligible dividend | | $10,000 | |
| Personal Tax Rate | | 36.54% | |
| Personal Tax | | $3,654 | |
| **Net Proceeds to Shareholder** | | **$6,346** | |
| **Summary** | | | |
| After tax proceeds to shareholder | $4,087 | $6,346 | $6,058 |
| **Combined tax if income earned through corporation** | **$5,913** | **$3,654** | **$3,942** |
| **Personal tax if income earned directly by individual** | **$5,350** | **$3,654** | **$3,567[12]** |
| **Tax cost by holding in corporation** | **$(563)** | **$ –** | **$(375)** |

11. The 2024 Federal Budget announced an increase in the capital gains inclusion rate, effective June 25, 2024, from one half to two thirds for corporations.
12. The 2024 Federal Budget announced an increase in the capital gains inclusion rate, effective June 25, 2024, from one half to two thirds for corporations, and trusts, and from one half to two thirds on the portion of capital gains realized in the year that exceed $250,000 for individuals, graduated rate estates (GREs) and qualified disability trusts (QDTs). For the example purposes, it is assumed that all capital gains are in excess of $250,000 annual threshold, therefore subject to the higher inclusion rate.

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# Interest and foreign income

Interest and foreign income earned by a corporation is fully taxable at high corporate tax rates. A portion of the corporate tax paid can be refunded to the corporation when non-eligible dividends are paid to the shareholder. In Holly's example, interest income is subject to corporate tax at 50.7%. However, a portion is refunded to the corporation when the after-tax profits are paid out to her as a taxable non-eligible dividend.

Assuming all of the after-tax profits are flowed out to Holly (net of refundable taxes), she will then have to pay personal tax on the non-eligible dividend received. The combined after-tax proceeds available to Holly is approximately $4,087, representing a combined tax rate of 59.13%, exceeding BC's top personal tax rate of 53.50%. This means, $563 additional tax was paid by earning the income through the corporation versus if Holly earned the income personally.

**A portion of the corporate tax paid can be refunded to the corporation when non-eligible dividends are paid to the shareholder.**

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# Taxable Canadian dividends

Usually when a corporation owns more than 10% of another corporation's stock in terms of votes and value the two corporations would be considered connected. The taxation of dividends received from a connected versus non-connected corporation is discussed below.

## 1 Portfolio dividends

Typically, dividends received from non-connected corporations are referred to as portfolio dividends. Canadian portfolio dividends are typically earned from Canadian publicly-traded companies and are subject to a special tax rate of 38.33%, also known as Part IV tax. Part IV tax on portfolio dividends is added to the eligible RDTOH account and can be fully refunded to the corporation at a rate of 38.33 cents for every $1 when either a non-eligible or eligible dividend is paid to shareholders. Non-eligible dividends first provide a refund based on the non-eligible RDTOH account balance and then eligible RDTOH balance may be accessed to obtain a dividend refund. Please refer to the discussion on the new passive investment rules as non-eligible RDTOH may not be refunded if an eligible dividend is paid.

Example 2 highlights the tax implications of Holly's corporation earning $10,000 of portfolio dividends versus Holly earning personally. Part IV tax of 38.33% applies to portfolio dividends and can be fully refunded when taxable dividends are paid to Holly.

Therefore, the full $10,000 (net of refundable tax) can be paid as an eligible dividend allowing a refund of the eligible RDTOH account. The eligible dividend will be taxed at her personal marginal rate of 36.54%. As a result, Holly is left with $6,346 after-tax. There is no difference whether the income is earned through the corporation or personally.

## 2 Dividends from connected corporations

Although irrelevant to Holly's situation, it is worth noting, dividends received from connected corporations are taxed differently under Canadian rules. These dividends could be received tax-free provided certain tests are met, otherwise the dividend can be taxed as a capital gain.

