

What are the key tax considerations for private clients in Canada

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Tax

Personal taxation Federal and provincial or territorial income tax

Canada taxes Canadian residents on their worldwide income from all sources, and non-residents on certain Canadian-source income, subject to international tax treaties. Income for Canadian tax purposes includes income from employment, business, property, 50 per cent of capital gains, and various other income sources, less certain deductions.

Canada is a federal state consisting of 10 provinces and three territories. The provinces and territories also tax income generally on the same basis as the federal government, except for Quebec, and increased federal tax applies to certain income not earned in a province or territory. Canadian tax is levied at graduated rates of up to approximately 55 per cent in combined federal and provincial rates on taxable income, less applicable tax credits.

Canada taxes non-residents on income earned in Canada, notably income from business or employment in Canada, and from certain taxable Canadian property, including Canadian real estate. A withholding tax of 25 per cent is deducted from certain income payable to non-residents, subject to international tax treaties that reduce the applicable rates.

Capital gains regime

Unlike most jurisdictions, Canada has no gift or inheritance tax. Instead, it levies taxes on capital gains. Prior to 25 June 2024, 50 per cent of all capital gains are included in income upon actual disposition or deemed disposition. The Canadian federal budget in 2024 announced an increase in the capital gains inclusion rate from 50 per cent to 66.6 per cent for corporations and trusts, and 50 per cent to 66.6 per cent on the portion of realised capital gains each year that exceed C\$250,000 for individuals for capital gains realised on or after 25 June 2024, and proposed legislation had been introduced. However, the new Liberal government has announced it intends to cancel the 2024 budget proposals to increase the capital gains inclusion rate. There is an exemption for capital gains on a principal residence and a lifetime exemption for capital gains on qualified small business corporation shares and on qualified farm or fishing property (C\$1,250,000 as of 25 June 2025). The basic tax unit is the individual. Limited opportunities exist for income splitting, including through the use of trusts. Tax on capital gains may be deferred on certain transfer of property, for example, between spouses, or on rollovers into private corporations in exchange for shares.

Developments relating to personal taxation Provincial or territorial tax brackets for high earners

The combined provincial or territorial and federal tax rates for high earners in 2025 range from 44.5 per cent in Nunavut to 54.8 per cent in Newfoundland and Labrador. The highest tax rate in 2025 in Ontario is 53.53 per cent. In 2015, Alberta introduced graduated tax rates for taxpayers. Prior to the new rates, all Albertans paid tax based on a flat provincial tax rate of 10 per cent. As of 1 October 2015, the highest combined provincial and federal tax rate for Albertans has been 48 per cent. Over the past 10 years, there has been a significant increase in the top marginal rate. Combined rates in Ontario and Quebec in 2009 were below 50 per cent.

Alternative minimum tax

Canada has had an alternative minimum tax (AMT) since 1986, and it imposes a minimum level of tax on taxpayers who claim certain deductions, exemptions and tax credits that reduce tax they owe to low levels. The AMT rate has been increased commencing with the 2024 tax year to 20.5 per cent, and the basic exemption amount available to individuals and trusts for 2025 has been increased to C\$177,882 from C\$40,000 prior to 2024 and targets high-income individuals. The government projects that an additional C\$3 billion of tax revenue will be generated over five years.

Intergenerational small business and farm transfers

A private member's bill received royal assent on 29 June 2021 and limits the application of certain anti-avoidance rules that resulted in a sale of small business shares to an arm's-length purchaser being taxed at lower capital gains rates than a sale to a child or grandchild. The anti-avoidance rules operate so that the owner receives a dividend at higher rates. The result of the former rules was to penalise intergenerational sales because of this increased tax burden. The legislation levels the playing field so that a sale to a family member has the same level of tax as would a sale to an arm's-length purchaser, thereby facilitating intergenerational sales. However, the federal government later announced it would introduce legislation to safeguard against tax avoidance. Proposed amendments were introduced in the 2023 federal budget and received Royal Assent on 20 June 2024. The 2024 federal budget outlined further details, and later proposed legislation was introduced that includes new restrictions and additional requirements with the objective of ensuring that there is a genuine transfer of the business to the next generation.

