

# The corporate tax deferral – saving surplus inside your corporation

Your corporation pays tax at low initial tax rates on active business income. After meeting business and personal lifestyle needs, your corporation may have surplus for future use. Generally, it makes sense to maximize your [RRSP and TFSA](#) savings for personal savings and use. Thereafter, retaining money inside your corporation can make sense for many business owners if proper planning is in place.

## The potential tax deferral

Small businesses benefit from low tax rates on active business income (the “general rate”). The combined federal and provincial/territorial general rate ranges from 23%-30% across Canada. There is a further tax rate reduction known as the small business deduction (the “small business rate”) up to a threshold. The combined federal and provincial/territorial tax at the small business rate ranges from 9%-12.20% on the first \$500,000. Some provinces also provide their lower rate up to a higher threshold.

Your personal tax rates can exceed both corporate active business income tax rates in many cases. For ordinary income, the highest combined marginal tax rates average more than 50% across Canada. For dividends, the highest combined rates are approximately 28%-46% for eligible dividends and 37%-50% for non-eligible dividends. The lower personal tax rate on dividends reflects the corporate tax already paid. Eligible dividends reflect the general rate, and non-eligible dividends reflect the small business rate already paid.

The difference between the higher personal tax rates and lower corporate tax rates may result in a tax deferral. If your corporate tax rate is lower than your personal tax rate, there is more after-tax to invest in your corporation. Across Canada, the potential deferral is shown below.

### Corporate income taxed at the small business rate

	BC	AB	SK	MB	ON	PQ	NB	NS	PEI	NL	YK	NWT	NU
<b>Highest personal rate</b>	53.50%	48.00%	47.50%	50.40%	53.53%	53.31%	52.50%	54.00%	52.00%	54.80%	48.00%	47.05%	44.50%
<b>Corporate tax</b>	11.00%	11.00%	10.00%	9.00%	12.20%	12.20%	11.50%	10.50%	10.00%	11.50%	9.00%	11.00%	12.00%
<b>Tax deferral</b>	<b>42.50%</b>	<b>37.00%</b>	<b>37.50%</b>	<b>41.40%</b>	<b>41.33%</b>	<b>41.11%</b>	<b>41.00%</b>	<b>43.50%</b>	<b>42.00%</b>	<b>43.30%</b>	<b>39.00%</b>	<b>36.05%</b>	<b>32.50%</b>

### Corporate income taxed at the general rate

	BC	AB	SK	MB	ON	PQ	NB	NS	PEI	NL	YK	NWT	NU
<b>Highest personal rate</b>	53.50%	48.00%	47.50%	50.40%	53.53%	53.31%	52.50%	54.00%	52.00%	54.80%	48.00%	47.05%	44.50%
<b>Corporate tax</b>	27.00%	23.00%	27.00%	27.00%	26.50%	26.50%	29.00%	29.00%	30.00%	30.00%	27.00%	26.50%	27.00%
<b>Tax deferral</b>	<b>26.50%</b>	<b>25.00%</b>	<b>20.50%</b>	<b>23.40%</b>	<b>27.03%</b>	<b>26.81%</b>	<b>23.50%</b>	<b>25.00%</b>	<b>22.00%</b>	<b>24.80%</b>	<b>21.00%</b>	<b>20.55%</b>	<b>17.50%</b>

Of course, you may not be at the highest tax rate personally. To calculate your potential deferral, subtract your corporation’s tax rate from your current personal tax rate. The larger the potential deferral, the more you can initially invest inside your corporation.

Having a lower tax rate inside your corporation does not automatically result in a deferral advantage. The goal is to have more after-tax to you personally when you choose to liquidate the investment and distribute proceeds. The key items that influence the tax deferral analysis include:

- Your corporation’s initial tax rate on active business income (general or small business rate).
- Whether you are in the same, lower or higher tax bracket when you invest compared to when you liquidate the investment.
- Form of investment income generated (interest, dividends, capital gains, or deferred gains).
- Time horizon (the length of time the money stays invested).

## Investment vehicle characteristics

Below is a summary of the tax differences between removing and investing in a non-registered account personally or retaining inside corporation.

