CORPORATE STRATEGY SERIES — NO. 01

The Canadian Business Owner's Complete Tax Planning Guide

A comprehensive framework for incorporated entrepreneurs navigating corporate tax, passive income, estate planning, and long-term wealth extraction — written in plain language, built on current CRA guidance.

READING TIME
~18 minutes

BEST FOR
CCPC Owners & Incorporated Professionals

LAST REVIEWED
2026

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SECTION 01

How corporate tax actually works

If you've incorporated your business, you're no longer taxed as an individual on everything the business earns. The corporation is its own taxpayer, with its own return, its own rates, and its own set of rules. Understanding that separation is the foundation everything else in this guide builds on.

A Canadian-controlled private corporation (CCPC) — broadly, a private company controlled by Canadian residents — is eligible for preferential tax treatment on active business income, up to a limit. Income earned above that limit, and most forms of investment income, is taxed at the higher general corporate rate.

~11–13%	~23–27%	$500K
TYPICAL COMBINED SMALL BUSINESS RATE	TYPICAL COMBINED GENERAL RATE	FEDERAL BUSINESS LIMIT

Exact combined rates depend on your province, since each one sets its own small business and general corporate rates on top of the federal rate. The gap between the two, however, is consistent everywhere: it's usually somewhere in the range of 10 to 15 percentage points. That gap is the reason so much of corporate tax planning is about managing which income lands inside the lower bracket and which doesn't.

SECTION 02

Your $500,000 small business deduction

The small business deduction (SBD) is what creates that lower rate. It applies to the first $500,000 of active business income earned by a CCPC each year — this is called the "business limit." Income above that threshold is taxed at the general corporate rate.

Two things can shrink your $500,000 limit before you even get near it:

- **Associated corporations.** If you operate through more than one corporation that the CRA considers "associated" (broadly, under common control), those corporations share a single $500,000 limit rather than each getting their own.
- **Taxable capital.** Once the combined taxable capital employed in Canada by your corporation and any associated corporations passes $10 million, the limit begins to shrink

on a straight-line basis, disappearing entirely at $50 million.

For most owner-managed businesses, the more immediate issue isn't taxable capital — it's the passive income grind, which is common enough, and easy enough to trigger by accident, that it deserves its own section.

SECTION 03

The passive income trap

This is the rule that catches the most business owners off guard, usually a year or two after they've started building up cash in the company. Once your corporation's investment income — interest, taxable capital gains, and similar passive income, referred to by the CRA as Adjusted Aggregate Investment Income (AAII) — crosses $50,000 in a year, your $500,000 business limit for the *following* year starts shrinking.

THE GRIND, IN PLAIN TERMS

For every dollar of passive investment income above $50,000, your small business deduction limit shrinks by five dollars. The limit is fully eliminated once passive income reaches $150,000.

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SBD Reduction = (Prior-Year AAII − $50,000) × 5
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Because the reduction is five-to-one, it doesn't take much. A corporation earning $80,000 of passive income in one year loses $150,000 of its business limit the next — meaning $150,000 of active business income that would have been taxed at the small business rate now gets taxed at the general rate instead. And because the calculation runs off the *prior* year's numbers, there's no way to undo it after the fact — only to plan around it going forward.

This is precisely why so many incorporated business owners end up looking at holding companies, corporate-owned life insurance, or other structures that keep long-term savings from counting as AAII in the operating company. We cover the main options in Section 05.

SECTION 04

Salary vs. dividends: getting money out

Once your corporation has earned money, the next decision is how to pay yourself. The two main options — salary and dividends — are taxed very differently, and the right mix depends on your personal circumstances more than any universal rule.

FACTOR	SALARY	DIVIDENDS
Creates RRSP room	Yes	No
Corporate deduction	Yes — reduces corporate income	No — paid from after-tax profit
CPP contributions	Yes, on both sides	No
Payroll admin	Required	Simpler
Best suited for	Building RRSP & CPP, qualifying for mortgages	Owners prioritizing flexibility & lower admin

Canada's tax system is designed around "integration" — the theory that, over time, it shouldn't matter much whether you pay yourself salary or dividends, since the combined corporate-plus-personal tax should land in roughly the same place. In practice, integration is rarely perfect, and the better choice often comes down to whether you value RRSP room and CPP credits, or simplicity and flexibility. Many owners use a blend of both, adjusted year to year.