Additionally, Part IV tax applies to the receiving connected corporation equal to their share of the dividend refund received by the payer corporation. The Part IV tax is generally added to the non-eligible RDTOH account and can be refunded when a non-eligible taxable dividend is paid.

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# Capital gains and the capital dividend account

Capital gain earned by a corporation is subject to a 66.67%[13] inclusion rate. That is, two thirds of the capital gain is subject to tax. In a corporate structure, the non-taxable one third portion of the capital gain may be paid out of the corporation to shareholders on a tax-free basis by election. The mechanism which tracks the tax-free portion of capital gains is known as the Capital Dividend Account (CDA).

The CDA is an important aspect of the integration process. It is a 'notional' tax account available to CCPCs that accumulate certain non-taxable receipts that can be paid to shareholders as a tax-free dividend.

## The three most common sources that contribute to the CDA are:

- The non-taxable portion of realized capital gains (net of capital losses)
- Tax-free life insurance proceeds received by the corporation (net of the adjusted cost basis)
- 100% of the capital gain when a security is donated in-kind

As a result, capital gains earned by the corporation will increase the balance in the CDA by the amount of the non-taxable portion of the capital gain. At any time when there is a positive balance in the CDA, the corporation may elect to pay tax-free capital dividends to shareholders.

Example 2 assumes $10,000 of capital gains are earned by Holly's corporation. The non-taxable portion $3,333 will accumulate in the CDA. The $6,667 taxable portion is subject to the corporate investment tax rate. Therefore, the after-tax proceeds available to Holly personally is $6,058. Although, earning capital gains through the corporation is more tax efficient than earning interest or foreign income, Holly pays an additional $375 more in taxes by earning capital gains through her corporation versus earning personally.

13. The 2024 Federal Budget announced an increase in the capital gains inclusion rate, effective June 25, 2024, from one half to two thirds for corporations, and trusts, and from one half to two thirds on the portion of capital gains realized in the year that exceed $250,000 for individuals, graduated rate estates (GREs) and qualified disability trusts (QDTs).

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# Passive investment rules

## The 2018 Federal Budget introduced two new rules relevant to investing in a corporation.

### 1 Small business limit reduction

Tax rules for corporate tax years beginning in 2019, target active businesses that invest passively. As previously discussed, an incorporated business owner can access the small business rate on up to $500,000 of ABI. Under the passive investment rules, the SBL can be reduced if the passive investment income (subject to certain adjustments) earned by the corporation as well as any other "associated" corporations (see "Note") exceeds $50,000 for that taxation year. Specifically, the SBL will be reduced $5 for every $1 over and above $50,000. The SBL will be fully eliminated once the passive investment income is $150,000.

For example, Holly's corporation earns $500,000 of ABI and has been claiming the full SBL to access the lower small business tax rate. Assume the corporation also earns $125,000 of AII. Based on the tax rules, her corporation has earned $75,000 over the permitted exemption ($125,000 less $50,000) reducing her SBL by $375,000 ($75,000 × $5). This means in the next corporate tax year, the corporation's SBL will be reduced from $500,000 down to $125,000.

Only $125,000 of ABI will benefit from the low tax rate, and the remaining ABI will be subject to the higher general corporate tax rate. This measure will increase the taxes Holly's corporation pays on its ABI.

**Note:** Generally, associated corporations share the SBL. There are several ways corporations could be deemed associated for purposes of these rules. This concept is beyond the scope of this module, however as a general comment, corporations may be considered associated if the shareholder exercises a certain amount of control over the corporation (generally represented by owning more than 50% of the outstanding voting shares)

### 2 Refundability of taxes

The second tax rule introduced in 2018 restricts refundable tax when an eligible dividend is paid. Also effective for taxation years beginning in 2019, RDTOH may only be refundable when a non-eligible dividend is paid. There is an exception if RDTOH is generated from portfolio dividends received and the non-eligible dividend account is NIL. This necessitates the need for two RDTOH accounts; a "non-eligible RDTOH" as well as an "eligible RDTOH" account. The non-eligible RDTOH accumulates a portion of AII as per the usual rules, with the exception that the eligible RDTOH account will only accumulate Part IV tax from portfolio dividends and certain intercorporate dividends. That is, if the corporation does not have a balance in the eligible RDTOH pool, any eligible dividends paid to the individual shareholders will not generate a refund of RDTOH.