	Personal non-registered	Corporate
<b>Tax prior to investing</b>	Personal tax at your tax bracket to receive money from corporation. No corporate tax if your corporation pays you salary. Corporate tax on business income at active business income tax rates if your corporation pays you a dividend.	Corporate tax on business income at the general or small business rate (depending on total corporate income)
<b>Tax on growth while invested</b>	<p>You pay tax on interest, dividends, and capital gains personally at your marginal personal tax rates when incurred:</p> <ul style="list-style-type: none"> <li>• Interest is fully taxable.</li> <li>• Dividends are grossed up (15% for non-eligible and 38% for eligible) on your personal tax return and a dividend tax credit applied. Most dividends in a public stock company, mutual fund, or ETF are eligible dividends.</li> <li>• Tax on capital gains is 50% of the rate on interest.</li> </ul>	<p>Your corporation pays tax depending on the type of passive investment income:</p> <ul style="list-style-type: none"> <li>• Interest (46.67%-53.67%), taxable Canadian dividends (38.33%) and capital gains taxed as investment income.</li> <li>• Tax on capital gains is 50% of the above rate on interest. The non-taxable portion credits the notional capital dividend account (CDA).</li> <li>• Passive investment tax generates a credit to notional accounts known as the refundable dividend tax on hand (RDTOH). Your corporation recoups this when it pays taxable dividends to you as shareholder.</li> </ul>
<b>Tax inside the entity upon disposition</b>	N/A	Capital gains taxed as passive investment income inside the corporation when you liquidate or rebalance the investment
<b>Personal tax on removal</b>	Capital gains taxed personally when you liquidate the investment.	<p>Your corporation can pay dividends to you as follows:</p> <ul style="list-style-type: none"> <li>• Tax-free capital dividends up to the CDA balance.</li> <li>• Taxable eligible and non-eligible dividends. Dividends are grossed up (15% for non-eligible and 38% for eligible) on your personal tax return and a dividend tax credit applied. Paying taxable dividends allows your corporation to recoup RDTOH previously paid.</li> </ul>

**Does the upfront corporate tax deferral provide more after-tax to you when you liquidate the investment and distribute the proceeds?**

## Comparing the options

To see the tax deferral in action, we'll analyse Andre's situation, a resident of Ontario at the highest tax bracket. His corporation is also resident in Ontario and has \$10,000 before-tax surplus.

Andre's corporation pays him a salary and deducts \$10,000 from the corporation's pre-tax profits (reducing corporate tax to nil). Andre receives the \$10,000 and pays tax at his tax rate of 53.53%. The result - Andre invests \$4,647 in a personal non-registered account.

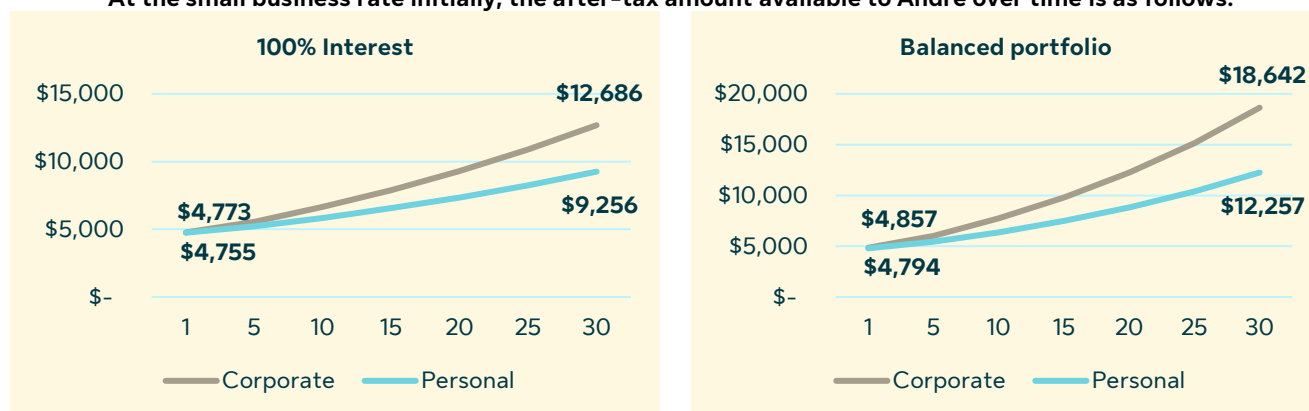
If Andre's corporation retains the surplus, the after-tax amount available to invest depends on the corporation's tax rate:

- **Small business rate.** The \$10,000 profit has 12.2% corporate taxes, leaving \$8,780 available to invest.
- **General rate.** The \$10,000 profit has 26.5% corporate taxes leaving \$7,350 available to invest.

The corporation then invests the after-tax amount subject to corporate investment tax rates.

To compare apples to apples, Andre invests the after-tax amount in the same investment in both cases. We'll look at both a 100% interest portfolio and a hypothetical balanced portfolio earning 5% annually (equally divided between interest, dividends, capital gains, and deferred gains). To make it a fair comparison, we need to look at the after-tax value of each option to Andre personally. Therefore, we need to liquidate the money from the personal non-registered account and remove the money from the corporation.

At the small business rate initially, the after-tax amount available to Andre over time is as follows:



When the corporation initially pays tax at the small business rate, the corporate investment is slightly higher from the first year. This remains true, even after Andre removes the money from the corporation and pays tax.

