

Deciding on a  
business structure

Earning an income  
in a corporation

Pre-retirement  
planning

Succession and  
estate planning

Minimizing double  
taxation after death

# Business owner guide

A practical overview of key tax strategies to help  
plan for every stage of business ownership.



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Business owners face unique financial, investment, tax and estate planning challenges. Partnering with a financial advisor can help ensure these critical areas are addressed with a well-structured, personalized plan. This guide is designed to help financial advisors start meaningful conversations with their clients and take the first steps toward a more comprehensive strategy.



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# Deciding on a business structure

Business owners have unique financial, investment, tax and estate planning needs. Many opportunities become available through incorporating the business. For other business owners, a sole proprietorship may be the best structure.

## Sole proprietorship

A sole proprietorship is the simplest business structure to start and maintain. With a sole proprietorship, one individual owns the business and its assets, and is solely responsible for all debts and obligations of the business. In exchange, the business owner can make all decisions and is entitled to all profits.

Sole proprietors are considered self-employed and generally perform all functions required to successfully establish the business. These include securing capital, establishing and operating business processes, and paying all taxes, which are calculated and reported on their personal income tax return.

Since a sole proprietorship isn't considered a separate entity from the business owner, business losses can be used to reduce other income on their personal tax return, including investment, rental and/or other income. On the other hand, if the business doesn't have enough capital to fulfill its debt obligations, creditors would normally have access to the owner's personal assets. This is known as unlimited liability.

Unlike many corporations, sole proprietorships tend to have difficulty obtaining capital, since it isn't possible to issue shares in exchange for the investment. It may also be difficult to secure key employees, as there are generally fewer resources and limited opportunities for career advancement. However, it's typically less costly to operate a sole proprietorship, as government reporting requirements tend to be less onerous than the requirements for corporations.

Sole proprietorships are generally suggested for new businesses that don't carry the risk of personal liability and usually generate business losses that may be used to offset other personal income sources.

### Advantages

- Ability to make all decisions.
- Owners are entitled to all profits.
- Simple to establish and cost-effective.
- Business losses may be used to offset other sources of income, which may reduce personal income tax.

### Disadvantages

- Owners are personally responsible for all debts (unlimited liability).
- Limited ability to raise third-party capital.
- Owners need to be generalists; no partners with unique skills.
- Attracting high calibre employees may be difficult.
- There may be higher insurance costs to reduce the risk of unlimited liability.
- No tax deferral available when earning active business income.
- Can't benefit from the lifetime capital gains exemption (LCGE) upon the sale of the business.



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## Partnership

A partnership is an arrangement in which two or more individuals combine resources with a view towards sharing expenses and profits. Typically, there are two types of partnerships — general partnerships and limited partnerships.

**General partnership:** the partners share in the management of the business and each is personally liable for all debts and liabilities.

**Limited partnerships:** limit the liability of each partner to the amount that partner has invested in the business. Limited partners aren't personally liable for debts of the business, but are prohibited from participating in the day-to-day management.

It tends to be less costly to establish a partnership than a corporation because there are generally fewer government reporting requirements. Annual information returns are normally required for tax purposes, but income or losses of the partnership are reported on the personal tax returns of the partners.

One of the greatest advantages of a partnership is the ability to share in the unique skills and financial resources of the partners. A significant disadvantage, however, in the case of general partnerships, is that each partner is personally liable not only for their own business debts, but for those of all partners in the partnership.

A partnership can also be difficult to dissolve should disagreements arise between partners. However, establishing a partnership agreement at the outset can clearly define operating guidelines and provide a framework for resolving disputes for the benefit of all partners.

### Advantages

- Liability is shared among general partners.
- Benefit from unique skills of partners.
- Simple to establish; less costly than corporations.
- Combined financial resources of partners.
- High calibre employees can be made partners.
- Business losses may be used to offset other sources of income, which may reduce personal income tax.

### Disadvantages

- Decision-making is shared; potential for disputes.
- Unlimited personal liability; one partner's liability may detrimentally affect all general partners.
- Limited ability to raise third-party capital.
- Finding suitable partners may be challenging.
- Can be legally bound by partners; difficult to dissolve partnership; partnership dissolves on death of a partner.



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## Corporation

A corporation is another common business structure. Unlike sole proprietorships and partnerships, the law considers a corporation an entity that is separate from its owners/shareholders. In fact, corporations file their own tax returns independent of individual shareholders, and corporate losses can't be used to offset income on their personal income tax returns.

Ownership in a corporation can be easily transferred through the purchase and sale of shares without affecting the corporation's operations. With respect to commercial activities, corporations have the same rights and liabilities as individuals — they can sue and be sued, and they can own and sell property.

It can be easier to raise capital for a corporation than for a sole proprietorship or partnership, due to the ability to issue shares. Shareholders also have limited liability — they're generally not personally liable for debts and obligations of the corporation.

Shareholders of the corporation also have unique tax benefits, including reduced tax rates for business income earned in the corporation, a possible tax deferral and an exemption from capital gains tax when shares are sold — provided the sale meets specific criteria. Corporations also allow for sophisticated retirement planning, including the use of individual pension plans (IPPs), retirement compensation arrangements (RCAs) and estate freezes.

The main disadvantage of the corporate structure is cost. Corporations are complex and tend to be expensive to set up and operate. Depending on where the corporation operates, additional federal and provincial (or territorial) incorporations or registrations may be required, resulting in additional legal and accounting costs. In addition, corporations are heavily regulated and require various reporting and disclosure obligations, including detailed financial statements and tax filings.

Corporations can be private or public (traded on a stock exchange). They might be classified as "professional corporations" if, as is the case with most doctors, dentists and lawyers in certain provinces/territories, the activities of the business are governed by a professional association which permits incorporation.

### Advantages

- Separate legal entity, with rights similar to individuals.
- Creditor protection: personal assets are protected from business creditors (subject to some exceptions).
- Easier to raise third-party capital through issuance of shares.
- Tax deferral on retained business profits.
- Possible tax savings on sale or at death (LCGE and reduction of estate administration fees by use of secondary will).
- Greater flexibility in choosing remuneration and timing of tax liability (choosing combination of salary, bonus and dividends as compensation).

