Holdcos for investment purposes

February 2024

We are working on an update to this report, due to proposals in the 2024 federal budget (among them, an increase to the capital gains inclusion rate) that may affect the content below. For more information, please see the CIBC report titled 2024 federal budget: Selected measures, or Budget 2024 from the federal government.

Jamie Golombek and Debbie Pearl-Weinberg
Tax and Estate Planning, CIBC Private Wealth

Many Canadians own investment portfolios through a holding company (a "Holdco") for a variety of reasons. But how are income and gains earned on investments held inside the Holdco taxed? This report will look at the combined tax effects of earning investment income inside a Holdco, taking into consideration both the corporate level tax and the shareholder tax on the distributed dividends. We will also look at any deferral (dis)advantage.[1]

Total tax payable on Holdco investment income

Investment income and gains earned in a Holdco are taxed inside the corporation. The tax rate varies depending on the province or territory in which your Holdco resides as well as on the type of investment income or gain earned, since different tax rates apply to Canadian dividends, capital gains and other investment income such as interest and foreign dividends. When the after-tax income, or retained earnings, is eventually paid to an individual shareholder as a dividend, there is also personal tax levied on the shareholder, where, again, the rate varies by province or territory. In order to minimize any double taxation of the same income, the shareholder will be entitled to a dividend tax credit recognizing that tax was already paid inside the corporation. The amount of the credit will differ depending on the type of income (gain) which originally generated the dividend. Figure 1 shows the combined corporate and personal tax rates on various types of investment income and gains, across the various provinces and territories.[2]

Figure 1: Combined corporate and personal tax rates, by province or territory in 2024, when income is earned by a CCPC and distributed to an individual shareholder

Jurisdiction	Other investment income	Capital gains	Eligible dividends	Other than eligible dividends	Foreign income
AB	51.54%	25.77%	34.31%	42.31%	58.41%
BC	59.11%	29.56%	36.54%	48.89%	65.19%
MB	57.34%	28.67%	37.78%	46.67%	63.69%
NB	59.19%	29.60%	32.40%	46.83%	64.85%
NL	61.65%	30.83%	46.20%	48.96%	66.77%
NS	60.30%	30.15%	41.58%	48.28%	65.81%
NT	49.14%	24.57%	28.33%	36.82%	56.66%

1 This report will not review the impact of investing after-tax income from a corporation carrying on a business.

2 This report assumes that the investing within the Holdco is not considered to be carrying on a business. As such, the tax on split income rules have not been considered.

Jurisdiction	Other investment income	Capital gains	Eligible dividends	Other than eligible dividends	Foreign income
NU	50.23%	25.12%	33.08%	37.79%	57.64%
ON	57.93%	28.97%	39.34%	47.74%	64.15%
PE	61.50%	30.76%	36.20%	47.63%	66.43%
QC	58.71%	29.36%	40.11%	48.70%	64.81%
SK	52.69%	26.34%	29.64%	40.86%	59.73%
YT	55.24%	27.62%	28.93%	44.04%	61.90%

Source: Tax Templates Inc., January 1, 2024, assuming the shareholder pays tax at the top marginal tax rate.

Investments held personally or in a Holdco

There are certainly non-tax reasons to hold investments inside a Holdco. In order to determine, however, whether it is better from a tax perspective to hold investments inside a corporation or to hold the same investments personally, we need to compare the total tax bill in each case. In other words, we would compare the combined tax rate on the investment income earned in the Holdco plus the tax rate on the dividend when this after-tax investment income is paid to the shareholder, with the tax rate on investment income when it is earned personally. Figure 2 indicates whether investing the funds through the Holdco will yield an overall tax savings (or tax cost) compared to earning investment income personally using the top marginal tax for each type of income in the respective province or territory.

Figure 2: Tax savings (cost) from incorporating investment income, by province or territory in 2024

Jurisdiction	Other Canadian investment income	Canadian dividends	Net capital gains	Foreign income
AB	(3.5%)	0.00%	(1.8%)	(10.4%)
BC	(5.6%)	0.00%	(2.8%)	(11.7%)
MB	(6.9%)	0.00%	(3.5%)	(13.3%)
NB	(6.7%)	0.00%	(3.3%)	(12.4%)
NL	(6.9%)	0.00%	(3.4%)	(12.0%)
NS	(6.3%)	0.00%	(3.2%)	(11.8%)
NT	(2.1%)	0.00%	(1.1%)	(9.6%)
NU	(5.7%)	0.00%	(2.9%)	(13.1%)
ON	(4.4%)	0.00%	(2.2%)	(10.6%)
PE	(9.8%)	0.00%	(4.9%)	(14.7%)
QC	(5.4%)	0.00%	(2.7%)	(11.5%)
SK	(5.2%)	0.00%	(2.6%)	(12.2%)
YT	(7.2%)	0.00%	(3.6%)	(13.9%)

Source: Tax Templates Inc., January 1, 2024, assuming the shareholder pays tax at the top marginal tax rate.

Based on 2024 combined federal and provincial or territorial tax rates, while Canadian dividends have neutral treatment[3], in all other cases there will be a higher combined corporate and personal rate of tax paid by holding investments in a Holdco. The cost is most significant with foreign income.

This, however, is not the end of the story. We need to review whether there may be a tax deferral opportunity. That is, the rate of tax paid on investment income by the Holdco should be compared to the rate of tax paid by the individual. In some provinces or territories, the tax rate paid within the Holdco is lower than the tax rate paid by the individual. If there is a significant enough difference in these rates of tax, then there may still be a tax deferral benefit to earn income in the Holdco. That is, if the after-tax funds remain in the Holdco where they are reinvested, will this higher amount of after-tax investment income grow to a larger amount than if the investment income was earned personally?