Compared to earning interest income, the more capital gains and deferred gains in your portfolio, the lower the tax on your investment portfolio. However, your type of investment should meet your risk tolerance. We don't recommend choosing investments outside of your risk tolerance solely to produce a better tax result. Consult your financial advisor to review your risk tolerance and investment objectives prior to choosing your type of investment.

Now let's look at how the same investment performs across Canada at different tax rates. In all cases, we're looking for the time it takes the corporate investment to outperform the personal investment by 1%.

### If you're in the same tax bracket when removing the money

Below is a summary of the time needed for the corporate investment to outperform the personal non-registered investment by 1%. In all cases, we assume you remain in the same tax bracket throughout your lifetime. We display the time needed assuming you're at the second federal tax bracket (around \$57,000), third federal tax bracket (around \$114,000), or the highest tax bracket (around \$253,000+) during your lifetime.

Small business rates initially – years needed for corporate investment to outperform personal non-registered investment by 1%+

	100% Interest			Balanced portfolio		
	Second tax bracket	Third tax bracket	Highest tax bracket	Second tax bracket	Third tax bracket	Highest tax bracket
BC	8	4	3	3	2	2
AB	3	3	3	2	2	2
SK	0	0	0	0	0	0
MB	4	3	3	2	2	2
ON	5	3	2	3	2	2
QC	6	4	4	4	3	3
NB	3	3	3	2	2	2
NS	5	4	4	3	2	2
PEI	5	4	4	3	2	2
NL	2	2	2	0	0	0
YT	5	4	3	2	2	2
NWT	0	0	0	0	0	0
NU	Never	4	3	4	3	2

When your corporation initially pays tax at small business rates, your corporate investment generally outperforms by 1% or more within the first two to four years.

### If your corporation pays tax at the general rate

When your corporation initially pays tax at the general tax rate, it takes more time for the corporate investment to outperform. In general, the time needed for your corporate investment to outperform the personal investment by more than 1% is as follows:

- **At the second federal tax bracket (around \$57,000).** Never. This makes sense because the general tax rate is higher or equal to your lower personal tax rates. Therefore, there is little to no initial corporate deferral.
- **At the third federal tax bracket (around \$114,000).** For BC, NB and NWT it takes 2-4 years. For AB, SK, ON, and QC it takes between 6-7 years. For MB, PEI and NS it takes 11-14 years. For NL, YK, and NU the corporation investment never outperforms the personal investment or provides roughly the same.
- **At the highest federal tax bracket (around \$253,000+).** For BC, AB, SK, ON, QC, NB, YK, and NWT between 1-5 years. For MB, NS, PEI, and NL between 7-11 years. For NU it takes approximately 13 years.

So, it takes more time for the corporate investment to outperform the personal investment.

**In this case, it makes sense to retain money inside your corporation only if you're in the higher tax brackets and don't require the money until after the above noted times.**

## If you're in a lower tax bracket when removing the money

Not everyone stays at the same personal tax bracket during their lifetime. You may drop personal tax brackets from when you invest the money to when you remove the money. That is, you remove money at a higher current tax rate to invest personally. However, you remove corporate money and liquidate your personal investment at a lower personal tax rate in later years. In this case, the corporate tax deferral becomes more relevant and advantageous.

### Small business rate

When your corporation initially pays tax at the small business rate, the corporate deferral has a significant advantage. Across Canada, it takes one year for the corporate deferral to provide more after-tax. This makes sense because if you retain it inside your corporation, there is more inside your corporation to invest initially. You then remove the money from the corporation at lower personal tax rates in later years. This magnifies the corporate deferral advantage. **So, it makes sense to retain money inside your corporation if you expect to be in a lower tax bracket when you remove the money.**

### General rate

When your corporation initially pays tax at the general rate, the corporate deferral has a smaller advantage. However, across Canada, this still generally provides more after-tax to you when you drop tax brackets. Keep in mind at lower personal tax brackets, the advantage may not be significant. Further, the advantage may be smaller if your personal tax brackets only slightly drop. The more tax brackets you drop, the larger the corporate deferral advantage. **In most cases the corporate investment will likely provide more after-tax to you.**

## If you're in a higher tax bracket when removing the money

You may also increase personal tax brackets from when you invest personally to when you remove the money. That is, you remove money at a lower personal tax rate initially to invest personally. However, you remove corporate money and liquidate your personal investment at a higher personal tax rate in later years.

### Small business rate

When your corporation initially pays tax at the small business rate, the corporate investment typically needs time to outperform the personal non-registered investment. For example, if you initially invest at the second federal tax bracket (around \$57,000) and remove the money at the third federal tax bracket (around \$114,000):

- For AB, SK, NB, NS, NL, and NWT the corporate investment requires 8-13 years to provide more after-tax to you personally.
- For MB, QC, PEI, and YK the corporate investment requires 14-15 years to provide more after-tax to you personally.
- For ON BC, and NU, the corporate investment requires 22-24 years to provide more after-tax to you personally.