Canadian Entrepreneur Incentive

The Canadian Entrepreneur Incentive (CEI) was announced in the 2024 federal budget. It is to be phased in over 10 years commencing 1 January 2025 when it came into effect. It allows entrepreneurs in certain industries, including construction, technology and manufacturing a reduced capital gains inclusion rate when they sell a business on the first C\$2 million of gains phased in at C\$400,000 each year until it reaches C\$2 million in 2029. The reduced gains inclusion rate is one-third (as opposed to one-half) of capital gains.

Employee ownership trusts

The 2023 federal budget introduced a new trust called an employee ownership trust to facilitate the sale of a business to an employee group, which has favourable tax treatment and is a new concept in Canada, but which follows a growing trend in other jurisdictions including the United Kingdom and the US to increase employee ownership of businesses. This vehicle will potentially provide another option for business succession planning.

The new rules were enacted on 20 June 2024. There is a temporary tax exemption of up to C\$10 million of capital gains where there is a sale to an employee ownership trust for the tax years 2024 to 2026, subject to certain conditions.

Revised federal legislation on the taxation of trusts and new reporting requirements for trusts

Certain estates and testamentary trusts are taxed at graduated rates applicable to individuals, while trusts established during a person's lifetime are generally taxed at the top of marginal tax rates applicable to individuals. In 2016, graduated rates for certain estates and testamentary trusts were eliminated. Now, the top marginal rate is applied to testamentary trusts and certain estates. However, graduated rates continue to be available to 'graduated rate estates' for 36 months and to certain testamentary trusts having disabled beneficiaries who are eligible for the federal disability tax credit. In addition, the taxation year end for testamentary trusts is now 31 December, and testamentary trusts are required to make instalment payments of income tax.

New trust reporting rules were introduced in July 2018, the implementation of which was delayed and which are now effective for taxation years ending on or after 31 December 2023 further to federal Bill C-32, which received Royal Assent on 15 December 2022. Accordingly, 2024 was the first year for reporting under the new rules for many trusts.

The legislation also requires a bare trust to file a tax return and provide disclosure of information. However, four days before the filing deadline, Canada Revenue Agency announced that bare trusts would not have to file a tax return for the 2023 tax year. There was significant confusion and criticism of the overly broad scope of the original bare trust reporting requirements, resulting in a proposed repeal of the reporting rules in proposed legislation released on 12 August 2024, to be effective for the tax year ending after 31 December 2024. The former rules are to be replaced by a new set of bare trust reporting rules with a narrower scope. Only arrangements that constitute a deemed trust will be subject to the bare trust reporting rules and require that there be a separation of legal and beneficial ownership and that the owner can reasonably be considered to act as agent for those who have the benefit of the property. Exceptions would also include family members holding a joint account together where they hold for their own use and for each other.

The new rules require the identity of settlors, trustees and beneficiaries and those who have control over trustee decisions to pay income or capital, such as a protector, to be reported to the government. As well as this, all trusts (with limited exceptions) must file a tax return. There are proposed amendments released by the government on 12 August 2024 to be effective for the tax year ending after 30 December 2024 to expand the list of exceptions, including trusts whose assets had a fair market value of less than C\$50,000 throughout the year regardless of the nature of the assets; statutory trusts; trusts where the trust and each beneficiary are related party/family members, the fair market value of the trusts assets were less than C\$250,000, and the assets are limited to certain categories including money, publicly listed securities, and personal use property; as well as certain professional's trust accounts. Previously, a trust was required to file a tax return only if it had tax to pay or made distributions to the beneficiaries in a year and further to CRA administrative relief if the income received by the trust was less the C\$500. Non-resident trusts that are required to file a trust tax return are also subject to the new disclosure rules. There are significant penalties for non-compliance of the greater of C\$2500 or 5 per cent of the highest fair market value of the trust's assets. With the onset of these new obligations, it is incumbent on trustees to gather the necessary information.