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# Strategies for extracting corporate funds

One of the biggest challenges for individual shareholders is how corporate assets can be extracted tax efficiently. Generally speaking, there are only two ways to distribute corporate assets; a salary/bonus or a taxable dividend. Both of these methods trigger personal tax.

## There are some tax efficient alternatives worth considering if you wish to remove assets from a corporation to consume or invest personally.

### 1 Pay tax-free capital dividends

As mentioned previously, CDA is a notional tax account available to CCPCs that accumulate non-taxable receipts. To the extent that there is a positive balance in a corporation's CDA, a tax-free capital dividend can be paid to the individual shareholders by election.

### 2 Repay shareholder loans

If the corporation has borrowed money from an individual shareholder, the loans can be repaid on a tax-free basis.

### 3 Extract "Paid-up Capital" (PUC)

Paid-up capital is analogous to an 'adjusted cost base' and may be available either upon redemption of shares or through a PUC reduction in respect of a class of shares. PUC may be available if, for example, you paid a substantial amount when you first subscribed for the shares of the corporation or performed certain corporate reorganizations. PUC is an important concept since it represents the amount of money that can be returned to individual shareholders on a tax-free basis. When an individual shareholder sells shares back to the corporation, they will receive a taxable dividend only to the extent that the redemption proceeds exceed any PUC. The corporation may also be able to pay a 'return of capital', which reduces PUC without redeeming shares. Consult with your tax professional to determine whether PUC exists with your shares and whether this strategy makes sense for you.

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## 4 Redeem freeze shares

Succession planning for incorporated business owners sometimes involves undertaking an estate freeze in order to issue new common shares that will accrue to future generations, while the business owner receives special shares which retain the value of the company up to the time of the freeze. If the incorporated business owner requires cash from the corporation, they may consider redeeming special shares if it is not possible to extract cash tax efficiently from the methods previously described. Redeeming special shares may be preferred to simply paying dividends on these shares. While the tax implications are identical in both scenarios, the advantage to redeeming shares is that fewer shares will be owned at the time of death and therefore a lower capital gain will result at that time. This is a strategy used during retirement allowing a steady income stream that spreads the tax liability over several years, possibly accessing a lower marginal tax rate as opposed to having a large tax bill at death.

## 5 Salary/bonus and/or dividends

Incorporated business owners (and their families) may be able to receive income out of the corporation in the form of a salary/bonus provided its reasonable and there is an identifiable service being performed. A reasonable salary or bonus is taxable to the individual and is deductible by the corporation. Some of the benefits of paying a salary or bonus include the creation of RRSP contribution room (since salary and bonuses are considered "earned income"), reducing the corporation's taxable income i.e. tax liability (unless the bonus is not paid 180 days after year-end), entitlement to Canada Pension Plan benefits, and the ability to establish and make contributions to an Individual Pension Plan (IPP). Before January 1, 2018, incorporated business owners, could set up adult family members as shareholders for income splitting purposes.

This way, each adult family member not involved in the business could receive a dividend allowing the income to possibly be taxed to a family member in a lower tax bracket. Under the current rules, related family member shareholders who are not involved in the business and do not meet one of the exceptions may be taxed at top rates when a dividend is paid.

Benefits of paying taxable dividends to family member shareholders who meet an exception include; no requirement to withhold payroll tax, interest may be deductible where money was borrowed to purchase shares, potential refund from the non-eligible or eligible RDTOH accounts (as discussed), and a reduction in the "Cumulative Net Investment Loss" (CNIL) balance which preserves the capital gains deduction on the sale of Qualified Small Business Corporation (QSBC) shares.