### Disadvantages

- Costly to start and maintain (closely regulated by governments).
- Possible conflict between shareholders and directors; can restrict decision-making.
- Directors could be held liable.
- Personal guarantees can undermine limited liability.
- Certain income earned through a corporation may be taxed at higher rates than if earned personally (depends on jurisdiction).
- Double taxation can apply at death if post-mortem tax plan isn't considered.

Choosing a business structure that meets the needs of the business owner(s) is an important decision and will depend on the specifics of their situation. Professional financial, legal and accounting assistance is recommended.



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# Earning an income in a corporation

Many business owners wonder whether it makes sense to incorporate their business. The answer depends on several factors, including the type of income earned and the tax rates that apply to that income.

## Earning active business income in a corporation

A corporation is a separate legal entity from its shareholders. As a result, income earned in a corporation is subject to two layers of tax: first at the corporate level and again at the personal level when profits are paid out as dividends. However, when earnings are retained in the corporation, personal tax can be deferred, which is a key advantage of earning active business income (ABI) through a corporation.

In general, ABI is earned from providing services or selling/manufacturing products. It excludes most investment income and personal services business income.

One of the main benefits of earning ABI in a Canadian-controlled private corporation (CCPC) is access to the small business deduction (SBD), which provides a reduced tax rate on up to \$500,000 of

ABI (in most provinces). The combined federal and provincial tax rate on this income typically ranges from 9% to 12.2%, compared to top personal tax rates of approximately 44.5% to 54.8%.

This difference creates a significant tax deferral opportunity, between 32.5% and 43.3%, depending on the province. Retaining earnings in the corporation allow business owners to reinvest and grow after-tax income more efficiently.

When profits are eventually paid out as non-eligible dividends, personal tax applies. In many cases, the combined corporate and personal tax may slightly exceed top personal rates, meaning incorporation is primarily a tax deferral strategy, rather than a permanent tax savings opportunity.



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### EXAMPLE

Holly owns a business in British Columbia and is taxed at the top personal rate of 53.5%. Her business generates \$100,000 of ABI. The chart below illustrates the tax deferral opportunity and tax cost associated with earning her business income through a corporation and distributing the after-tax profits now as a non-eligible dividend versus earning the same income personally.

	Earn business income personally	Earn business income through the corporation
Corporate active business income	–	\$100,000
Corporate tax	–	\$11,000 <sup>1</sup>
After-tax income paid out as a non-eligible dividend	–	\$89,000 <sup>2</sup>
Total personal income	\$100,000 <sup>3</sup>	\$89,000 <sup>2</sup>
Personal taxes payable	\$53,500 <sup>4</sup>	\$43,512 <sup>4</sup>
Total tax on business income	\$53,500	\$54,512 <sup>5</sup>
Tax deferral by incorporating	–	<b>\$42,500<sup>6</sup></b>
Tax cost by incorporating	–	<b>(\$1,012)<sup>7</sup></b>

**Note:** The available tax deferral allows the business owner to pay tax in the future when they may be in a lower tax bracket, or tax rates fall.

The table above highlights the impact of the tax deferral as a key tax planning opportunity available, if Holly incorporates her business. First, if Holly can retain the after-tax business profits inside the corporation and not have it flowed out to her as a dividend, she's able to defer \$42,500 of income tax annually. This is measured by the difference between total taxes payable, assuming she earned the income personally, less the corporate taxes paid on the income earned through the corporation.

In Holly's case, this represents a tax deferral of 42.5%. Furthermore, Holly will pay more overall tax if she decides to distribute all the after-tax business profits to herself as a dividend. Her total tax cost in this case is \$1,012, calculated as the difference between the taxes she would have paid personally (\$53,500) and taxes paid by earning income through the corporation and flowing the after-tax proceeds to her as a non-eligible dividend (\$54,512). If Holly required cash flow, she would be better off earning the income personally since more tax is paid by incorporating.

1. Total federal/BC small business rate = 11.0%.

2. Non-eligible dividend.

3. \$100,000 of ABI.

4. Based on 2026 top marginal tax rates for BC.

5. Corporate tax \$11,000 plus personal tax \$43,512 on dividend.

6. Tax deferral-personal tax \$53,500 (if income earned personally), less corporate taxes paid \$11,000.

7. Tax cost-difference between personal tax \$53,500 (if income earned personally) less the combined corporate and personal tax \$54,512 (if income earned through the corporation).



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The tax deferral benefit is available across all provinces and territories. Incorporation may be most advantageous where profits can be retained within the corporation over time. The table below summarizes the tax deferral and tax savings/cost by province and territory.

Province/territory	Small business rate	Income earned personally	Tax deferral	Tax savings/cost
British Columbia	11.00%	53.50%	42.50%	(1.00%)
Alberta	11.00%	48.00%	37.00%	(0.70%)
Saskatchewan	10.00%	47.50%	37.50%	0.30%
Manitoba	9.00%	50.40%	41.40%	(1.10%)
Ontario	12.20%	53.53%	42.33%	(0.10%)
Quebec	12.20%	53.30%	41.10%	(1.60%)
New Brunswick	11.50%	52.50%	41.00%	(0.50%)
Nova Scotia	10.50%	54.00%	43.50%	(1.20%)
Prince Edward Island	10.00%	51.75%	42.00%	(1.10%)
Newfoundland and Labrador	11.50%	54.80%	43.30%	0.00%
Yukon	9.00%	48.00%	39.00%	(1.10%)
Northwest Territories	11.00%	47.05%	36.05%	3.30%
Nunavut	12.00%	44.50%	32.50%	(0.80%)

Rates as at April 2026. The small business rate applies to the first \$500,000 federally and in most provinces/territories, except Saskatchewan and PEI, which provide a provincial small business deduction of \$600,000, while Nova Scotia provides a provincial small business deduction of \$700,000. Assumes individual is in the top marginal tax bracket in their province or territory of residence. Represents the total tax savings/cost of earning ABI through a corporation, and flowing all after-tax profits out to the individual shareholder in the form of a non-eligible dividend versus the shareholder earning ABI personally.