**Retaining inside the corporation when you later increase tax brackets requires time.** The higher the tax brackets you increase, the more time the corporate investment needs to outperform. At lower initial personal tax brackets, the corporate investment may never outperform.

### General rate

When your corporation initially pays tax at the general rate, and your personal tax brackets increase later, the corporate investment takes significant time to outperform the personal non-registered investment. This makes sense. The corporate tax deferral is smaller than when your corporation initially pays tax at the small business rate. In fact, it takes more than 30 years for most provinces for the corporate investment to outperform by 1%. In some cases, the corporate investment never outperforms. **In these cases, only if you have significant time does it make sense to retain money in the corporation.**

## Other considerations

In addition to the above, keep in mind the following considerations:

- Goal for the investment (short term versus long term).
- Loss of income tested benefits (grossed up dividends increase net income).

- Creditor protection (corporate money may be exposed to the corporation's creditors unless you use a separate holding corporation).
- Available income splitting rules (tax on split income rules for corporate money or prescribed rate loan for personal non-registered money).
- Loss of low small business rate when accumulating passive income inside your associated corporations.
- Corporate structure and complexity and cost of post-mortem planning when retaining money inside your corporation.
- Succession planning and need for more complex structure (e.g. family trust and/or holding company) to ensure lifetime capital gains exemption remains available for the operating portion of your corporation.
- Need to remove corporate money as taxable dividend to recoup RDTOH inside the corporation.

## Is there a tax advantage to incorporating my personal investment portfolio?

In all the above situations, you initially earn income in your corporation at active business tax rates. The lower corporate tax rate creates the potential corporate deferral when compared to your personal tax rates. You may wonder if there is a tax advantage to incorporating your personal investment portfolio. In most cases, the answer is, no.

If you currently have a personal investment portfolio and transfer it to your corporation, there is no initial corporate deferral. You start, in both cases, with the same amount in your investment account. Thereafter, your corporation will pay passive tax rates on the income the investments produce. Across Canada, the corporate passive tax rates either are close to or surpass the highest personal tax rates for the same type of income. Integration for passive income earned inside a corporation is negative across Canada.

Integration looks at the total corporate and personal tax rate paid for earning investment income inside your corporation and paying it out to you personally. It compares this rate to the highest personal tax rate on that same type of investment income. Taxable Canadian dividends are perfectly integrated when earned inside the corporation and paid out personally. This is because the corporate tax is reduced to nil when the full amount is paid out and eligible RDTOH recouped by your corporation.

However, integration on interest income and capital gains across Canada is different.

### Interest income integration

	BC	AB	SK	MB	ON	PQ	NB	NS	PEI	NL	YK	NWT	NU
<b>Integrated corporate and personal tax rate</b>	59.11%	51.54%	53.07%	57.34%	57.93%	58.70%	58.53%	60.99%	59.90%	60.70%	55.23%	49.14%	50.23%
<b>Personal tax rate</b>	53.50%	48.00%	47.50%	50.40%	53.53%	53.31%	52.50%	54.00%	52.00%	54.80%	48.00%	47.05%	44.50%
<b>Tax cost</b>	(5.61%)	(3.54%)	(5.57%)	(6.94%)	(4.40%)	(5.39%)	(6.03%)	(6.99%)	(7.90%)	(5.90%)	(7.23%)	(2.09%)	(5.73%)

This results in more combined corporate and personal taxes paid compared to the personal tax rate on similar income.

Capital gains are also negatively integrated. At a 50% inclusion rate, the negative integration is 50% of the interest income integration shown above.

This results in a significant disadvantage (tax cost) to earning capital gains inside your corporation versus personally. Keep in mind that there is still a tax deferral when your corporation earns the original money for the investment as active business income shown above. This tax cost highlights the potential disadvantage for moving after-tax personal money into a corporation to then invest.

Incorporating your personal portfolio brings cost and complexity associated with a separate corporate entity. These include a separate corporate tax return, tax on split income rules and corporate attribution, to name a few. In the end, incorporating a personal investment portfolio will not provide a tax advantage to most on investment income earned. Keep in mind, incorporating a personal investment portfolio may be done for other more complex tax and non-tax purposes. This includes estate freezing, control of income, and potential income splitting, subject to tax on split income.

## The bottom line

In many cases, the corporate tax deferral provides you with an advantage. The after-tax value of your corporate investment may outperform personal non-registered investing over time. However, there is no one size fits all solution. It depends on corporate tax rates, personal tax rates (now and in the future) and your corporate succession planning needs. Use the above as a guideline to make an informed decision particular to your stated goals and objectives.

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