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Tax for the Owner-Manager

LACK OF INTEGRATION A WIN FOR SOME ONTARIO AND NEW BRUNSWICK TAXPAYERS

In 2018 and 2019, Ontario and New Brunswick, respectively, announced that they would not adopt the federal government's clawback (subsection 125(5.1)) of the small business deduction (SBD) when a CCPC's adjusted aggregate investment income (AAII) was more than $50,000. The federal SBD clawback is effective for a CCPC for a taxation year beginning after 2018, at a rate of $5 for every $1 of AAII when the AAII was more than $50,000 in the previous taxation year. The full $500,000 SBD is therefore eliminated when AAII exceeds $150,000 ($500,000 − $5 × [$150,000 − $50,000]). The Ontario and New Brunswick rules cause some unexpected integration results when corporate income is subject to the provincial (not the federal) SBD and the after-tax amount is ultimately paid out as dividends. (See "Ontario Announcement Throws a Wrench into Integration," *Canadian Tax Highlights*, January 2019.) Now, as we enter the third year of overintegration, it is useful to take an updated look at how some taxpayers in Ontario and New Brunswick are benefiting.

Ontario

In 2021, a CCPC in Ontario earning active business income (ABI) with access to the SBD is taxable at 12.2 percent (9% federal + 3.2% Ontario). At general rates (without the SBD), a CCPC is taxable at 26.5 percent (15% federal + 11.5% Ontario), and when the federal (but not the Ontario) SBD is clawed back, the tax rate is 18.2 percent (15% federal + 3.2% Ontario). As a result, an Ontario CCPC that is subject to the federal SBD clawback (because its AAII is more than $50,000) regains access to the 8.3 percent Ontario tax deferral, valued at up to $41,500 in 2021 ($500,000 × [11.5% − 3.2%]). It also saves 2.91 percent (54.12% − 51.21%) in tax when income is not eligible for the federal SBD but only for the Ontario SBD, as noted in table 1.

When after-tax corporate income is paid out to the shareholder, a CCPC with access to the SBD has total (integrated) corporate and personal taxes of 54.12 percent. A CCPC taxed at the general tax rates is subject to integrated taxes of 55.54 percent, and when the AAII results in a clawback of the federal but not the Ontario SBD, the CCPC is taxable at the combined integrated tax rate of only 51.21 percent. The result is a breakdown of integration, as shown in table 1.

Table 1 Ontario 2021

	No SBD	Federal and Ontario SBD	No federal SBD/Ontario SBD
Active business income	10,000	10,000	10,000
Corporate taxes: federal (A)	(1,500)	(900)	(1,500)
Corporate taxes: Ontario (B)	(1,150)	(320)	(320)
After-tax income available for dividends	7,350	8,780	8,180
Personal tax: federal (C)	(1,828)	(2,421)	(2,057)
Personal tax: Ontario (D)	(1,076)	(1,771)	(1,244)
Net cash to shareholder	4,446	4,588	4,879
Total integrated tax (A + B + C + D)	5,554	5,412	5,121
Integrated tax rate (%)	55.54	54.12	51.21

New Brunswick

In 2021, a CCPC in New Brunswick earning ABI with access to the SBD is taxable at 11.5 percent (9% federal + 2.5% New Brunswick). At general rates (without the SBD), a CCPC is taxable at 29 percent (15% federal + 14% New Brunswick). When the federal but not the New Brunswick SBD is clawed back, the tax rate is 17.5 percent (15% federal + 2.5% New Brunswick). As a result, a New Brunswick CCPC subject to the federal SBD clawback (because its AAII is more than $50,000) regains access to the 11.5 percent (14% − 2.5%) New Brunswick tax deferral, valued at up to $57,500 in 2021 ($500,000 × [14% − 2.5%]). It also saves 7.12 percent (53.76% − 46.64%) in tax when income is not eligible for the federal SBD but only for the New Brunswick SBD, as noted in table 2.

When after-tax corporate income is paid out to the shareholder, a CCPC with access to the federal and New Brunswick SBD has total (integrated) corporate and personal taxes of 53.76 percent. A CCPC taxed at the general tax rates is subject to integrated taxes of 52.7 percent, and when the AAII results in a clawback of the federal but not the New Brunswick SBD, the CCPC is taxable at the combined integrated tax rate of only 46.64 percent. The result is an even greater breakdown of integration than that in Ontario, as seen in table 2.

Table 2 New Brunswick 2021

	No SBD	Federal and New	No federal SBD/New

Corporate taxes: federal (A)	(1,500)	(900)	(1,500)
Corporate taxes: NB (B)	(1,400)	(250)	(250)
After-tax income available for dividends	7,100	8,850	8,250
Personal tax: federal (C)	(1,762)	(2,440)	(2,076)
Personal tax: NB (D)	(617)	(1,786)	(838)
Net cash to shareholder	4,721	4,624	5,336
Total integrated tax (A + B + C + D)	5,279	5,376	4,664
Integrated tax rate (%)	52.79	53.76	46.64

Conclusion

When the federal SBD is clawed back because of AAII, dividends paid by the CCPC to an individual are eligible dividends under federal rules. This outcome assumes that the provinces also treat the dividends as eligible and does not assume that a province, for example, taxes them at the lower SBD rate. (Ontario and New Brunswick could theoretically create their own provincial general rate income pool [GRIP] at the cost of additional complexity in an already excessively complicated tax system.) The result of paying eligible dividends from GRIP (defined federally in subsection 89(1)) is that a CCPC whose AAII exceeds $50,000 has a lower integrated tax rate and the federal government enjoys increased revenue at Ontario's and New Brunswick's expense.

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