

# Salary/bonus or dividends 2024

Choosing between salary/bonus ("salary") or dividends is an annual exercise for the owner-manager ("owner"). We discuss the main considerations to keep in mind below. However, each situation is different and requires advice from your external professional advisor.<sup>1</sup>

## Salary and dividend characteristics

Basic characteristics for salary and dividends include:

Salary	Dividends
Creates RRSP deduction room	Does NOT create RRSP deduction room
Canada/Quebec Pension Plan (CPP/QPP) contributions applicable	CPP/QPP contributions NOT applicable
Deduction from taxable income for the corporation	NOT a deduction from taxable income for the corporation – paid from after-tax profits
Fully taxable to shareholder – potential for deferral on declared bonuses up to 6 months	Subject to gross-up and a tax credit
Set up payroll accounts with CRA and issue a T4, with payroll administration and remittances	Write a cheque and issue a T5. Document dividends with director resolutions

## Integration

Integration is a theory under the Income Tax Act (ITA). It attempts to ensure an owner is indifferent to earning income as ordinary salary or dividends. That is, personal taxes on salary should be similar to the combined corporate and personal taxes on a dividend. As shown below, achieving perfect integration is difficult.

One form of integration occurs through the small business deduction (SBD) and dividend tax credits (DTC) in the ITA. Many small business corporations in Canada benefit from a tax reduction on active business income (ABI) up to a threshold. The SBD results in significantly lower tax rates than the general corporate tax rate for ABI. Combined federal and provincial/territorial tax rates on SBD income range from 9%-12.20% on the first \$500,000.<sup>2</sup> Compare this to 23%-31% on general ABI above the \$500,000 threshold.

After applying corporate tax rates, dividends paid from ABI will be in the form of "non-eligible" or "eligible" dividends. Your corporation pays non-eligible dividends from after-tax profits subject to the SBD rate and eligible dividends from after-tax profits subject to the general ABI rate. Dividends are grossed-up (15% for non-eligible dividends and 38% for eligible dividends) on your personal tax return and a DTC applied. This form of integration attempts to reduce personal taxes to reflect corporate taxes already paid.

## Integration in action

To see integration in action, we'll analyze Sarah's situation. As a starting point, we ignore other considerations such as CPP/QPP and payroll taxes (discussed later).

Assume Sarah is an Ontario resident for tax purposes at the highest marginal tax rate. Her corporation is resident in Ontario and has \$20,000 before-tax profit.

If Sarah's corporation pays her a salary, the \$20,000 of salary is a deduction from the corporation's pre-tax profits (reducing it to nil). Sarah receives the additional \$20,000 salary resulting in personal taxes at her highest marginal tax rate (53.53%). **Result:** Sarah has **\$9,294** after-tax.

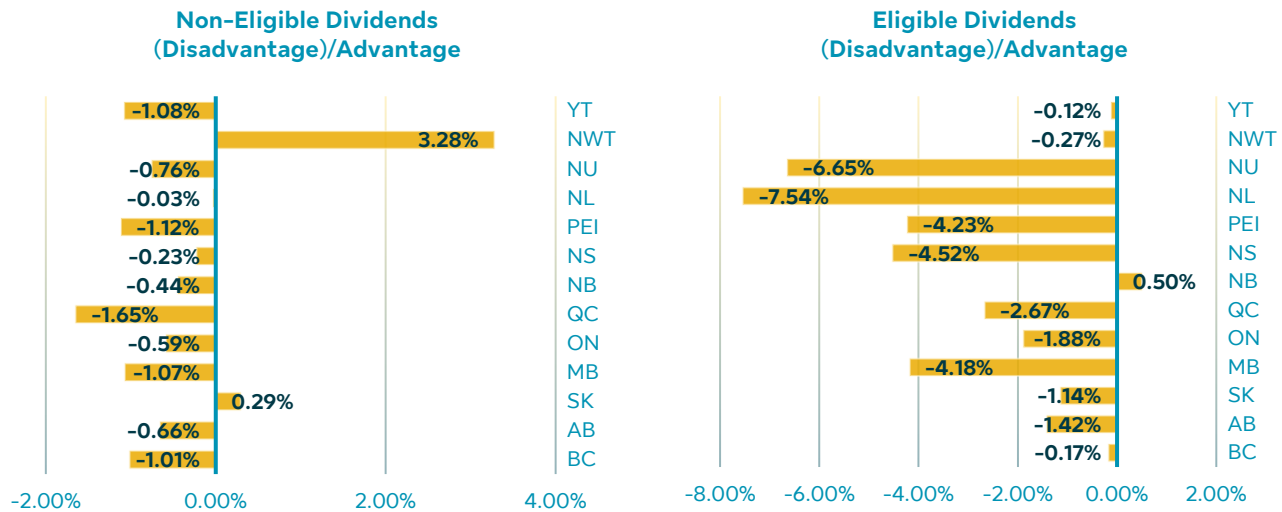
If Sarah wants to take income as a dividend, the after-tax amount available to declare depends on the corporation's tax rates:

- **SBD tax rates.** \$20,000 profit has 12.2% corporate taxes, leaving \$17,560 available to pay as a non-eligible dividend. Sarah then applies the gross-up and non-eligible DTC at her highest marginal tax rate. This results in a 47.74% tax rate personally. Sarah has **\$9,177** after-tax; or
- **General ABI tax rates.** \$20,000 profit has 26.5% corporate taxes, leaving \$14,700 available to pay as an eligible dividend. Sarah then applies the gross-up and eligible DTC at her highest marginal tax rate. This results in a 39.34% tax rate personally. Sarah would have **\$8,917** after-tax.

**Sarah has more after-tax money paying salary at the highest marginal tax rates in Ontario.**

## Integration across Canada at the highest marginal tax bracket

Most provinces and territories have either a nominal difference (achieved integration) or a slight disadvantage for non-eligible dividends at the highest marginal tax rates. The difference is more obvious for eligible dividends at the highest marginal tax rates.



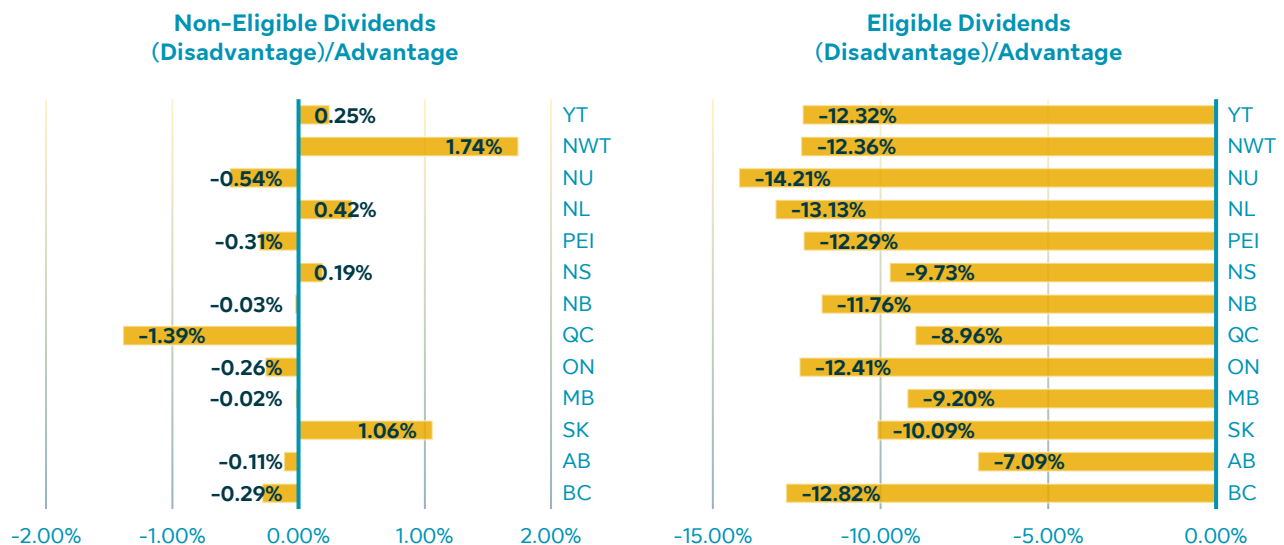
- Non-eligible dividends: Saskatchewan has a slight advantage for non-eligible dividends over salary. Only Northwest Territories has a noticeable advantage for non-eligible dividends over salary. In all other provinces and territories, salary results in less income tax than non-eligible dividends.
- Eligible dividends: In New Brunswick, there is a slight advantage for eligible dividends at the highest marginal tax rate. In British Columbia, Yukon and Northwest Territories, the disadvantage is under 1%. In all other provinces and territories, there is a noticeable disadvantage for eligible dividends.