## Earning investment income in a corporation

Incorporated business owners often use after-tax active business profits to invest in passive assets such as rental properties or investment portfolios. The income earned from these assets (such as interest, rent, royalties, taxable capital gains and foreign income) is generally referred to as aggregate investment income (All) and is taxed at higher rates than active business income (ABI). Dividends from Canadian corporations are excluded from All and are instead subject to Part IV tax.

Historically, corporations were commonly used to earn investment income due to their tax deferral advantages. However, changes to corporate and personal tax rates have largely eliminated this benefit. In most provinces, earning investment income in a corporation now results in little to no deferral and often a higher overall tax cost compared to earning it personally.

In addition, it's subject to refundable tax, which acts as a prepayment of tax and is refunded when the corporation pays taxable dividends to

shareholders. This mechanism is intended to achieve tax integration, so that earning income through a corporation results in a similar overall tax outcome as earning it personally.

There are two refundable tax accounts:

- **Non-eligible Refundable Dividend Tax on Hand (RDTOH):** generally, tracks refundable tax on All and certain Part IV tax; refunded when non-eligible dividends are paid.
- **Eligible RDTOH:** tracks Part IV tax on eligible dividends; refunded when eligible dividends are paid (or after non-eligible RDTOH is exhausted).

Both accounts typically generate a refund of \$0.3833 per \$1 of taxable dividends paid.

Many incorporated business owners still accumulate passive investments inside their corporations using deferred ABI. While this can support long-term wealth accumulation, excess passive assets may jeopardize access to the lifetime capital gains exemption (LCGE) on a future share sale.



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Due to refundable tax and higher initial tax rates, there's generally no tax advantage to earning investment income in a corporation on a standalone basis. For business owners investing retained earnings, the tax impact will depend on the type of income earned and how and when funds are distributed. This is best illustrated in the following example.

### EXAMPLE

Let's assume Holly incorporated her active business and took advantage of the significant tax deferral by accumulating profits in her corporation. Using the accumulated profits, she has created an investment portfolio which generated \$10,000 of investment income in 2025. She continues to be a resident of BC and is taxed at the top personal tax rate.

The following chart compares the tax implications of earning \$10,000 of investment income as: Interest and foreign income; Eligible portfolio dividends; or Capital gains.

Investment income in a CCPC: BC (2026)			
	Interest and foreign income	Eligible portfolio dividends	Capital gains
Investment income	\$10,000	\$10,000	\$10,000
Non-taxable portion – CDA	–	–	\$5,000
Taxable portion	\$10,000	\$10,000	\$5,000
Tax rate (BC)	50.70%	38.33%	50.70%
Corporate tax	\$5,070	\$3,833	\$2,535
Net income before refundable tax	\$4,930	\$6,167	\$7,465
Refundable tax rate	30.67%	100%	30.67%
Refundable tax (\$)	(\$3,067)	(\$3,833)	(\$1,534)
Available for distribution to individual shareholder			
Taxable distribution	\$7,997	\$10,000	\$3,999
Non-taxable distribution	\$–	\$–	\$5,000
Individual shareholder			
Non-taxable CDA distribution	\$–	\$–	\$5,000
Taxable non-eligible dividend	\$7,997	\$–	\$3,999
Personal tax rate (non-eligible)	48.89%	–	48.89%
Personal tax (non-eligible)	\$3,910	–	\$1,955
Taxable eligible dividend	–	\$10,000	–
Personal tax rate (eligible)	–	36.54%	–
Personal tax (eligible)	–	\$3,654	–
Net proceeds to shareholder	\$4,087	\$6,346	\$7,044
Summary			
After-tax proceeds to shareholder	\$4,087	\$6,346	\$7,044
Combined tax if earned through corporation	\$5,913	\$3,654	\$2,956
Personal tax if earned directly	\$5,350	\$3,654	\$2,675
Tax cost by holding in corporation	(\$563)	\$–	\$281



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## EXAMPLE CONTINUED

### Interest and foreign income

Interest and foreign income earned by a corporation is fully taxable at high corporate tax rates. A portion of the corporate tax paid can be refunded to the corporation when non-eligible dividends are paid to the shareholder. In Holly's example, interest income is subject to corporate tax at 50.7%. However, a portion is refunded to the corporation when the after-tax profits are paid out to her as a taxable non-eligible dividend.

Assuming all after-tax profits flow to Holly (net of refundable taxes), she'll then have to pay personal tax on the non-eligible dividend received. The combined after-tax proceeds available to Holly are approximately \$4,087, representing a combined tax rate of 59.13%, exceeding BC's top personal tax rate of 53.50%. This means, \$563 additional tax was paid by earning the income through the corporation versus if Holly earned the income personally.

### Taxable Canadian dividends

Usually when a corporation owns more than 10% of another corporation's stock (in terms of votes and value), the two corporations would be considered connected. Dividends received from a connected versus non-connected corporations are taxed differently.

#### 1. Portfolio dividends

Typically, dividends received from non-connected corporations are referred to as portfolio dividends. Canadian portfolio dividends are typically earned from Canadian publicly-traded companies and are subject to a special tax rate of 38.33%, also known as Part IV tax.

Part IV tax on portfolio dividends is added to the eligible RDTOH account and can be fully refunded to the corporation at a rate of 38.33%

when either a non-eligible or eligible dividend is paid to shareholders. Non-eligible dividends first provide a refund based on the non-eligible RDTOH account balance and the eligible RDTOH balance may be accessed to obtain a dividend refund. Refer to the discussion on the new passive investment rules as non-eligible RDTOH may not be refunded if an eligible dividend is paid.

This example highlights the tax implications of Holly's corporation earning \$10,000 of portfolio dividends versus Holly earning it personally. Part IV tax of 38.33% applies to portfolio dividends and can be fully refunded when taxable dividends are paid to Holly.

Therefore, the full \$10,000 (net of refundable tax) can be paid as an eligible dividend allowing a refund of the eligible RDTOH account. The eligible dividend will be taxed at her personal marginal rate of 36.54%. As a result, Holly is left with \$6,346 after-tax. There's no difference whether the income is earned through the corporation or personally.