SECTION 05

Making retained earnings work

If you don't need all of your corporation's profit personally, leaving it inside the company to grow can make sense — corporate tax rates on active income are often lower than your personal marginal rate. The challenge, as covered in Section 03, is that investing that cash directly inside the operating company can trigger the passive income grind. A few structures are commonly used to work around this:

- **Holding companies.** Moving surplus cash from your operating company into a separate holding company (usually tax-free, via an inter-corporate dividend) keeps investment income out of the operating company's AAII calculation, protecting its small business deduction. The holdco itself still pays tax on the income it earns.
- **Corporate-owned life insurance (COLI).** Permanent life insurance held by the corporation can grow on a tax-advantaged basis, and — depending on the policy's structure — a meaningful portion of the death benefit can often be paid out to shareholders tax-free through the capital dividend account (see Section 06).
- **Individual pension plans (IPP).** For owners in their 40s and up drawing T4 salary, an IPP can allow significantly larger tax-deductible contributions than an RRSP, while also offering creditor protection.
- **Retirement compensation arrangements (RCA).** A supplementary retirement vehicle that can allow high-income owners to defer a larger portion of compensation than registered plans permit, with its own funding and tax rules.

None of these is a one-size-fits-all answer — each comes with trade-offs in cost, liquidity, and complexity. The right combination depends on your cash flow, your age, how the business is structured, and what you're ultimately planning for.

SECTION 06

The capital dividend account

The capital dividend account (CDA) is one of the few genuinely tax-free mechanisms in the Canadian system, and it's worth understanding even if you never use it directly. When your corporation realizes a capital gain, only half of it is taxable — the other half flows into the CDA. Life insurance proceeds received by a corporation can also flow into the CDA, often for the full amount above the policy's adjusted cost basis.

WHY IT MATTERS

Balances in the capital dividend account can be paid out to shareholders as a tax-free capital dividend — no personal tax owing on receipt. It's one of the main reasons corporate-owned life insurance is used as an estate planning tool: the death benefit can fund a large, tax-free payout to the next generation or the estate.

Filing the paperwork correctly (and on time) matters here — an improperly elected capital dividend can trigger penalties. This is a step best handled with an accountant, but it's worth knowing the mechanism exists before that conversation happens.

SECTION 07

Estate planning & the estate freeze

If your corporation has grown in value, an important question eventually comes up: what happens to that growth — and the tax on it — when you die or hand the business down? By default, Canada treats death as a "deemed disposition," meaning your shares are considered sold at fair market value immediately before death, potentially triggering a significant tax bill in your estate's final return.

An **estate freeze** is the standard tool for managing this. In simple terms, you exchange your common shares (which carry the future growth) for fixed-value preferred shares, and new common shares — carrying all future growth — are issued to your children, a family trust, or another successor. Your tax liability is "frozen" at today's value, and any further increase in the business's value accrues to the next generation, outside of your estate.

- Caps the tax exposure in your estate at today's value, rather than a future, larger number
- Allows the next generation (or a trust on their behalf) to begin participating in future growth
- Can be combined with life insurance to fund the eventual tax liability on the frozen value
- Often paired with a family trust for flexibility in how future growth is eventually distributed

An estate freeze isn't a one-time form — it's a structural decision that typically involves your accountant, a corporate lawyer, and a coordinated insurance strategy working together. Getting the valuation and share structure right at the outset matters more than almost any other step in this guide.

SECTION 08

Building your plan

None of the tools in this guide work well in isolation. A holding company without a coordinated insurance strategy just defers a decision. An estate freeze without updated wills and family agreements can create more conflict than it prevents. The value comes from sequencing these decisions correctly, and revisiting them as the business, tax rules, and your own goals change.

A reasonable starting sequence for most incorporated business owners looks like this:

1. Confirm how close you are to the passive income grind threshold this year and next
2. Review your current salary/dividend mix against your retirement savings goals
3. Decide whether a holding company structure makes sense for surplus cash
4. Evaluate whether corporate-owned life insurance, an IPP, or an RCA fits your timeline
5. Discuss an estate freeze once the business has meaningful embedded growth

This is exactly the coordination Canadian Allied Services is built around — bringing your accountant, lawyer, and financial plan into a single strategy instead of leaving each decision to be made in isolation.

Ready to build your plan?

Book a no-obligation discovery call and we'll walk through where these strategies could apply to your business.

Book a Discovery Call

This guide is provided for general educational purposes only and does not constitute tax, legal, or financial advice. Tax rates, thresholds, and rules — including the $500,000 business limit and the $50,000 / $150,000 passive income grind figures cited above — reflect general federal rules as of 2026 and vary by province; they are subject to change and may not apply to your specific situation. Please consult a qualified accountant, lawyer, or financial advisor before acting on any strategy described here.