**Many other factors come into play when choosing between salary and dividends. However, from an income tax perspective, salary will result in more after-tax money in most provinces and territories.**

## What about those not paying tax at the highest marginal tax bracket?

Not everyone pays tax at the highest marginal tax bracket. Therefore, an analysis for a lower level of total income is helpful.

Assume Sarah's corporation has \$50,000 before-tax corporate profit. Sarah is deciding between paying herself salary or declaring a dividend. Taxes assume no other personal income in the year and reflect the personal basic credit against Sarah's tax rates. The analysis reflects the following:



- **Non-eligible dividends:** at \$50,000, Northwest Territories and Saskatchewan have an advantage for non-eligible dividends over salary. Quebec has an advantage for salary. In all other provinces and territories, the difference is negligible.
- **Eligible dividends:** at \$50,000, eligible dividends have a noticeable disadvantage over salary in all provinces and territories. This makes sense since general ABI corporate tax rates average 27% across Canada. Average personal income tax rates on \$50,000 of ordinary income is between 15% and 21%.

**Similar results occur if the total before-tax corporate profit is \$100,000.**

## CPP/QPP

All the examples above focus on income tax aspects for salary versus dividends. CPP/QPP contributions are prominent for owners because you can see you pay both the employer and the employee portions. This can result in a combined outlay of \$8,111 (CPP), or \$8,696 (QPP) in 2024. However, paying dividends and foregoing CPP/QPP contributions does not compare apples to apples in the context of a holistic financial plan. To compare apples to apples, you can choose to:

- pay salary and contribute to CPP/QPP to build future government benefits; or
- declare dividends and set equivalent funds aside to replace the foregone CPP/QPP benefits.

In both cases, you set aside the amount of the CPP/QPP contributions to compare the tax on the remainder. Alternatively, you may have maximized CPP/QPP contributions for the year and want to decide between additional salary or dividends. In all these cases, the income tax analysis above continues to apply.

Despite the above, you may choose to pay dividends and forego CPP/QPP contributions for immediate cash flow purposes. For example, you may need more immediate cash flow to meet lifestyle needs today. Alternatively, you may need funds inside your corporation to grow the business or meet business needs. Both are valid reasons to pay dividends and forego CPP/QPP contributions to maximize after-tax money available for the year. However, if you do so without setting aside equivalent savings, keep in mind the foregone CPP/QPP benefits. CPP/QPP benefits include potential for retirement, disability, orphan's, survivor's, and death benefits during your lifetime. Employment insurance is generally not a consideration for owners unless they elect into the program.

## Other tax considerations

In addition to income tax and CPP/QPP, other tax considerations include:

- Provincial or territorial payroll taxes;
- Ability to recover of alternative minimum tax (AMT) which may require personal taxable income;
- Desire to recover refundable taxes or use corporate notional accounts;
- Staying below the passive investment income threshold inside your corporation to avoid an SBD grind;
- Claiming charitable donations; and
- Tax on split income.

## Non-tax considerations

Finally, in addition to tax considerations, there are non-tax aspects to keep in mind. These include:

- Personal preference;
- Need for money in current year;
- Benefits relating to RRSPs (which requires salary income) such as potential creditor protection;
- Ability to implement an individual pension plan for higher income earners (which requires salary income);
- Corporate structure/other shareholders that may restrict dividend payment; and
- Personal borrowing/credit considerations which may require salary income by the financial institution.

## Summary

There is no "right" answer applicable to every person. Each situation takes into account personal and corporate taxes, payroll taxes, and other tax and non-tax considerations. Use the above as a guideline to make an informed decision particular to your stated goals and objectives.

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<sup>1</sup> Deciding between salary or dividend for corporate profit earned and paid out in the same year is a different analysis than determining whether to retain funds corporately or how to remove accumulated funds in later years. This article focuses on salary versus dividends paid out in the same year they are earned by the corporation.

<sup>2</sup> Provincial and territorial thresholds for SBD income are all \$500,000 other than in Saskatchewan where the threshold is \$600,000. This results in a hybrid federal and provincial tax rate of 16% for ABI between \$500,000 and \$600,000 in Saskatchewan.