#### 2. Dividends from connected corporations

Although irrelevant to Holly's situation, it's worth noting, dividends received from connected corporations are taxed differently. These dividends could be received tax-free provided certain tests are met, otherwise the dividend can be taxed as a capital gain.

Additionally, Part IV tax applies to the receiving connected corporation equal to their share of the dividend refund received by the payer corporation. The Part IV tax is generally added to the non-eligible RDTOH account and can be refunded when a non-eligible taxable dividend is paid.



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## EXAMPLE CONTINUED

### Capital gains and the capital dividend account

Capital gains earned by a corporation are subject to a 50% inclusion rate — one half of the capital gain is subject to tax. In a corporate structure, the non-taxable one-half portion of the capital gain may be paid out of the corporation to shareholders on a tax-free basis by election. The mechanism which tracks the tax-free portion of capital gains is known as the Capital Dividend Account (CDA).

The CDA is an important aspect of the integration process. It's a "notional" tax account available to CCPCs that accumulate certain non-taxable receipts that can be paid to shareholders as a tax-free dividend.

### The three most common sources that contribute to the CDA are:

- The non-taxable portion of realized capital gains (net of capital losses).
- Tax-free life insurance proceeds received by the corporation (net of the adjusted cost basis).
- 100% of the capital gain when a security is donated in-kind.

As a result, capital gains earned by the corporation will increase the balance in the CDA by the amount of the non-taxable portion of the capital gain. At any time when there's a positive balance in the CDA, the corporation may elect to pay tax-free capital dividends to shareholders.

This example assumes \$10,000 of capital gains are earned by Holly's corporation. The non-taxable portion \$5,000 will accumulate in the CDA. The \$5,000 taxable portion is subject to the corporate investment tax rate. Therefore, the after-tax amount available to Holly personally is \$7,044. Although, earning capital gains through the corporation is more tax efficient than earning interest or foreign income, Holly pays an additional \$281 more in taxes by earning capital gains through her corporation versus earning personally.



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## Investment strategies for corporate passive assets

### Passive investment rules

Corporate tax rules target active businesses that invest passively. As previously discussed, an incorporated business owner can access the small business rate on up to \$500,000 of ABI. Under the passive investment rules, the SBL can be reduced if the passive investment income (subject to certain adjustments) earned by the corporation — and any associated corporations — exceeds \$50,000 for that taxation year. Specifically, the SBL will be reduced \$5 for every \$1 over and above \$50,000, which fully eliminates the SBL once the passive investment income reaches \$150,000.

## Invest in growth focused investments

Growth focused investments can be a tax efficient investment for two reasons:

### Tax efficient distributions

The taxation of distributions depends on the type of investment income earned. Interest and foreign income are fully taxable, while eligible dividends and capital gains receive preferential tax treatment in Canada.

The typical mutual fund trust distributes all types of income including interest, foreign income, dividends and capital gains, which retain their character and are taxed accordingly in the hands of the investor (personally or corporately).

In contrast, capital growth-focused investments typically don't distribute income. Instead, investors can control the timing of taxation by realizing capital gains through partial redemptions. Only 50% of capital gains are taxable, while the non-taxable portion is added to the corporation's capital dividend account (CDA).

### Tax-efficient growth

Investors who hold GICs, bonds or dividend-paying stocks in a non-registered account will pay tax every year that you hold the investment. Investing in capital growth focused securities can give business owners the ability to minimize and defer tax along the way, keeping more money in their account and allowing it to compound over time. The less tax they pay, and the later they pay it, the greater their growth potential.



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# Pre-retirement planning

Retirement planning is important for everyone. It's especially critical for incorporated business owners, because they invest significant time and capital in their businesses, often expecting the business's value to form a key component of their retirement strategy. As a result, proactive planning is essential to identify opportunities for growth, capital preservation and tax efficiency.

## RRSP contributions or corporate investing?

Incorporated business owners can save for retirement by:

1. withdrawing profits as salary or bonus to fund their RRSP;
2. retaining earnings to invest within the corporation; or
3. a combination of both.

To contribute to an RRSP, the owner must have available contribution room, calculated as 18% of their earned income (salary or bonus, but not dividends), up to a maximum of \$33,810 for 2026,

which would require earned income in 2025 of \$187,833. Paying themselves a salary or bonus creates RRSP room, reduces the corporation's taxable income and allows a business owner to claim a personal tax deduction.

Alternatively, profits can be retained within the corporation and invested. This allows the business owner to benefit from tax deferral, as personal tax isn't payable until funds are distributed as dividends.

**Each strategy has its benefits and drawbacks as follows:**

	Benefits	Drawbacks
RRSP	<ul style="list-style-type: none"> <li>• Salary/bonus deductible in the corporation — reducing taxes payable.</li> <li>• Tax deferral on investment income earned in plan.</li> <li>• Reduction in passive assets in the corporation — access to the Lifetime Capital Gains Exemption (LCGE) and Small Business Limit (SBL).</li> </ul>	<ul style="list-style-type: none"> <li>• Salary (less RRSP contribution) is fully taxable.</li> <li>• Future RRSP (RRIF) income is fully taxable.</li> </ul>
Corporation	<ul style="list-style-type: none"> <li>• Tax deferral on business profits retained in the company (see Income in a Corporation tax card for active business income).</li> <li>• Investment income retains its character.</li> </ul>	<ul style="list-style-type: none"> <li>• Higher corporate tax rate applies to investment income and no deferral opportunity.</li> <li>• Annual taxation on investment income.</li> <li>• Excessive passive income may jeopardize access to the small business limit.</li> <li>• Excessive passive assets may jeopardize an individual's ability to utilize the LCGE.</li> <li>• CPP benefits may be lower in retirement.</li> </ul>



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## Other key considerations

Aside from investment strategy and tax rates during an owner's working and retirement years, several other factors can influence the decision between RRSP contributions and corporate investing.

### Government pensions in retirement

Retirement benefits under the Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) are based on contributions made during a business owner's working years, which are tied to salary and bonus income. Dividends aren't considered contributory earnings. As a result, business owners who place a higher value on receiving CPP/QPP benefits in retirement may prefer to contribute to an RRSP rather than invest through their corporation. It's also important to note that incorporated business owners are required to remit both the employer and employee premiums.