The decision to pay a salary/bonus or dividend (provided you are a shareholder) is dependent on a number of factors, including whether the corporation earns ABI and/or investment income, personal and corporate tax rates and whether you will be affected by the income sprinkling rules. Speak to a tax professional as to what is best for your situation.

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# Investment strategies for corporate passive assets

It may be difficult to extract corporate assets tax efficiently once you have exhausted the strategies noted previously. It may make sense to retain in the corporation and invest tax efficiently using the following strategies.

## 1 Invest in growth focused investments

As outlined earlier in this module, passive income is taxed at higher rates when earned in a corporation compared to ABI. In addition, new rules may increase the taxation of ABI through the reduction of the SBL when passive income exceeds $50,000. As a result, active businesses that invest passively should consider growth focused investments as part of a properly diversified corporate investment portfolio.

### Growth focused investments can be a tax efficient investment for two reasons:

**Tax efficient distributions**

The taxation of distributions depends on the type of investment income generated. As previously discussed, some types of investment income are taxed more favourably than others. Interest and foreign income are fully taxable to the investor. Eligible dividends (i.e., dividends earned from Canadian publicly traded companies) and capital gains have preferential tax treatment in Canada and are taxed more favourably than interest and foreign income.

The typical mutual fund, structured as a trust, distributes all types of income (net of fees) to an investor, including interest, foreign income, eligible dividends and capital gains which retain their original character. The investment income is taxable to the investor at their personal marginal tax rate, or corporate tax rate as the case may be, depending on the character of the distributions received. Alternatively, capital growth focused investments do not distribute income. Instead, investors would have full flexibility in realizing capital gains as needed by redeeming a portion of their investments. Only 66.67%[14] of the realized capital gains would be taxable to the corporation and the remaining non-taxable capital gains would be added to the corporation's CDA.

**Tax-efficient growth**

If you invest in GICs, bonds or dividend-paying stocks outside of a registered account, you will pay tax every year that you hold the investment. Investing in capital growth focused securities can give you the ability to minimize and defer tax along the way, keeping more money in your account to allow your investment to compound over time. The less tax you pay, and the later you pay it, the more your investments can potentially grow.

The combination of these benefits can potentially assist individual shareholders with passive investments in their corporations to reduce the level of non-refundable corporate income taxes, protect their SBL and focus on growing their capital tax efficiently over time.

14. The 2024 Federal Budget announced an increase in the capital gains inclusion rate, effective June 25, 2024, from one half to two thirds for corporations.

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## 2 Individual Pension Plans (IPPs)

IPPs are alternative retirement savings vehicles that offer enhanced tax relief and increased pension benefits as compared to RRSPs. These are Defined Benefit Pension Plans that can be set up for a business owner (including incorporated professionals) or for a group of employees within the same company. IPPs can only be set up by corporations carrying on an active business and are ideally suited for individuals who are 40 years of age or older and earning at least $100,000 of T4 or T4PS income.

All contributions, set up fees, and maintenance fees paid by a corporation in regards to IPPs are fully tax deductible for the corporation and tax-deferred to the employee member(s). IPPs can be used to extract corporate passive assets to invest tax efficiently. IPP assets are also protected from the corporation's creditors. Investment returns earned inside IPPs are not taxable to the corporation, meaning the high corporate passive income tax rates and the SBL reduction rules are avoided. The withdrawals are taxable to the plan member personally in the future as pension income.

## 3 Retirement Compensation Arrangements (RCAs)

RCAs are designed to assist high income earners such as senior executives and owner-managers in supplementing their pensions over and above what RRSPs can offer. An RCA is a non-registered retirement plan, in the form of a trust, that can be established by a corporation to provide retirement savings to an employee.