Residence of trusts for tax purposes

The Supreme Court of Canada in 2012 clarified the law on the factual tax residence of a trust in *Fundy Settlement v. Canada*.¹ The Supreme Court of Canada held that the residence of a trust is where the central management and control of the trust occurs, a significant change from the former focus on a trustee's residence. *Discovery Trust v. Canada*² was the first decision to apply the test that was articulated in *Fundy Settlement*. In *Discovery Trust*, the court held that the beneficiaries' involvement in the administration of the trust did not result in the trust being



resident in the province in which the beneficiaries resided, as the trustee still made all decisions with respect to the administration of the trust. Instead, the court held that the trust was resident in the province in which the trustee resided. The Canada Revenue Agency (CRA) position in determining the location of the central management and where control of a trust takes place includes a review of whether the control rests with the trustee or someone else.³

In addition to factual residence, trusts may also be subject to statutory deemed residence rules for Canadian tax purposes. Trusts that are not factually resident in Canada may be deemed resident in Canada for certain tax purposes, including computing the trust's income. Deemed residence may apply to a trust if it has a Canadian-resident contributor or beneficiary.

Principal residence rules

In the Canadian system, capital gains are subject to taxation, and arise on the disposition of capital property. The capital gain is the difference between the property's adjusted cost base plus costs of disposal, and the proceeds of disposition. The adjusted cost is the actual cost of the property, subject to certain adjustments. Proceeds of disposition are, generally, the actual proceeds, but are subject to certain deeming provisions that will deem the proceeds to be equal to the fair market value of the property in respect of dispositions that are not at arm's length. A property is exempt from taxation on capital gains in the years that it is designated a principal residence.

Since 3 October 2016, both individuals and trusts must report the disposition of a principal residence and make a principal residence designation in the prescribed form and manner. The period in which the CRA can reassess beyond the normal reassessment period is indefinitely extended if the disposition of a property is not reported and a penalty applies for late filing. For dispositions on or after 3 October 2016, an individual who is a non-resident of Canada in the year of acquisition of a principal residence loses the bonus exemption year when calculating the principal residence exemption.

As of 2016, only certain eligible trusts may designate a property as a principal residence for any year of ownership after 2016. Eligible trusts include qualified disability trusts, alter ego trusts, spousal or common law partner trusts, joint spousal and joint common law partner trusts, and certain trusts for the exclusive benefit of the settlor during the settlor's lifetime. Eligible trusts also include 'orphan' trusts where the settlor died before the start of the year; the eligible beneficiary is a minor child whose parent died before the start of the year and is a minor child of the settlor, even if the other parent is living; and at least one beneficiary of the trust is a resident of Canada during the year and is a specified beneficiary of the trust for the year.

There is continued speculation that the government may in future introduce a number of tax reforms to address income inequality, including curtailing the principal residence exemption so that it is no longer unlimited, but instead is capped. Canada is one of the very few Organisation for Economic Co-operation and Development (OECD) countries that allow for a full exemption. Criticism has been levelled that a full exemption results in increased income inequality, because the owners of high-value homes receive a windfall by allowing them to be untaxed.

Non-resident purchasers of residential properties

To date, three Canadian provinces – Ontario, British Columbia and Nova Scotia – have enacted additional land transfer taxes that apply to foreign buyers. As of 21 April 2017, the Ontario government introduced a 15 per cent on the value of the consideration when a residential property in the Greater Golden Horseshoe area is purchased or acquired by individuals who are not citizens or permanent residents of Canada, foreign corporations, or taxable trustees of trusts involving foreign individuals or corporate trustees or beneficiaries. As of 30 March 2022, the r



New

was increased to 20 per cent and expanded to apply to all residential properties purchased across Ontario, called Non-Resident Speculation Tax and later as of 25 October 2022 further increased to 25 per cent. Residential property is defined as land that contains between one and six single family residences. The Toronto Municipal Non-Resident Speculation Tax came into effect for all transfers registered commencing 1 January 2025 and applies in addition to the generally applicable land transfer taxes payable on Toronto properties at a rate of 10 per cent. In 2022, Toronto also implemented an empty-home tax of 1 per cent which increased to 3 per cent in 2025.

As of 2 August 2016, British Columbia enacted a similar 15 per cent property transfer tax payable by foreign individuals, corporations or taxable trustees in addition to the general property transfer tax of approximately 2.5 per cent on transfers of residential property located in the metro Vancouver regional district (Vancouver district). The 2018 British Columbia budget introduced an increase to the tax to 20 per cent, effective as of 21 February 2018, and expanded the tax outside the Vancouver district to cover several other regions. British Columbia also has an annual speculation and vacancy tax that has a rate of between 0.5 to 2 per cent for certain foreign owners, and it applies to residential properties in certain areas of the province. In 2017, Vancouver also implemented an empty-home tax, which is 3 per cent in 2025. On 1 April 2022, Nova Scotia introduced the Provincial Deed Transfer Tax which applies to all non-residents of Nova Scotia buying a residential property and requires an increased land transfer tax be paid of 5 per cent of the purchase price.