### Lifetime capital gains exemption (LCGE)

Accumulating excessive passive assets in a corporation may disqualify a business owner from claiming the LCGE upon the sale (or deemed sale) of their shares. Without proper planning, saving too much in the corporation may jeopardize this important tax benefit, and must be factored into the RRSP versus corporate investing decision (more on the LCGE below).

### Suitability for individual pension plans (IPPs)

In certain cases, IPPs may provide higher retirement benefits than what RRSPs can offer to an incorporated business owner. There must be a history of T4 earnings and RRSP contributions in order to benefit from an IPP later in life. The suitability of an IPP as part of the retirement plan may play a role in choosing whether to save through an RRSP versus a corporation.

### Changing tax rates

The decision of whether to choose an RRSP or corporation will largely depend on current tax rates, and how tax rates change over the course of business owner's lifetime, as well as their expected tax rate in retirement.

### Income splitting

Payments to family members in lower tax brackets can provide a tax-efficient way to distribute income from a corporation. To the extent that income splitting opportunities are available (subject to the tax on split income (TOSI) rules), a business owner may choose to forgo a corporate investing strategy and instead utilize personal savings vehicles such as RRSPs, TFSAs and non-registered accounts for retirement planning.

## Lifetime capital gains exemption

Canadian individual taxpayers (not corporations) are entitled to a \$1,275,000 (2026) lifetime capital gains exemption (LCGE) on the sale of qualified small business corporation (QSBC) shares, and the sale of qualified farm or fishing properties (qualified properties). The LCGE effectively shelters capital gains (up to the threshold) from tax when qualified property is sold.

Qualified farm or fishing properties can include assets such as real estate and intangible properties (such as milk and egg quotas) whether held in a sole proprietorship, partnership or corporation. Other than these specific assets utilized by qualified farm or fishing properties, the LCGE is only accessible on the sale of QSBC shares and not underlying corporate assets.



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For individual QSBC shareholders, the LCGE can only be accessed when the shares are sold and the following three conditions are met:

- At the time of sale/date of death, at least 90% of the business' assets are used primarily in an active business in Canada.
- In the 24-month period prior to sale/date of death, the shares were owned by the individual seller or a related person.
- In the 24 months prior to sale/date of death, more than 50% of the active assets fair market value (FMV) was used in an active business in Canada.

Assets used to earn passive income (investment or rental) generally don't satisfy the above criteria because they wouldn't be considered to be used in an active business. For this reason, many business owners consider "purification" strategies (more on this below). This way, shares of an active business can remain eligible for the LCGE. It's also possible to multiply the exemption where family members (spouse and children) are shareholders of the corporation, whether the shares are held directly or indirectly through a family trust. Potentially, this may be a valid strategy even if the child is a minor or not involved in the business.

### Preservation of the lifetime capital gains exemption

Where an active business accumulates significant assets that aren't being used to earn ABI (passive assets), the shares may not qualify for the LCGE when sold. If passive assets exceed 10% of total assets, the shareholders should consider strategies, so the exemption may be available in the future.

### Purification strategies

To access the LCGE on a future share sale, the following purification strategies may be considered:

- Excess cash can be used to pay down debt, shareholder loans or to purchase active business assets.
- Consider paying a tax-free capital dividend to the shareholder, thus reducing excess cash in the company.

- Consider a family trust to hold shares of the operating company. The trust can allocate a dividend paid from the company to a corporate beneficiary. This shifts excess assets out of the operating company, so the shares could potentially qualify.
- Consider transferring the operating company's (Opco) value in excess of the LCGE to a new company (Holdco). This can help the business owner access the LCGE while excess assets can be transferred out of Opco so the shares qualify for the exemption. These are complex strategies that should be discussed with a tax professional.

## Other benefits of holding companies

### Creditor protection

It isn't unusual for businesses to protect assets from potential creditors. Typically, an operating company earning ABI can accumulate substantial assets in the corporation. Where this is the case, they should consider how to protect assets from potential creditors.

One possible strategy involves transferring excess retained earnings to Holdco by way of an inter-corporate dividend. Holdco can lend the funds back to Opco on a secured basis. Also, significant assets (such as real estate or investment portfolios) may benefit from being held in a Holdco rather than the operating company in case of future litigation. These are complex strategies that should be discussed with a tax professional. The easiest solution to deal with potential creditors may be to purchase additional insurance within Opco.

### Control over cash management

Where there are multiple shareholders of an Opco, it can be difficult for individual shareholders to clearly identify their portion of retained earnings. Individuals can hold their shares of Opco through a Holdco allowing individual shareholders to access their respective asset allocation from the Opco indirectly through their respective Holdco's. Additionally, this allows greater flexibility for individual shareholders, over the timing of taxable distributions and cash



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management, as the funds may be retained in the company without incurring tax at the personal level. This can help preserve income sensitive benefits such as Old Age Security (OAS) and avoid potential conflict with other shareholders regarding management of allocated earnings.

### Retiring allowance for business owners

At retirement, incorporated business owners may receive a retiring allowance from their corporation if their employment relationship ends (even if they remain a shareholder) and the amount is reasonable, based on factors such as years of service, historical compensation and available retirement benefits.

Retiring allowances can be particularly beneficial for service prior to 1996. If the individual is 71 or younger, up to \$2,000 per year of pre-1996 service can be transferred to an RRSP without using contribution room. An additional \$1,500 per year of pre-1989 service may also qualify where no pension or deferred profit sharing plan (DPSP) benefits were earned. This portion is referred to as the eligible retiring allowance, with any excess treated as non-eligible.

Retiring allowances are tax-deductible to the corporation and taxable to the recipient unless transferred to an RRSP. Payments can also be made over time to help manage corporate cash flow and defer personal taxation.

### Income splitting with a company in retirement

The tax on split income (TOSI) rules, introduced in 2018, generally apply top-rate tax to certain payments made from a corporation to adult family members, limiting income splitting opportunities.

