CI GLOBAL ASSET MANAGEMENT

CORPORATE INVESTMENTS AND THE TAXATION OF INCOME

CORPORATE INVESTMENT OVERVIEW

Passive Investments Controlled Private Corporation (CCPC) may hold investments for any number of reasons, including:

- A tax deferral on active business income, which creates investment capital for the CCPC;
- Income-splitting opportunities for shareholders; and
- Flexibility and control over the income paid to shareholders.

Appropriate investment solutions for a CCPC are in part dependent on whether the corporation is in an accumulation, maintenance or drawdown phase, coupled with a need to ensure alignment between the tax-efficient investing of investment capital and the needs and wants of shareholders.

If the CCPC is in an accumulation phase, it typically does not require excess investment income and likely is looking for capital growth. If the CCPC is in a maintenance phase – meaning it requires income or cash flow to support its business operations or capital expansion – the question becomes income and cash flow options at the corporate level. In the last phase where shareholders are drawing income or cash flow from the corporation - the drawdown phase - the issue becomes more complex as two taxpayers (the corporation and shareholders) need to think about:

- How corporate assets can can be accessed with minimum taxation at the corporate level; and
- How income received from the corporation is taxed at the shareholder level.

INTEGRATION– A TAX CONCEPT TO CONSIDER

Integration means that an individual earning income through a corporation should be in the same after-tax position they would have been in had they earned the income personally. For example, when a business owner generates net income in a corporation and draws a salary or dividend from the corporation to support personal lifestyle needs, he or she should be in the same after-tax position had they earned the income directly via an unincorporated business.

Perfect integration results when the difference on an after-tax basis is nil and the business owner is indifferent as to whether to incorporate or not. As corporate and personal tax rates are different across the provinces and territories, perfect integration is often not a reality. This may impact salary versus dividend discussions and whether to use a CCPC to carry on an active business or to hold investments. For more information on integration rates for each province, see CI GAM's Corporate Tax Quick Reference Card here: https://ci-arena.ci.com/od/ba49130f

Tools such as dividend gross-up and tax credits, the corporate Refundable Dividend Tax on Hand (RDTOH) account and the Capital Dividend Account (CDA) support the concept of integration between a CCPC and its shareholder(s).

WHAT CAN BE DONE TO MINIMIZE TAXES PAID BY BOTH THE CCPC AND ITS SHAREHOLDERS ON PASSIVE INCOME EARNED BY THE CCPC?

If excess taxable investment income is realized, unnecessary tax will be payable, which will reduce investment capital. If the CCPC is in an accumulation phase, it is likely looking for capital growth and investing for capital gains over time can be efficient.

If the CCPC is in a maintenance or drawdown phase, there are two federal notional tax accounts to consider when accessed income is earned by a CCPC, and when dividends are paid to shareholders:

1. RDTOH tracks refundable taxes paid by the CCPC on investment income earned, and also dividend refunds received by the CCPC when it distributes taxable dividends to shareholders. To the extent the CCPC has a positive RDTOH balance, it receives a dividend refund of 38.33% for every $1 of taxable dividends declared and paid by the corporation to shareholders.
2. When capital gains are realized, only 50% of the capital gain is reported for tax purposes by the CCPC. The non-taxable portion of the capital gain is added to the corporation's CDA. The CDA is made up of several components, such as the non-taxable portion of net capital gains, and if the CDA has a positive balance, a capital dividend can be declared and paid as a tax-free income receipt.

CCPCs in the maintenance or drawdown phases should consider the above two notional accounts when contemplating cash flow needs to ensure overall tax efficiencies for both the corporation and its shareholders.

WHAT ARE THE BENEFITS OF USING CORPORATE CLASS FUNDS WITHIN A CCPC?

CCPCs in any phase of their development should consider corporate class mutual funds as an appropriate investment solution. There are two main benefits to using corporate class funds within a CCPC:

1. Minimization of income distributions, meaning reduced corporate taxes and a focus on capital appreciation over time.
2. Tax-efficient investment income in the form of Canadian eligible and capital gain dividends and capital gains upon the disposition of corporate class shares. Corporate class funds cannot pay distributions in the form of interest or foreign income, both of which are taxed less favourably than Canadian dividends or capital gains.

In summary, corporate class funds provide for greater control over the nature of investment income earned and the timing of one's tax liability. Corporate class funds easily integrate into the two notional tax accounts mentioned above (RDTOH and CDA) allowing for an efficient movement of assets from CCPC to shareholders.

FOR MORE INFORMATION ON PASSIVE INVESTING WITHIN A CORPORATION, SEE THE FOLLOWING CI GAM RESOURCES:

1. Tax planning using private corporations: https://ci.com/en/resources/financial-literacy/Tax%20planning%20using%20private%20corporations
2. Right on the Money: Options for Extracting Cash Flow from a Corporation: https://ci.com/en/resources/financial-literacy/Right-on-the-Money-Options-for-Extracting-Cash-Flow-from-a-Coporation
3. Corporate Investments and the Role of RDTOH: https://ci.com/en/resources/financial-literacy/corporate-investments-and-the-role-of-rdtoh

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