A 1 per cent federal tax effective 1 January 2022 on foreign-owned vacant property under the underused housing tax (UHT) rules is important to understand and comply with, as many Canadian and foreign owners will have filing obligations even if they are exempt from paying tax, and face stiff penalties for not filing a UHT return. The first return was due 20 April 2023. However, the CRA announced penalties will be waived for the 2022 calendar year if required returns are filed and tax paid by 31 October 2023. Additional relief was announced in the autumn of 2023 and enacted as of 20 June 2024, which excludes certain owners from filing obligations starting with the 2023 returns. The objective of the tax is to discourage housing speculation and vacancy of homes in major urban centres. The 2022 federal budget took aim at foreign purchasers and proposed a ban on foreign buyers of residential real estate for a period of two years in an effort to deal with the housing crisis and housing affordability. Legislation is in effect under the Prohibition on the Purchase of Residential Property by Non-Canadians Act, which bans certain foreign buyers from 1 January 2023 until 31 December 2025. On 4 February 2024, the government announced its intention to extend the existing ban on foreign ownership for an additional two years to 1 January 2027.

General anti-avoidance rule in respect of income tax

The Income Tax Act (Tax Act) contains a general anti-avoidance rule (GAAR), which may be applied to deny a tax benefit otherwise available under the Tax Act where certain conditions are met. In considering whether the GAAR applies, a court will generally consider whether there was a tax benefit, whether the transaction (or series of transactions) giving rise to the tax benefit was an avoidance transaction and whether the avoidance transaction giving rise to the tax benefit was abusive. The 2023 federal budget proposed changes to the GAAR, including to reduce the threshold for determining whether a transaction is an avoidance transaction from a 'primary purpose' test to 'one of the main purposes' test. In addition, a rule regarding economic substance has been introduced that provides that if an avoidance transaction that significantly lacks economic substance is indicative (but not conclusive), then the transaction is a misuse or an abuse. A penalty will apply to a transaction that is subject to the GAAR of 25 per cent of the tax benefit.

The new rules came into effect with the passage of Bill C-59, which received Royal Assent on 20 June 2024 and apply to transactions that occur on or after 1 January 2024.



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Whistle-blower rules, audit initiatives and compliance measures

The CRA launched the offshore tax informant programme in January 2014, under which the CRA will enter into a contract to provide financial compensation to individuals who provide information that leads to the assessment and collection of additional federal taxes in excess of C\$100,000, provided all recourse rights associated with the assessment have expired and the non-compliant activity involves property located outside Canada or certain other foreign elements. As of 2020, the CRA has assessed over C\$60 million in additional taxes. Banks and other financial intermediaries are required to report international electronic funds transfers of C\$10,000 and over to the CRA. Such transfers are currently reported to Canada's Financial Transactions and Reports Analysis Centre of Canada (FINTRAC). The CRA's related party audit programme (RPAP) is now known as the global high-wealth (GHW) program, under which those, including high net worth individuals (generally, who control more than C\$50 million) and related entities, have been asked to provide detailed information and supporting documents about Canadian and foreign interests. The CRA approach is to audit an entire group of entities, not just a single tax payer, including trusts, partnerships and corporations. Thresholds relating to value and complexity have been relaxed, and groups not under audit are also being asked for such information.

An aggressive tax planning reporting regime generally requires advisers to report to the CRA information concerning certain transactions on Form RC312 by 30 June of the following year. Reportable transactions or a reportable series of transactions will generally include an avoidance transaction or series of transactions for the purposes of GAAR if they feature two of the following: contingent fees, confidentiality protection or contractual protection. Where the Form is not filed, a denial of tax benefits and possible penalties may result.

New reporting requirements have been introduced including 'notifiable transactions' which apply to individuals, corporations, trusts and partnerships. The rules apply to transactions occurring after 21 June 2023 for reportable and notifiable transactions and included in the list are certain transactions to avoid a deemed disposal of trust property, which can impact 21-year planning under Canadian rules for which there is a deemed disposition of trust property for certain trusts every 21 years. Guidance was published by CRA on 5 July 2023 and further guidance was made on 15 August 2024.

