For individuals with cash or investments within their corporation the tax cost of withdrawing these funds or winding up the corporation can be quite high. In order to defer these taxes, these individuals often choose to keep the corporation going and concentrate on maximizing its investment returns.

Having the corporation invest in a tax-efficient manner can make a big difference to its net after-tax return; unfortunately the taxation of investment income within a corporation is often not well understood.

Let’s review the taxation of corporate investment income.

Corporate investment income is taxed as passive income at a fixed rate that varies by province. There are no graduated tax rates for corporate investment income. The corporate tax rate on investment income is usually higher than the highest personal marginal tax rate and approaches 50 per cent in some provinces.

Interest income and foreign income, including foreign dividends, are taxed as regular income at the passive income tax rate. A portion of the tax is refundable and added to the Refundable Dividend Tax on Hand account (RDTOH).

Capital gains are a more tax efficient form of income as only half are taxable (the “taxable capital gain”) and they are taxed at the passive income tax rate. A portion of the tax is also refundable and added to the RDTOH account. The non-taxable half of the capital gain is added to the Capital Dividend Account (“CDA”).

Dividends received from taxable Canadian corporations are subject to a 33.33 per cent refundable tax which is all added to the RDTOH account.

---

1This assumes the corporation is a Canadian Controlled Private Corporation (CCPC). The taxation of investment income within a corporation can be complex. Please consult with your tax advisor about the application of the rules to your specific situation.
**CAPITAL DIVIDEND ACCOUNT (CDA)**

No money is actually paid into the CDA. It is a notional account that includes the non-taxable 50 per cent of all capital gains. Corporations can elect to pay a “capital” dividend up to the balance in the CDA and the dividend is received tax-free by the shareholder. This is very attractive to shareholders.

**TIP**

Where a corporation realizes an increase in the CDA it is usually a good idea to pay out the CDA balance promptly (via a tax-free “capital” dividend). If the CDA balance is not paid out, 50 per cent of any subsequent capital losses will reduce the CDA and potential “capital” dividend.

---

**REFUNDABLE DIVIDEND TAX ON HAND (RDTOH) ACCOUNT**

The RDTOH account is also a notional account. It includes all of the 33.33 per cent tax on dividends received from a taxable Canadian corporation. For all other investment income (i.e. interest and foreign income and taxable capital gains) 26.67 per cent of that income is also added to the RDTOH account. When the corporation pays a taxable dividend to shareholders it will receive a tax refund of $1 for every $3 of dividends paid, up to the balance of the RDTOH account. The taxable dividend received by the shareholder is included on their tax return and will be subject to a dividend gross-up and dividend tax credit.

---

### The taxation of investment income within a Canadian corporation

<table>
<thead>
<tr>
<th>INVESTMENT</th>
<th>TAX RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canadian Dividend-Paying Securities</td>
<td>33.33% Cdn. dividends</td>
</tr>
<tr>
<td>GIC/Bonds or Foreign Dividend-Paying Securities</td>
<td>47% Interest and foreign income</td>
</tr>
<tr>
<td>Mutual/Segregated Funds or Stocks</td>
<td>23.50% Capital gains</td>
</tr>
</tbody>
</table>

**Canadian Dividend Income**

All taxes paid are refundable.  

**Interest and Foreign Income**

A portion of taxes paid are refundable.  

**Capital Gains**

50% of gains taxable to corporation.  

A portion of taxes paid are refundable.  

| 2 |

1. All taxes paid on Canadian dividend income and 26.67 per cent of interest and foreign income and taxable capital gains is refundable (added to RDTOH).  

Assumes corporate tax rate of 47 per cent.
CONCLUSION

Money that's invested in a corporation, regardless of the source, should be invested as tax efficiently as possible to mitigate the high corporate tax rates that apply to investment income in a corporation. Just as with individuals, all other things being equal, capital gains are tax preferred over interest income, whether the corporation leaves the income invested in the corporation to grow or pays it out to a shareholder via a dividend. Understanding the taxation of investment income with a corporation can have a significant impact on the corporation's and owner's bottom line.

For more information on corporate taxation or corporate investments see our related pieces entitled Investments Owned by Private Corporations (MK2206E), Earning Income Inside a Corporation (MK2609E) and Professional Corporations Offer Tax Breaks (MK2435E).
The commentary in this publication is for general information only and should not be considered investment or tax advice to any party. Individuals should seek the advice of professionals to ensure that any action taken with respect to this information is appropriate to their specific situation. Any amount that is allocated to a segregated fund is invested at the risk of the contractholder and may increase or decrease in value. Income bonuses are not cash deposits, they increase the basis for calculating guaranteed income. The income bonus is available each year following the initial deposit to the IncomePlus Series, provided no withdrawals are taken. Exceeding the withdrawal thresholds and/or withdrawals taken prior to the Election of LWA (Lifetime Withdrawal Amount) may have a negative impact on future income payments. The LWA becomes available for election on January 1st of the year the annuitant or the younger of the annuitant and the Joint Life (if applicable) turns age 55. Other conditions may apply. The Manufacturers Life Insurance Company is the issuer of the Manulife GIF Select insurance contract which offers the IncomePlus Series and the guarantor of any guarantee provisions therein. Manulife, the Block Design, the Four Cube Design, Strong Reliable Trustworthy Forward-thinking are trademarks of The Manufacturers Life Insurance Company and are used by it, and by its affiliates under licence.