Canadian tax integration on private company income

Last updated: October 2023

A central theme of Canadian income taxation is tax integration. Tax integration is achieved when a particular stream of income is subject to the same or similar total tax rate once it reaches the individual taxpayer level, regardless of the number of corporate tiers the income has passed through before reaching the individual taxpayer.

These tables provide an illustration of how the Canadian income tax integration system works. Integration is approximate. Depending on the applicable tax rates, there may be a slight tax savings, or tax cost, to earning income through a corporation followed by a distribution of after-tax profits paid to an individual shareholder by way of a dividend. This is because the combined corporate level tax and the personal level tax on dividends may be slightly higher or lower than personal tax if the income were earned by the individual earned the income directly, depending on his or her marginal tax rate.

Unless otherwise stated, references herein are to the Income Tax Act.

For illustrative purposes, we assumed the individual shareholder is resident in Ontario and subject to a combined federal and Ontario tax rate of 53.53%. The actual personal tax rate will vary depending on the individual's income tax bracket. Any benefits that may occur as a result of deferring the personal level of tax are not considered for purpose of illustration..

Table 1:

Income earned by a private corporation		General rate income	Small business income	Investment income[1]	
		Eligible dividend[2]	Non-eligible dividend[3]	Eligible dividend	Non-eligible dividend
At the corporate level					
Corporate level income	A	$100.00	$100.00	$100.00	$100.00
Combined federal and Ontario tax rates[4]		26.50%	12.20%	50.17%	50.17%
Less: Dividend refund rate[5]	K			30.67%	30.67%
Net corporate tax rate	C	26.50%	12.20%	19.50%	19.50%
Cash retained in the company available for dividend distribution[6]	**D = A x (1-C)**	**73.50%**	**87.80%**	**80.50%**	**80.50%**

[1] Investment income is "ordinary investment income" i.e., not foreign investment income or capital gains.

[2] Eligible dividends, defined in subsection 89(1) of the Income Tax Act, are dividends paid to Canadian residents by public companies and by Canadian-controlled private corporations (CCPC) out of income taxed at the federal general corporate tax rate. CCPCs cannot pay eligible dividends from income that is subject to the federal small business deduction or subject to refundable tax treatment.

[3] Non-eligible dividends are those that are not subject to the eligible dividend rules.

[4] For a detailed summary of the combined federal and provincial rates, please refer to the 2023 – 2024 Federal and Provincial / Territorial Corporate Income Tax Rates' table

[5] Passive income earned by a CCPC is subject to a higher tax rate at the corporate level. A portion of the higher tax is refundable when the corporation distributes taxable dividends to its shareholder. Please refer to Table 3: Dividend refund mechanism for more details.

[6] Assumed the individual shareholder does not require the after-tax investment income retained in the corporation. The dividend tax can be deferred until the dividend is paid, and thus tax deferrals are available by delaying the payment of dividends to the individual share.

Table 2:

Income earned by corporation and distributed to individual		General rate income	Small business income	Investment income	
		Eligible dividend	Non-eligible dividend	Eligible dividend	Non-eligible dividend
At the individual level					
Actual dividend paid to the individual shareholder[7]	D	$73.50[8]	$87.80	$80.50	$80.50
Dividend gross-up rate—paragraph 82(1)(b)[9]	E	38.00%	15.00%	38.00%	15.00%
Taxable dividend inclusion	**F = D x (1+E)**	**$101.43**	**$100.97**	**$111.09**	**$92.58**
Personal marginal tax rate	B	53.53%	53.53%	53.53%	53.53%
Cash retained in the company available for dividend distribution	**F x B**	**$54.30**	**$54.05**	**$59.47**	**$49.56**
Less: Federal dividend tax credit on actual dividend—section 121[10]	G	20.73%	10.39%	20.73%	10.39%
Less: Ontario dividend tax credit on actual dividend[11]	H	13.80%	3.43%	13.80%	3.43%
Total dividend tax credit	**D x (G+H)**	**$25.38**	**$12.13**	**$27.79**	**$11.13**
Personal tax on dividends after dividend tax credit	**I**	**$28.92**	**$41.92**	**$31.67**	**$38.43**
After-tax income retained	**D – I**	**$44.58**	**$45.88**	**$48.83**	**$42.07**

Tax rate comparison for illustrative example		General rate income	Small business income	Investment income	Investment income
		Eligible dividend	Non-eligible dividend	Eligible dividend	Non-eligible dividend
Tax rate if income earned by the individual shareholder directly	B	53.53%	53.53%	53.53%	53.53%
Tax rate if income earned by corporation and received by individual as dividends	1 – (D-H)/A	55.42%	54.12%	51.17%	57.93%
Tax saving (cost) if income earned by corporation		**(1.89%)**	**(0.59%)**	**2.36%**	**(4.40%)**

[7] The amount is rolled forward from Table 1: Income earned by a private corporation.

[8] The DTC for general rate income assumes that there is sufficient GRIP to pay out the entire dividend of $73.50 as eligible dividend.

[9] The taxable income inclusion at the individual level requires a gross up to account for any tax the corporation has paid on the dividend received by the individual.