Possible upcoming tax reforms

There is significant speculation about what tax reform measures might be introduced in future. But what is needed most is comprehensive tax reform and the newly-elected government has promised an overall review which will be important in strategically creating the right incentives to grow the economy and create economic self-sufficiency. Possible tax reforms include curtailing the principal residence exemption previously discussed. It is possible that the rate of graduated sales tax for higher income earners could also be increased. There has been significant professional writing and media discussion about the introduction of a wealth tax, estate tax or inheritance tax, or some combination of them. An annual wealth tax was proposed by the New Democratic Party (NDP) in both the 2019 and 2021 federal elections, and the NDP also introduced a motion to the House of Commons in 2020 for an annual wealth tax, but it was defeated. In July 2021, the Parliamentary Budget Office released a report that considered the revenue that could be generated on a 1 per cent tax on family net wealth over C\$20 million and on a one-time wealth tax.

Cross-border structuringImmigration to Canada

Canada relies heavily on immigration and offers certain tax concessions to immigrants. These same concessions, along with the lack of gift and inheritance tax, make Canada an attractive destination. Upon immigration to Canada an individual receives a step up in the tax cost of his or her capital property (excluding taxable Canadian property).



which eliminates Canadian tax liability for capital gains accrued to that point. In some cases, it may be possible to transfer a foreign-registered pension plan into a Canadian-registered retirement savings plan on a tax-free basis.

Non-resident trusts and immigration trusts

Certain non-resident trusts established by non-resident settlors, provided various conditions are met, may be exempt from Canadian taxes and can distribute trust capital to Canadian-resident beneficiaries tax-free, which provides tax-planning opportunities where a non-resident trust is situated in a low-tax jurisdiction. However, the opportunities for trust planning with non-resident trusts have been significantly curtailed by revised Section 94 of the Tax Act, which deems certain trusts with Canadian-resident contributors or Canadian-resident beneficiaries to be Canadian-resident and taxable on their worldwide income. Where a trust is deemed to be Canadian-resident, Canadian-resident contributors and beneficiaries may be liable for the trust's Canadian income tax, along with the trust itself.

Previously, an immigration trust could be set up to benefit an immigrant to Canada and his or her family, and the income and capital gains in the immigration trust could accrue tax-free for up to 60 months following immigration. If the trust was settled in a foreign jurisdiction (including a low-tax offshore jurisdiction) with foreign trustees who held the foreign investment assets, there could be significant tax savings depending on the applicable tax rates. However, this planning opportunity was unexpectedly eliminated as a result of the 2014 federal budget. Immigration trusts, including those established prior to the legislative changes, are now subject to Canadian tax on their worldwide income, and the 60-month exemption from the deemed residence rule is eliminated.

Emigration from Canada

A taxpayer emigrating from Canada must pay a departure tax, which taxes gains on his or her property accrued during his or her Canadian residency, subject to exceptions including for certain Canadian situs property and retirement plans. Payment of the departure tax may be deferred upon providing security to the CRA.

Tax treaties

Canada is party to many bilateral tax treaties, which in part aim to prevent double taxation of income. Among other benefits, Canada's tax treaties generally include tiebreaker rules for determining tax residency for treaty purposes and to reduce the amount of withholding tax otherwise payable by taxpayers who are entitled to benefit under such treaties. Often, the withholding tax is reduced to 15 per cent from 25 per cent, and in certain cases to zero per cent. Owing, however, to variations in the internal taxation laws of treaty nations, there can be mismatches in tax credits and timing that are not addressed in the treaties. In 2014, Canada ratified an intergovernmental agreement (IGA) relating to the US Foreign Account Tax Compliance Act (FATCA), a US law that imposes strict reporting requirements to the US taxing authority, including on financial institutions located in Canada. Canada has also implemented the OECD Common Reporting Standard (CRS), which is based on FATCA. As of 1 July 2017, financial institutions located in Canada are subject to the CRS and are required to provide the CRA with certain information pertaining to accounts and account holders. Information exchanges commenced in June 2018. On 20 April 2020, the CRA released detailed revised guidance on FATCA and the CRS and further guidance on 5 April 2024.

