# Understanding Passive Corporate Investment Income


*"We achieve what we Plan and what's Measurable"*

~ Harvard Business Review

Wealth Without Worry

West End wealth planning

Investment Planning Counsel®

IPC SECURITIES CORPORATION

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Many small and medium sized business owners take advantage of the 15% small business tax rate by leaving surplus corporate dollars in their corporation and investing in a corporately owned investment account vs. taking the funds out of their corporation and paying tax personally. This strategy results in having $0.85 to invest corporately vs. only $0.464[(1)] to invest if the funds were to taken personally and tax paid at the highest marginal tax bracket in Ontario of 53.53%. Other benefits of corporate investing can include:

1. Preferred tax rate (ineligible dividend) when funds are withdrawn from the corporation
2. Reduction or elimination of CPP premiums & Ontario Health Tax
3. Flexible withdrawals vs. forced RRIF payments starting at 72 years of age
4. Potential estate tax planning benefits

There are other considerations however that can lessen the attraction of corporate investing. One is the 50.17% [(2)] combined tax on passive corporate income and a second being the Refundable Dividend Tax on Hand (RDTOH). RDTOH is a refundable tax payable each year on passive investment income such as interest, eligible dividends, taxable capital gains and net rental income. The purpose of the RDTOH is prevent a significant deferral on portfolio income. The good news is that there are ways to minimize the detrimental effect of the RDTOH and high tax on passive income.

One way maximize is to maximize the use of the **Capital Dividend Account** (CDA), which allows the tax-free portion of eligible capital property (this can be capital gains earned in a corporately owned investment account) to be transfer virtually tax free to shareholders. Another is by changing higher taxed income (interest and eligible dividends) to more tax efficient deferred capital gains. ***Download Report from our website on Tax Free Withdrawals Using the Capital Dividend Account. for more information.***

Since the only important dollar is an after-tax dollar, the illustration below compares how much a business owner will end up on an after-tax basis personally by investing $1,000,000 for 25 years in a corporate investment account by generating all interest income (column 1), all eligible dividends (column 2) and all deferred capital gains (column 3).

| | Column 1 Interest Income @ 4% | Column 2 Dividend Income @ 4% | Column 3 Def. Cap. Gains @ 4% |
|---|---|---|---|
| **Initial Investment in Corporate Account** | $1,000,000 | $1,000,000 | $1,000,000 |
| | | | |
| **After-Tax Value in year 25 (3)** | $1,121,364 | $1,390,028 | $2,035,498 |
| | | | |
| **Extra After Tax Benefit vs. Interest Income** | | 23.95% | 81.51% |

The illustration shows clear advantages with by generating deferred capital gains vs. both interest and eligible dividends. This can be accomplished through certain ETF and mutual fund structures which effectively change interest and eligible dividend income into capital gains which are not triggered until the investor decides to sell.

But is more beneficial to take a salary from your corporation and contribute to an RRSP rather than keeping investment capital within a corporate investment account? For more insight, see the Financial Post article by, ***Jamie Golombek*** Managing Director, Tax & Estate Planning with CIBC Wealth Strategies Group, compared investing in an RRSP vs. within a corporation and concluded that an RRSP investment is superior on an after-tax basis if the corporate investment account generated eligible dividends or interest income and similar when comparing to realized capital gains. However, when generating deferred capital gains the corporate account produced superior after tax benefits.

Corporately owned investment accounts can be a powerful tax and investment tool but is not necessarily suitable for every business owner. Other considerations must be taken into account such as:

1. Does the business owner want or need to keep a corporate structure active after retirement?
2. is the business owner's investment risk tolerance consistent with generating mostly, if not all, capital gains?
3. Are there estate tax considerations which using a corporation can allow more tax efficient solutions?

Remember to always consult an experienced professional Advisor well experienced with the tax and investment implications of corporately owned investment account before implementing any strategy.

(1) Assuming the top marginal tax rate in Ontario of 53.53%
(2) EY Canada for Ontario 2016
(3) At the end of year 25 the entire investment is liquidated and paid to the shareholder and The after-tax value to the shareholder includes corporate non- refundable tax and personal tax on the dividend. The refundable tax is included and calculated by tracking it each year and the corporation received the appropriate refund in each scenario which was paid to the shareholder.

# West End Wealth Planning, Part of IPC Securities Corporation


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## OUR PERSONAL WEALTH MANAGEMENT STRATEGY

Many Canadians worry about if they will be ready for a comfortable retirement, if their portfolio is positioned for growth without undue risk, if they are paying more tax than necessary, or if they will lose too much of their estate due to taxes and fees.

If you are concerned about achieving your life's important financial contact us.

*To provide you with a better understanding about how your financial decisions are effecting your current and future wealth, we will cover the cost of a professional assessment on your overall financial and investment strategies*

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