SALARY VS. DIVIDEND

If you own a business through a corporation, you have the ability to pay yourself a salary or dividends or a combination of both.

Our personal and corporate income tax structure is as fair as it has ever been. It is what accountants refer to as being “fully integrated”. This means that at the end of the day, whether you pay yourself a salary or dividend, when you take the income taxes paid at the corporate level and those paid personally, the combined taxes should be the same whether you take all salary, all dividends, or a combination of the two. That being said, nothing in life is perfect and, in almost all cases, there is a discrepancy of one or two percentage points that can work for you or against you and potentially influence your decision on how you compensate yourself.

SALARY

If you are paying yourself a salary, the payments become an expense of the corporation and then employment income for you personally – you will receive a T4, which you will report on your personal tax return. The expense reduces the corporation’s taxable income which reduces corporate taxes owing.

To pay yourself a salary, the corporation will be required to register a payroll account with CRA. Each time that you are paid, the corporation will need to withhold source deductions (CPP and Income Tax) from your pay. These source deductions are then remitted to the CRA on a regular basis. In addition, each year, the corporation must prepare and file T4s for any employees that earned a salary.

DIVIDEND

Dividends are paid from the retained corporate income that has already been subject to corporate tax. When dividends are received by the shareholders and included on their personal income tax returns, they will receive a dividend tax credit equal to the taxes already paid at the corporate level to prevent double taxation.

Dividends are investment income, which is a return on your shares. As such, they are not subject to normal payroll deductions and charges such as CPP and EI premiums, provincial payroll/health taxes, workers’ compensation premiums, etc. They are also not subject to a withholding tax at source (although if you continually take all dividends, you will likely be subject to personal quarterly income tax installments as you can not wait until you file your tax return each year to give the government their portion). These amounts can have a significant impact on how much is left in your pocket at the end of the day and must be taken into consideration. Dividends are a clean source of compensation in this regard. Also, dividends have a less personal tax liability than wages because they come with a dividend tax credit.

In practice, paying dividends to shareholders of a corporation is simple. Dividends are declared and cash is transferred from the corporate account to a shareholder’s personal account in one or many transactions. Each year, the corporation must prepare and file T5s for any shareholders who received dividends.

Dividends are issued and paid based on share ownership. For example, if a company plans to issue $100,000 in dividends to the owners of its Class A common shares, it must do so based on percentage of ownership.

So, if Shareholder #1 owns 30% of the company’s Class A shares and Shareholder #2 owns the other 70%, then Shareholder #1 would receive $30,000 and Shareholder #2 would receive $70,000. This can make it difficult to allocate different amounts of income to multiple shareholders if they all own the same class of shares.

TAX PLANNING

There is no single correct answer when determining if a salary or a dividend is the best method to pay yourself. You should consider every situation on its own merits and it is worth the effort for proper tax planning early on to avoid paying unnecessary taxes.

GEIB & COMPANY
PROFESSIONAL CORPORATION
CHARTERED PROFESSIONAL ACCOUNTANTS

#1020—10201 Southport Road SW
Calgary, AB T2W 4X9
403.259.4519 | info@geibco.com

SALARY VS. DIVIDEND (PAGE 2/2)

COMMON SCENARIOS TO CONSIDER AS A BUSINESS OWNER:

Administrative Tasks - If making payments on time is a weakness that you have, then it may be easier and less costly to pay yourself using dividends. Salary requires the regular, on-time payment of source deductions. If source deduction payments are missed or late, the penalties can add up quickly.

Qualifying for Financing - If you plan on purchasing a home in the near future and know that you will need to qualify for a mortgage, it may be advantageous to pay yourself as an employee (wage/salary). Banks prefer to see the steady income more than sporadic dividend payments.

Paying Bonuses - Tax can be reduced or deferred by paying wages in the form of a bonus to business owners. This is a bit complicated and is not applicable for every scenario, however it is important to know that this technique exists.

ADVANTAGES:

Salary	Dividends
Receive legally recognizable personal income	Avoid mandatory retirement contributions means more flexible cash flow for the business (you do not pay into CPP)
Easier to save for retirement through involuntary CPP and RRSP contributions	Less chance for payroll penalties
Fewer surprise tax bills	Less tax payments
Easy to apply for bank loans and mortgages because you have a record of consistent income	No need to register for payroll and remittance. You can declare a dividend and transfer cash from your company to your personal account anytime.
Qualifies for the basic non-refundable employment tax credit on annual personal income tax return	Dividends from income taxes at the lowest corporate tax rate results in all-out tax savings of a couple percentage points
Can have non-taxable benefits like health and dental insurance coverage.	Can be an effective means of income splitting with family members (the TOSI rules need to be reviewed by a professional before consideration of income splitting)