[10] In years after 2019, at the federal level, the deduction rates applied to eligible and non-eligible dividends are 6/11 and 9/13, respectively, pursuant to section 121. Refer to Table 4: Summary of the federal and provincial dividend tax credit rates table below for more details.

[11] See Table 3: Dividend refund mechanism's provincial tax credit calculation as an example for 2023. Ontario dividend tax credit rates on taxable dividends are 10.00% for eligible dividends (or 13.80% on actual dividends) and 2.9863% for ineligible dividends (or 3.43% on actual dividends

Table 3: Dividend refund mechanism

This table is used to demonstrate how the dividend refund mechanism works, using the assumptions from the illustrative example.

		Non-eligible dividend	Eligible dividend [Assume ERDTOH = $30.67]
Investment income earned by corporation	A	$100.00	$100.00
Corporate rate (federal + provincial)		50.17%	50.17%
Less: Dividend refund rate—subsection 129(4)[12]	K	30.67%	30.67%
Net corporate tax rate	C	19.5%	19.5%
Cash available for distribution after taxes	**I = A X (1 – C)**	**$80.50**	**$80.50**
Refund rate to private corporation—subsection 129(1)[13]	J	38.33%	38.33%
Dividend refund to private corporation	**I X J**	**$30.67**[14]	**$30.67**

Provincial tax credit calculation example for 2023[14]:		**Non-eligible dividend**	**Eligible dividend**
Gross-up rate—paragraph 82(1)(b)	E	15.00%	38.00%
Deduction rate applied—section 19.1 of the Taxation Act (Ontario)	L	22.8950%	36.3158%
Tax credit as % of actual dividend	**H = E x L**	**3.43%**	**13.80%**
Tax credit as % of taxable dividend	**H / (1+E)**	**2.99%**	**10.00%**

[12] Refundable Part I tax paid on investment income is tracked in a CCPC's notional Eligible (ERDTOH)/ Non-eligible (NERDTOH) refundable dividend tax on hand accounts. Generally, NERDTOH tracks a corporation's refundable tax paid on a CCPC's investment income. ERDTOH tracks refundable taxes paid on eligible dividends received from corporations that are not connected, as well as eligible dividends received from connected corporations to the extent that these dividends triggered a dividend refund to the payor corporation.

[13] Investment income of CCPCs gives rise to NERDTOH of 30.67%. When non-eligible taxable dividends are paid, this income tax is refundable at the rate of 38.33%.

[14] The maximum dividend refund available to private corporations on non-eligible dividends paid is limited to the amount of NERDTOH balance available (if ERDTOH is otherwise nil). As per row K, the NERDTOH balance is $30.67 (i.e., $100 * 30.67%). A dividend of $80.50 (row I) generates a maximum dividend refund of $30.86 (row I x J). Therefore, the dividend refund is capped at $30.67. Similarly, for eligible dividends paid, the maximum amount of dividend refund available is limited to the amount of ERDTOH balance available and hence is capped at $30.67.

[15] This table demonstrates how the Ontario tax credit rate for 2023 is calculated.

Table 4: Summary of the federal and provincial dividend tax credit rates currently applicable

This table summarizes the dividend tax credit rates based on 63rd edition of the Practitioner's Income Tax Act, Tax Reference Tables in I-6 Eligible Dividend Tax Credit Rates and I-7 Non-Eligible Dividend Tax Credit Rates for 2023.

Jurisdiction	Reference	Eligible dividend tax credit rates		Non-eligible dividend tax credit rates	
		Actual dividend	Taxable dividend	Actual dividend	Taxable dividend
Federal	Section 121 of the ITA	20.73%	15.02%	10.39%	9.03%
Alberta	Section 21 of Alberta Personal ITA	11.20%	8.12%	2.51%	2.18%
British Columbia	Section 4.69 of the ITA (British Columbia)	16.56%	12.00%	2.25%	1.96%
Manitoba	Subsection 4.7(1) of the ITA (Manitoba)	11.04%	8.00%	0.90%	0.78%
New Brunswick	Finance and Treasury Board— Dividend Tax Credit	19.32%	14.00%	3.16%	2.75%
Newfoundland and Labrador	Section 20 of the ITA (Newfoundland and Labrador)	8.69%	6.3%	3.68%	3.20%
Northwest Territories	Part 4 – Northwest Territorial Tax, Line 13	15.87%	11.50%	6.90%	6.00%
Nova Scotia	Section 21 of the ITA (Nova Scotia)	12.21%	8.85%	3.44%	2.99%
Nunavut	Section 2.32 of the ITA (Nunavut)	7.60%	5.51%	3.00%	2.61%
Ontario	Section 19.1 of the Taxation Act (Ontario)	13.80%	10.00%	3.43%	2.99%
Prince Edward Island	Section 20 of the ITA (Prince Edward Island)	14.49%	10.50%	1.50%	1.30%
Quebec	Changes in dividend tax credit rates (Quebec)	16.15%	11.70%	3.93%	3.42%
Saskatchewan	Section 32 of the ITA (Saskatchewan)	15.18%	11.00%	2.421%	2.105%
Yukon	Section 39 of the ITA (Yukon)	16.59%	12.02%	0.77%	0.67%

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