All contributions to RCAs are tax deductible to the corporation. Fifty percent of the contributions are held in a non-interest bearing refundable tax account with Canada Revenue Agency ("CRA") and the other fifty percent are deposited in the RCA trust account for investment. The funds are only taxable to the employee when received upon retirement or loss of employment. Similar to IPPs discussed above, RCAs can be used to extract corporate passive assets and provide creditor protection. Investment returns earned inside RCAs are not taxable to the corporation (although the refundable tax at the rate of 50% still applies) and the earnings do not impact the corporation's SBL.

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## 4 Exempt Life Insurance Policies

Corporate passive assets can be used to purchase a corporately owned exempt life insurance policy with an investment component. Although a tax deduction may not be available to the corporation for insurance premiums, the annual investment income earned inside the investment component is tax-exempt and the income does not impact the corporation's SBL, as long as the policy's cash value is within the maximum tax actuarial reserve ("MTAR") limits to maintain an "exempt" status.

The added benefit of using a life insurance is the opportunity for tax-efficient wealth transfer. The death benefits received from the life insurance policy less the adjusted cost basis ("ACB") of the policy are added to the corporation's CDA which can be used to distribute tax-free capital dividends as mentioned previously.

It is important to note that the investment component of the life insurance policy is treated as a passive investment for the corporation. The insurance policy would generally be valued at its cash surrender value which could impact the qualification for the lifetime capital gains exemption ("LCGE").

## 5 Mackenzie Charitable Giving Program

Donating securities is a tax efficient option for those with philanthropic goals. If a corporate appreciated security is donated, the capital gain is not taxable, plus 100% of the capital gain is added to the corporations CDA account allowing a tax-free payment to shareholders. In addition, the corporation will receive a charitable donation receipt equal to the FMV of the security donated, which will help reduce net income for tax purposes from all sources. For more information on this strategy please refer to the Mackenzie Charitable Giving Program Guide.

## 6 Mackenzie Private Wealth

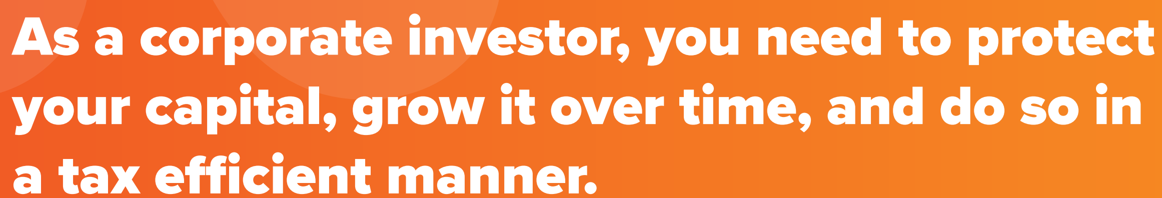
Incorporated business owners have greater needs with respect to their financial, investment, tax and estate planning requirements. Mackenzie's Private Wealth is dedicated to serving affluent incorporated business owners and their families by providing a deeply personalized wealth counselling service to households with $500,000 or more in investable assets.

**The following benefits are available in Mackenzie Private Wealth:**

- Completely tailored portfolio solutions
- Professional money management
- Risk management
- Preferred pricing
- State of the art reporting and communication
- Superior tax efficiency
- A complementary Tax & Estate Summary Report

# Mackenzie Investments can help

As a corporate investor, you need to protect your capital, grow it over time, and do so in a tax efficient manner. Money held, in your active business or an investment holding company, should be invested as tax efficiently as possible to mitigate high corporate tax rates that apply to investment income while navigating the passive investment rules for active businesses investing passively. Mackenzie Investments has a full range of funds that may be able to help meet both your personal and corporate tax and investment planning needs.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# Advisors

# Investors

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That's **better** together

## General Inquiries

For all of your general inquiries and account information please call:

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**E-mail:** service@mackenzieinvestments.com
**Web:** mackenzieinvestments.com

**Find fund and account information online through Mackenzie Investments' secure InvestorAccess. Visit mackenzieinvestments.com for more information.**

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Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read a fund's prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

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