Foreign investment entity and foreign trust rules

Foreign trust rules designed to more effectively tax Canadian residents' passive investment, including income arising through non-resident trusts, have been enacted, following numerous amendments to draft legislation over a protracted period. The non-resident trust rules deem a trust to be resident in Canada if there is a Canadian-resident contributor, broadly defined, or a Canadian-resident beneficiary who meets certain requirements, and require tax



be withheld on distributions from trusts deemed Canadian-resident, subject to exceptions. An election may be made to treat a portion of the trust as non-resident that will not generally be taxable in Canada. Provisions for taxing offshore investment funds have also been enacted, along with transitional provisions for those who filed under proposed foreign investment entity rules that were never enacted. Additional reporting requirements for certain non-resident trusts and, as noted previously, new reporting rules, were introduced in 2018.

Canadian taxpayers holding specified foreign property outside Canada with a cost amount of C\$100,000 or more are required to provide more detailed information about such property on a revised Form T1135, a foreign income verification statement including names of the countries and institutions where assets are held, foreign income earned on the assets and a maximum cost amount of the assets in the applicable year. If Form T1135 is filed late or contains certain errors or omissions, the normal reassessment period is extended for three years, and severe penalties apply for failure to file.

Regulatory issues Regulation of banking and related industries

A significant portion of Canada's private wealth services are highly concentrated in the hands of six major Canadian national banks. In 2017, *Bloomberg Markets* magazine ranked four Canadian banks among the world's top-10 strongest banks with US\$100 billion or more of assets. No other country dominated the list as Canada did, and Canada continues to shine when it comes to international recognition of the strength and stability of its banking sector. In general, the major Canadian banks are better capitalised and have more liquidity given tight regulation. In June 2023, capital ratios were increased to 3.5 per cent by 50 base points in view of rising borrowing costs, high debt levels and stress on the financial system. Banking is federally regulated by the Office of the Superintendent of Financial Institutions Canada, while the related investment industry, trust companies and insurance firms are regulated both federally and provincially. Canada's major banks are strongly capitalised and tend to have relatively conservative lending policies compared to other banking institutions.

In 1986, the federal government began to eliminate the four pillars of Canadian finance: Canada's traditional regulatory separation between banks, trust companies, insurance companies and investment companies. Numerous acquisitions of investment firms and trust companies by the six largest Canadian banks followed. In 1998, the proposed merger of two of the largest major Canadian banks was rejected by the federal government. In the past decade, Canada's major banks have expanded significantly into the United States. Canada's major banks offer an increasing array of services, including daily banking, investment services, financial planning and insurance, and wealth management, which tend to be fairly uniform among the banks.

For Canada, deregulation resulted in a flurry of mergers and acquisitions in the 1990s, leading to consolidation and the three largest insurance companies controlling about two-thirds of the domestic market.

Issues affecting holders of active business interests Corporate taxation

Corporate tax rates declined for small businesses' active business income between 2007 and 2017 but have substantially increased since then, making Canada far less competitive than previously, particularly given the substantial decrease in the US corporate tax rates, the United States being Canada's largest trading partner. The combined net federal and provincial corporate tax rates applicable to general corporations' active business income in 2025 range between 23 and 31 per cent.

Preferential tax treatment is offered to small business corporations, which benefit from a reduced combined federal and provincial tax rate of between 9 and 12.2 per cent on at least the first C\$500,000 of its active business income and in some jurisdictions a higher threshold. A small business corporation is a Canadian-controlled private



New

corporation (CCPC) carrying on active business in Canada. The small business income limit is reduced on a straight-line basis for CCPCs that alone or as members of an associated group have taxable capital employed in Canada of between C\$10 million and C\$50 million in the previous year. Taxable capital is generally comprised of the corporation's retained earnings, surpluses and advances.

In 2018, amendments to tax legislation were enacted to reduce the small business deduction in the case of corporations that have more than C\$50,000 per year of passive investment income. These changes follow the 2017 taxation changes that target corporations that accumulate income that had benefited from the low small business tax rate. The small business limit for CCPCs and associated corporations is reduced on a straight-line basis for CCPCs that earn between C\$50,000 and C\$150,000 of investment income such that the small business limit would be completely eliminated where a corporation earns C\$150,000 of investment income per year. For this purpose, a definition of investment income or adjusted aggregate investment income (AAII) was introduced. Generally, AAII will exclude taxable capital gains from the sale of active investments and investment income that is incidental to the business. These exclusions are included for the purpose of protecting investment interests in the Canadian innovation industry. Ontario and New Brunswick subsequently decided they would not create parallel legislation and instead have preserved the small business limit at the provincial level.