However, several exclusions exist. For business owners in retirement, the retirement exclusion allows income splitting with a spouse once the contributing business owner reaches age 65. At that point, dividends can be paid to a spouse or common-law partner without TOSI applying, even if they weren't actively involved in the business.

In addition, this treatment continues on death, allowing the surviving spouse or common-law partner to benefit from the deceased's prior contributions.



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# Succession and estate planning

A well-executed estate plan could minimize tax payable at death, reduce conflict amongst beneficiaries and maximize assets available to heirs.

Incorporated business owners can face difficult tax and estate planning decisions involving their shares. In the absence of a tax-deferred rollover of qualified property, such as shares of an incorporated business, all capital property including private company shares are deemed to be sold at FMV immediately before the shareholder's death, which typically results in a significant tax bill. Since many businesses are built from the ground up with little to no investment capital, a business can have high FMV but a low adjusted cost base (ACB) resulting in high taxable capital gains. This often translates into a significant tax liability for the deceased's estate, which can force the sale of the company should other assets not be available to cover the tax bill.

## What is an estate plan?

An estate plan includes strategies for funding an individual's lifestyle in retirement, transferring private company ownership and wealth protection.

At some point, incorporated business owners will need to decide who will take over the business. This could be a transfer or sale to a family member, partner, key employee or a third party. Some incorporated business owners will require the sale proceeds to fund their retirement lifestyle, while others may not.

Whether selling to an unrelated or related party, tax-efficient strategies should be considered before a sale or transfer of the shares.

As a final thought, business owners should also have plans to facilitate the transfer of shares of their businesses on their passing.

For incorporated business owners looking to exit the business, the following options can be considered:

- Sale or gift of shares.
- Discontinue the company.
- Estate freeze.

## Sale or gift of shares

Individuals connected by blood, marriage or adoption are generally considered related, and in some cases, unrelated parties may also be deemed related if acting in concert. It's best to consult an accountant who can make the distinction and help structure the transaction tax-efficiently.

Business owners exiting their company will typically sell shares to a third party or a family member at FMV, potentially accessing the lifetime capital gains exemption (LCGE).

When shares are sold to a related family member, the seller is deemed to dispose of them at FMV, regardless of the agreed price. However, the purchaser's adjusted cost base (ACB) is based on what they actually paid. Pricing above or below FMV can result in double taxation when viewed across both parties.

If the intent is to gift shares, no consideration can be exchanged. The seller is still taxed on FMV proceeds, and the recipient's ACB is deemed to be FMV, not the amount paid.



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### EXAMPLE

Fabio wants to sell his private company shares (ACB \$100) to his brother Enzo and is willing to accept an amount below FMV. The shares are currently worth \$10,000. Although Fabio doesn't require the proceeds, he's unaware of the tax implications of gifting the shares versus selling them at a discounted price.

#### Fabio's tax implications

	Gift	Sell for \$1
Deemed proceeds	\$10,000	\$10,000
ACB	\$100	\$100
Capital gain	\$9,900	\$9,900
Taxable capital gain	\$4,950	\$4,950
Tax 53.53%	\$2,650	\$2,650

Enzo, on the other hand, will have an ACB equal to the FMV, provided his brother gifts him the shares. However, if Fabio charges Enzo, even \$1, Enzo's ACB becomes what he actually paid. This, unfortunately, taxes Enzo on the same capital gain as Fabio, resulting in double taxation (see below). The following is an ACB/tax comparison if Enzo received a gift of shares versus paying \$1 on the transfer. Below are Enzo's income tax implications when he sells, assuming no share appreciation and rate change.

#### Enzo's tax implications

	Gift	Sell for \$1
Deemed proceeds	\$10,000	\$10,000
ACB	\$10,000	\$1
Capital gain	–	\$9,999
Taxable capital gain	–	\$4,999
Tax 53.53%	–	\$2,676

When selling to related parties, it's important to either gift the property or charge FMV. This will ensure the related family member's ACB equals FMV, since a price charged above or below exposes the parties to a double tax.

To complicate matters, there may be further tax implications if the LCGE was claimed on the sale to a related family member. For instance, the portion sheltered could result in dividend taxation when undergoing certain corporate restructuring. Speaking with a qualified tax practitioner can help execute a tax-efficient plan.

#### Discontinue the company

Another option available for incorporated business owners if the LCGE isn't available or if the shares can't be sold (for example, there's no operating business), is to liquidate the underlying corporate assets and wind up the company. This usually involves paying tax when corporate assets with appreciated gains are sold.

When the underlying net corporate proceeds (cash or other properties) are distributed, the individual shareholder will receive a dividend equal to the net value of the company in excess of paid-up capital. The excess amount can be significant and could be taxed at top rates. For this reason, it may be better to undergo an estate freeze which can help defer and manage the tax bill.



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### EXAMPLE

Rocco wants to sell his company which holds a piece of equipment (assume no tax depreciation) used exclusively in his active business (no further assets or liabilities). The equipment is currently worth \$10 million and has an ACB of \$5 million.

Rocco incorporated his company years ago for a nominal amount. From a tax perspective, he isn't sure whether to sell the asset directly and proceed to wind up or sell the shares assuming they qualify for the LCGE.

Asset sale		Share sale	
Proceeds	\$10,000,000	Proceeds	\$8,327,667 <sup>1</sup>
Adjusted cost base	(\$5,000,000)	Adjusted cost base	(\$100)
Capital gain	\$5,000,000	Capital gain	\$8,327,567
Taxable capital gain	\$2,500,000	LCGE	(\$1,275,000)
		Net capital gain	\$7,052,567
Corporate tax	(\$1,254,250)	Taxable capital gain	\$3,526,284
Refundable tax	\$766,750	Personal tax	\$1,887,620
Net corporate tax	\$487,500		
Tax-free dividend payment	(\$2,500,000)		
Excess proceeds distributed as taxable non-eligible dividend	\$7,012,500		
Tax on non-eligible dividend	(\$3,347,768)		
Combined after-tax proceeds	\$6,164,732	After-tax proceeds	\$6,440,047

Assumptions: 2026 Ontario tax rates. Corporate tax: 50.17%. RDTOH: 30.67%. Non-eligible dividends: 47.74%  
<sup>1</sup>The share value is discounted for corporate tax.