Figure 3 indicates whether there will be tax deferral (or tax prepayment) from investing the funds through the Holdco, compared to earning investment income personally. As you can see, there is often a tax prepayment by earning investment income corporately and even where there is a deferral potential, the amount of the deferral is very small. This is quite different than the situation where a corporation earns active business income where there is generally a significant tax deferral.[4]

Figure 3: Tax deferral (prepayment) from incorporating investment income, by province or territory in 2024

Jurisdiction	Other Canadian investment income	Eligible dividends	Net capital gains	Foreign income
AB	1.3%	(4.0%)	0.7%	1.3%
BC	2.8%	(1.8%)	1.4%	2.8%
MB	(0.3%)	(0.6%)	(0.1%)	(0.3%)
NB	(0.2%)	(5.9%)	(0.1%)	(0.2%)
NL	1.1%	7.9%	0.6%	1.1%
NS	1.3%	3.3%	0.7%	1.3%
NT	(3.1%)	(10.0%)	(1.6%)	(3.1%)
NU	(6.2%)	(5.3%)	(3.1%)	(6.2%)
ON	3.4%	1.0%	1.7%	3.4%
PE	(2.9%)	(2.1%)	(1.5%)	(2.9%)
QC	3.1%	1.8%	1.6%	3.1%
SK	(3.2%)	(8.7%)	(1.6%)	(3.2%)
YT	(2.7%)	(9.4%)	(1.3%)	(2.7%)

Source: Tax Templates Inc., January 1, 2024, assuming the shareholder pays tax at the top marginal tax rate.

This lack of a significant tax deferral (if any), combined with the higher combined corporate and personal tax rates on investment income (as shown in Figure 2), means that generally you do not have a better after-tax return by earning investment income in a Holdco.

For example, even if Canadian eligible dividends were earned where the overall rate of tax would be the same, whether the dividends are earned personally or through a Holdco, the tax deferral for an Ontario resident would

3 A refundable Part IV tax of 38 1/3% is levied on dividends that a Canadian private corporation receives from another, non-connected Canadian corporation. The "Part IV tax" is notionally tracked in a Refundable Dividend Tax on Hand (RDTOH) account and is fully refundable at a rate of $38.33 for every $100 of taxable dividends distributed to the shareholder. Both the after-tax income and refunded tax may be distributed to the shareholder, either as eligible or non-eligible dividends, according to the type of dividends originally earned.

4 For further information on the taxation of active business income earned in a corporation and the tax deferral available, see our report In good company: Earning investment income in your corporation.

be a mere 1.0% (as shown in Figure 3). In addition, the costs of incorporating and maintaining the Holdco must be taken into account to determine if there is an overall net benefit to holding investments in a Holdco.

US estate taxes

As indicated above, there is generally an even higher tax cost of earning US dividend income through a Holdco than other types of investment income. This is due to the calculation of the foreign tax credit.[5] For instance when $1,000 of US dividends are earned through a Holdco in Ontario in 2024, only $358 would remain in your hands after tax. This means that combined corporate and personal taxes amount to $642, which is 64.15% of the $1,000 of foreign dividends. If, instead, you earned $1,000 of foreign dividends personally, you would only pay tax of $536. Consequently there is a tax cost of $106 or 10.6% (that is, you pay an extra 10.6% of income in taxes when income is earned through your corporation). It may, therefore, be more tax effective to hold foreign investments that pay interest or dividends personally, rather than in your corporation. That being said, if all your investments are held corporately, holding U.S. dividend-paying stocks in a corporation may still be beneficial from a total portfolio asset allocation perspective despite the higher tax cost on those dividends.

Further, despite this tax cost, if US estate taxes are of concern, then holding US investments such as common shares of US corporations in a Holdco may be considered. If you are not a US citizen, or other “US person”, US estate tax is imposed on the fair market value of “US situs property”, which includes shares of a US corporation, that you hold at the time of your death. The top US estate tax rate is 40% in 2024.[6] US estate tax should not apply where US investments are held in a Canadian Holdco, rather than directly by the shareholder. Be sure to speak with a knowledgeable cross border tax advisor before embarking on this strategy.

Small business deduction

Private corporations are generally entitled to a reduced tax rate on the first $500,000 of active business income due to the small business deduction (the “SBD”.)[7] Where certain passive investment income is earned in excess of $50,000, it may reduce access to the federal, and in most provinces, provincial SBD in the following tax year. For the purpose of this calculation, the passive investment income of associated corporations is pooled. As such, even if the Holdco itself does not have any active business income that would be eligible for the SBD, passive income earned within the Holdco may impact access to the SBD for an associated corporation.

Further information about these rules can be found in the report CCPC Tax Planning for Passive Income. This is yet another consideration to take into account before incorporating an existing investment portfolio.

Conclusion

The decision whether or not to incorporate a Holdco is indeed complex. There are many instances where a Holdco may be useful, even where there is no tax advantage to having one. This assessment should be fully investigated with both a tax and legal professional. This article contains general information only. Individual situations vary and, accordingly, tax and legal professionals should be consulted.

---

5 Further information on this tax cost can be found in our report In good company: Earning investment income in your corporation .

6 A credit is available that may eliminate some or all of this tax.

7 This SBD limit must be shared among corporations that are associated for tax purposes. The SBD limit for Saskatchewan provincial tax purposes is currently $600,000.

Jamie Golombek, FCPA, FCA, CPA (IL), CFP, CLU, TEP is the Managing Director, Tax and Estate Planning with CIBC Private Wealth, Toronto.

jamie.golombek@cibc.com

Debbie Pearl-Weinberg, LL.B. is the Executive Director, Tax and Estate Planning with CIBC Private Wealth, Toronto.

debbie.pearl-weinberg@cibc.com