Shares of a small business corporation are eligible for a lifetime capital gains exemption of C\$1,250,000 for 2025, indexed for inflation starting in 2026, as are certain qualified farm and fishing properties.

Investment income earned in a CCPC is taxed at very high rates. For instance, in 2025, CCPCs in Prince Edward Island, the province with the highest provincial tax rate for investment income earned in CCPCs, will pay income taxes on their investment income at a rate of 54.7 per cent. In other provinces, CCPC investment income is taxed at rates ranging between 46.7 per cent in Alberta and 53.7 per cent in Newfoundland and Labrador. General corporations (non-CCPCs), who do not benefit from the small business deduction pay taxes on their investment income at lower rates – at combined federal and provincial rates of up to 31 per cent in 2025.

For extracting corporate income by way of dividends, a gross-up dividend tax credit (an enhanced tax credit in the case of dividends funded by the corporation's active business income that did not benefit from the small business tax rate) and a corporate refundable tax mechanism (in the case of corporations that earn investment income) is provided to avoid double taxation of income earned in the corporation that is subsequently paid to its individual shareholders, who are taxed at their marginal tax rates.

The 2017 tax amendments made significant changes to shareholder taxation. The changes make dividends received by individual shareholders taxable at the top marginal rates (these provisions being called a tax on split income (TOSI)), unless the shareholders receiving the dividends can show substantial labour or capital contributions to the operations of the business of the corporation. For example, TOSI will not apply to a business owner's spouse or common-law partner aged 65 or older; shareholders over the age of 18 who make a substantial labour contribution to the corporation's business of at least 20 hours per week; and shareholders over the age of 25 who own 10 per cent or more interest in the corporation that earns less than 90 per cent of its income from the provision of services. The shares cannot be shares of a professional corporation. Those shareholders who do not meet these 'bright line' tests will face a 'reasonableness' test review by the CRA.

There are generally two kinds of dividends that can be paid to individual shareholders of CCPCs: eligible and non-eligible dividends. Generally, eligible dividends are funded by the corporation's income that did not benefit from small business tax rate. Eligible and non-eligible dividends are taxed at different rates in the hands of individual



shareholders. For instance, in 2025 in Ontario, the highest individual tax rate on eligible dividends is 39.34 per cent and that on non-eligible dividends is 47.74 per cent. As part of the current tax integration rules, when a corporation pays a dividend to its shareholders, it may be able to receive a tax refund that is based on the corporation's notional refundable dividend tax on hand (RDTOH) account, which is calculated in reference to the corporation's investment income. New rules introduced in 2018 that apply to taxation years after 2018 limit CCPCs' access to the RDTOH refund to the payment of non-eligible dividends, with an exception for that portion of the RDTOH that arises from the corporation's eligible portfolio income. A tax-deferred transfer or rollover of certain eligible property to a taxable Canadian corporation for consideration, which must include shares of the corporation, is available, subject to certain conditions. The corporation may retain the shareholder's tax cost of the property or may elect a higher tax cost, within limits. Among other results, the corporation then assumes the tax liability relating to gains on the property, the payment of which is deferred to a later date.

The 2025 Liberal election platform included a proposal to conduct an expert review of the corporate tax system based on the principles of fairness, transparency, simplicity, sustainability and competitiveness. It will be interesting to see how the newly-elected Liberal government moves forward on this election promise.

Goods and services tax, provincial sales tax and harmonised sales tax

Federally, Canada levies a 5 per cent supply-side tax on most services and goods, including those made in Canada and imported, and certain property. Goods and services tax (GST) applies at all stages of production, subject to an input tax credit for tax paid at an earlier stage, and businesses are responsible for collecting and remitting the tax. The provinces and territories levy their own sales tax in addition to GST. Five provinces have harmonised GST with provincial sales tax, and this is known as harmonised sales tax. Combined, these taxes range from 5 per cent (in Alberta, British Columbia, Manitoba, the Northwest Territories, Nunavut, Quebec, Saskatchewan and Yukon) to 15 per cent (New Brunswick, Newfoundland and Labrador, Nova Scotia and Prince Edward Island).

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