### Capital gains reserve

The capital gains reserve allows a taxpayer to spread the realized capital gain over a period of more than one year, provided the proceeds are also received over the same time. Whether the shares are sold to a related or unrelated party the capital gains reserve may allow a tax reduction and/or deferral. The maximum period over which the reserve may be claimed is usually five years, or 10 years for qualified small business corporation shares or qualified farm/fishing property. Structuring the transaction so the capital gains reserve is available should be discussed with their accountant before entering into a purchase and sale agreement.

### Estate freeze

An estate freeze involves exchanging common shares for fixed-value preferred shares equal to the company's FMV. New common shares are then issued, typically to family members or a family trust, for nominal value, allowing future growth to accrue to the next generation.

This strategy provides certainty over the value of the estate for tax purposes, enabling advance planning to fund the liability at death. It can also create a steady income stream, as preferred shares are redeemed over time.



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Preferred shares generally don't participate in future growth, so the original owner receives value through gradual redemptions, often resulting in tax deferral and potential tax savings.

The new growth shares are commonly held by family members directly or through a family trust. When distributing income, it's important to consider the income sprinkling (TOSI) rules, as top-rate taxation may apply if exceptions aren't met.

**Here are some additional points to consider:**

- Each beneficiary of a family trust can utilize their LCGE when the shares are sold.
- Dividends paid to minor beneficiaries will be taxed at top rates.
- Dividends allocated to adult beneficiaries must consider the income sprinkling rules (discussed below).
- The shares held in the trust bypass any deceased estates.
- Incorporated business owners undergoing any corporate reorganization should look to update estate planning documents accordingly.

One of the advantages of implementing an estate freeze is to provide some certainty with regard to a business owner's eventual tax liability at death, which allows for advanced planning to fund the liability.

**Dual wills**

Incorporated business owners may use a dual will strategy to reduce probate fees, particularly where private company shares have high value. One will covers probatable assets, while a secondary will deals with non-probatable assets (such as private shares), allowing them to pass outside probate. This can also provide added privacy. Availability varies by province.

While it's legally questionable whether this strategy is applicable throughout Canada, it's been held to be applicable in Ontario and British Columbia.

**EXAMPLE**

Rocco is the sole shareholder of a successful company. Currently, Rocco is seeking to exit the business, and his children intend to take over. The shares are worth \$1 million which will provide the funds required for Rocco's retirement.

In speaking with his financial advisor, Rocco was informed that he could "freeze" the value of his company shares while future growth and the associated tax liability accrues to his adult children. Doing so would allow Rocco to estimate (and plan for) his potential tax liability at death while gifting the future growth of the company to his children with little upfront investment.

Rocco exchanged his common shares for \$1 million fixed value preferred shares redeemable for \$1 per share. The value of the exchange must equal the value of the company at that time. Now that the current value is held by Rocco in the form of preferred shares, Rocco's children can subscribe directly for common growth shares for a nominal amount or indirectly through a family trust.

The \$1 million preferred shares allows Rocco to estimate and plan for his total tax liability for his shareholdings. In the meantime, he can redeem the shares, which not only reduce his current holdings, but also provides a steady income flow and spreads the tax liability over his remaining years. The remaining unredeemed preferred shares held on his death will be deemed disposed of for FMV. Once the freeze is implemented, Rocco would proceed to update his will for the change in ownership.



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## Powers of attorney

Uncertainty can arise if an incorporated business owner loses the mental capacity to make decisions. Without a power of attorney (POA) in place, the business may be left without direction, particularly where time-sensitive decisions are required.

A POA is a simple and cost-effective way to appoint someone to act on a business owner's behalf. An enduring or continuing POA remains effective in the event of incapacity and can take effect immediately or upon a triggering event. The appointed attorney, such as a spouse, adult child or professional advisor, can manage both business and personal matters.

Where appropriate, separate POAs can be established for business and personal decisions, particularly where different skills or expertise are required to manage the business versus personal affairs.

If no POA exists, a substitute decision-maker may need to be appointed by the courts, which can be costly, time-consuming and may result in someone being chosen who's unfamiliar with the business.

## Shareholder agreements

A shareholder agreement is a legal document used when there are multiple owners of a company. It helps protect shareholder rights, manage relationships and ensure the business can continue in the event of disputes, divorce, death or disability.

By setting terms in advance, shareholders can avoid disagreements and provide clarity on key events. For example, on death, the agreement can specify whether family members may become shareholders or whether the company must redeem the shares. This can help ensure beneficiaries receive their inheritance without being tied to the business. Corporate-owned life insurance is often used to fund share purchases or redemptions.

Shareholder agreements can also outline a process to appoint a successor in the event of death or incapacity, helping ensure continuity of the business.

## Life insurance

For incorporated business owners, life insurance can be an effective way to fund estate taxes without having to sell corporate assets or wind up the business. The death benefit is received tax-free, whether owned personally or corporately. For corporate-owned policies, proceeds in excess of the policy's ACB are generally credited to the capital dividend account (CDA) and can be paid out tax-free to shareholders. These funds can be used to redeem shares, pay tax liabilities or provide liquidity to the estate.

Life insurance can also help equalize inheritances where not all children are involved in the business, allowing the business to pass to active children while others receive insurance proceeds.

In addition, it can fund buy-sell arrangements, providing liquidity to business partners or the corporation to purchase a deceased owner's interest.



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# Minimizing double taxation after death

Part of a sound estate plan for an incorporated business owner involves planning for taxation after death, often referred to as post-mortem tax planning. Without proper planning, a business owner's graduated rate estate (GRE) may be subject to double — or even triple — taxation.

## Post-mortem tax planning

*Terminal tax* is triggered when the deemed disposition of shares is reported at FMV on the business owner's final tax return (the first level of tax).

*Corporate tax* is triggered when the underlying corporate assets are disposed (the second level).

Finally, dividend rates apply to the value extracted when the company is wound up or shares redeemed by the executor of the deceased's GRE (the third level).

The deceased GRE has now been exposed to double taxation because the FMV has been taxed twice, once at capital gains rates (the deemed disposition of the shares at death) and again at the higher dividend rates on wind up or redemption.

