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Investing Inside or Outside a Private Holding Company: An Update and Common Considerations

IN THIS ISSUE

In its simplest form, the purpose of a holding company ("Holdco") is to hold all of your investment assets often including the shares of your private business (the "Opco"). Owner-managers typically funnel their business earnings as tax-free dividends from their Opco to their Holdco and use those earnings to invest passively.

However, investment income earned by a private corporation is subject to special taxes that do not otherwise apply to individual investors. Overall, there is a tax cost of earning the investment income in a Holdco once the after-tax income is paid out to you as a dividend.

Personal and corporate taxes would be perfectly integrated where the tax paid with respect to investment income earned by an individual is the same as if he or she earned it through a corporation. When it comes to earning dividends, assuming you are in the highest tax bracket, you will pay the same amount of tax had you earned the dividends directly or through your Holdco. However, integration does not hold true when it comes to capital gains, interest, or foreign income. Depending on which province/territory you reside in, you may either defer or prepay taxes when you earn investment income in a Holdco. This means that although you pay more tax at the end of the day, you may have more (or less) cash at your disposal by choosing to hold your investments in your Holdco.

The table below illustrates the deferral (or prepayment) and tax cost of earning investment income through a private corporation. The assumption is that you are personally taxed in the top federal and provincial tax rates, and you or your corporation earned $10,000 of that income type.

	Portfolio Dividends		Capital Gains		Interest	
	Deferral (Prepayment)	(Cost)	Deferral (Prepayment)	(Cost)	Deferral (Prepayment)	(Cost)
Alberta	(662)	Nil	(133)	(210)	(267)	(420)
British Columbia	(703)	Nil	(98)	(210)	(197)	(419)
Manitoba	(55)	Nil	(13)	(310)	(27)	(619)
New Brunswick	(413)	Nil	57	(208)	113	(416)
Newfoundland and Labrador	221	Nil	(193)	(272)	(387)	(543)
Northwest Territories	(1,000)	Nil	(155)	(60)	(312)	(120)
Nova Scotia	325	Nil	(33)	(285)	(67)	(570)
Nunavut	(525)	Nil	(308)	(229)	(617)	(458)
Ontario	101	Nil	168	(122)	336	(244)
Prince Edward Island	(411)	Nil	(164)	(298)	(330)	(597)
Quebec	150	Nil	137	(86)	274	(171)

To further complicate matters, the taxation of investment earned by private corporations is expected to change, effective in 2016. Although not yet enacted, a bill tabled in parliament proposes to change the tax rates applicable to investment income earned by private corporations after December 31, 2015. These amendments are consequential to maintaining the integration of personal and corporate tax after the federal government increases the top personal tax rate to 33% (previously 29%). The figures in the table above reflect these proposed changes.

Sparing you the details, the tax rates applicable to investment income earned by Holdcos increased in 2016. The rate applicable to investment income (excluding portfolio dividends) increased by 4%. The rate applicable to portfolio dividends (i.e., dividends received from an unrelated corporation) increased by 5%. Fortunately, both of these taxes are refundable if the Holdco pays a sufficient dividend. The result is that, compared to previous years, investment income earned and retained within the Holdco is subject to higher refundable taxes.

All of this being said, owner-managers may choose to invest using a Holdco for non-tax reasons. When it comes to making the decision of whether or not to invest using a Holdco, there is no definitive guideline. Rather, it depends on an assessment of all your circumstances. Non-tax reasons for holding assets (including investment assets) in a Holdco include (but are certainly not limited to):

- protecting the assets from your Opco's creditors;
- controlling the timing of your dividends (say you expect your personal tax rate to decrease in future years and would rather pay taxable dividends later to take advantage of that lower tax rate);
- shielding your assets from the probate costs (provided that you have a secondary Will); and

- shifting passive assets from your Opco in order to preserve its qualified small business corporation status so that its shares are eligible for the capital gains exemption.

Therefore, holding investment assets in a Holdco may not be a purely tax-centric decision. Assuming the Holdco is created strictly for investment purposes, there are costs of filing a second set of tax returns and costs of incorporation itself. For large amounts of investment income used primarily for reinvestment rather than personal use, the tax deferral may be of sufficient value to justify the costs. One must weigh in each case (and in each province) the tax deferral on incorporation of investment assets against the eventual tax cost as well as the non-tax benefits of structuring your affairs in this manner.