The good news is that, with proper planning, double taxation can be reduced or eliminated. For instance, the capital gain reported at death can be offset by the capital loss under what is known as a "164(6) loss carry-back" strategy. This would eliminate the capital gains tax and instead expose the GRE to dividend tax rates. On the other hand, an alternative strategy known as the "post-mortem pipeline" can alleviate the dividend tax when the corporate proceeds are distributed on wind up or redemption, accessing the lower capital gain rates.

**At death, taxes can be triggered at three levels:**

1. Personal or terminal
2. Corporate
3. Estate



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### EXAMPLE

Rocco, an incorporated business owner in Toronto, held all the outstanding nominal shares on death. Rocco's company manages an active investment portfolio, holding investments worth \$10 million with no accrued gains. Rocco's ACB and paid-up capital (PUC) are both \$1. The ACB refers to what he paid for the shares, and PUC is derived from transactions with the company. Assuming top rates and no corporate balances.

#### Terminal tax

A deceased individual is deemed to have disposed of all capital property at FMV immediately before death. Thus, for terminal tax, Rocco's deemed disposition of shares amounts to the difference between the FMV of \$10 million and ACB of \$1, 50% of which is a taxable capital gain. As shown in the table below, Rocco's personal tax owing at death is almost \$2.7 million.

#### Corporate tax

Usually, corporate tax would be payable if the company held an investment portfolio with accrued gains. Half of the capital gain is subject to corporate taxes, and the non-taxable portion can be paid tax-free to the GRE by way of the capital dividend account (CDA). Corporate tax can be reduced through the corporation's refundable dividend tax on hand (RDTOH) account when a required dividend is paid. This requirement can be met when the executor winds up the corporation or the company's shares are redeemed. In this case, there are no accrued corporate gains, and therefore corporate tax is nil.

#### Estate tax

The deceased's GRE is deemed to have acquired the shares at FMV immediately after death. In order to distribute proceeds to GRE beneficiaries, the executor can either wind up the company or authorize a share redemption deeming the GRE to receive a dividend equal to the company's value in excess of PUC (see table below). In addition to the deemed dividend, the GRE is also deemed to dispose of their shares of the company.

The proceeds of disposition can be reduced by the deemed dividend, creating a capital loss. The capital loss can be carried back to the terminal return to offset the capital gain tax reported at death, provided the windup or redemption is administered in the GRE's first taxation year (164(6) strategy). For those who don't plan, the capital loss may be wasted and will only be available for future taxation years.

Without any tax planning, a 74% tax rate could apply. Rocco's company has been taxed twice: once at capital gain rates arising from the deemed disposition of the shares reported on the terminal return, and again at the higher non-eligible dividend rate when the company is wound up or shares redeemed.



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### EXAMPLE CONTINUED

Metric	No planning	164(6) carry-back	Pipeline strategy
<b>At death (deemed disposition)</b>			
Proceeds	\$10,000,000	\$10,000,000	\$10,000,000
ACB	\$10,000,000	\$10,000,000	\$10,000,000
Capital gain	\$10,000,000	\$10,000,000	\$10,000,000
Taxable capital gain (50%)	\$5,000,000	–	\$5,000,000
<b>Post-mortem</b>			
Deemed dividend (wind-up)	\$10,000,000	\$10,000,000	–
<b>Tax impact</b>			
Terminal tax (deemed disposition)	\$2,676,500	–	\$2,676,500
Estate tax (deemed dividend)	\$4,774,000	\$4,774,000	–
Total tax	\$7,450,500	\$4,774,000	\$2,676,500
Effective tax rate	74.50%	47.74%	26.76%
After-tax value	\$2,549,500	\$5,226,000	\$7,323,500

- Top marginal personal tax rates (Ontario, 2026 assumed):
  - Capital gains: 53.53% (effective rate on taxable capital gains)
  - Non-eligible dividends: 47.74%
- Shares are assumed to have nominal ACB prior to death, resulting in a full deemed capital gain.

## 164(6) Loss carry-back strategy

The 164(6) strategy allows a capital loss realized in the estate (GRE) to be carried back to offset the capital gain reported at death, eliminating double taxation. This loss typically arises from the difference between the estate's high adjusted cost base and the proceeds on share redemption or wind-up.

The election must be made in the GRE's first taxation year, and the loss is applied to the deceased's terminal return by either filing a T1 adjustment or making the designation with the original T1 return.

To access this strategy, the estate must qualify as a graduated rate estate, generally it must be a testamentary trust, be designated as the GRE in its first taxation year and no other estate can be designated for the same individual. Maintaining GRE status is critical, as it can be lost if certain conditions aren't met.

The strategy is most effective where corporate assets with accrued gains are realized first, preserving tax attributes such as CDA and RDTOH, which can help reduce dividend tax. However, the available loss may be restricted if excessive CDA is paid.

While the 164(6) strategy reduces overall tax (to ~47.74% in the example), it results in taxation at dividend rates, which are generally higher than capital gains rates. As a result, it's less tax-efficient than a pipeline strategy but remains a cost-effective option where timely GRE administration is possible.



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## Post-mortem pipeline strategy

The pipeline strategy allows the estate to extract corporate funds at capital gains rates, avoiding higher dividend tax.

On death, the estate acquires the shares at \$10 million, creating a “hard ACB.” This hard ACB can be converted into cash or debt and withdrawn tax-free.

To implement the strategy, the estate incorporates a new company (Newco) and transfers the shares to it in exchange for a \$10 million promissory note. Because the shares are transferred at FMV (\$10 million), equal to the estate’s ACB, no additional capital gain arises.

Newco now owns the shares and owes \$10 million to the estate. The underlying corporate assets are sold for \$10 million, the cash is paid to Newco, and Newco uses the funds to repay the promissory note to the estate, allowing the \$10 million to be extracted without dividend tax.

This results in taxation at capital gains rates (≈27% in the example), rather than higher dividend rates.

In some cases, an 88(1)(d) bump may be available to increase the ACB of certain assets (such as land or marketable securities), reducing future corporate tax, provided specific conditions are met.



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