

Salary/bonus or dividends 2023

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.¹

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. In 2023, combined federal and provincial/territorial tax rates on SBD income range from 9%-12.20% on the first \$500,000.² 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”³ or “eligible”⁴ dividends. Dividends are grossed-up⁵ on the 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 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.⁶ **Result:** Sarah has **\$9,294** after-tax.

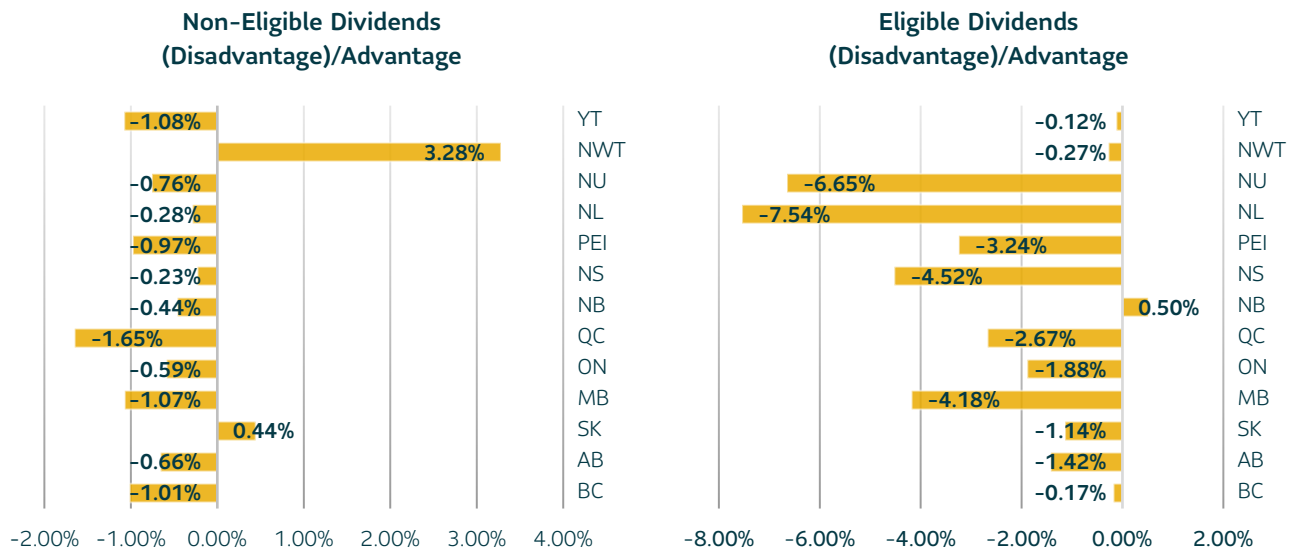
If Sarah wants to take income as a dividend, the after-tax amount available to declare depends on the corporation’s tax rates:

- **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.⁷ Sarah would have **\$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.⁸ Sarah then applies the gross-up and eligible DTC at her highest marginal tax rate.⁹ 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.



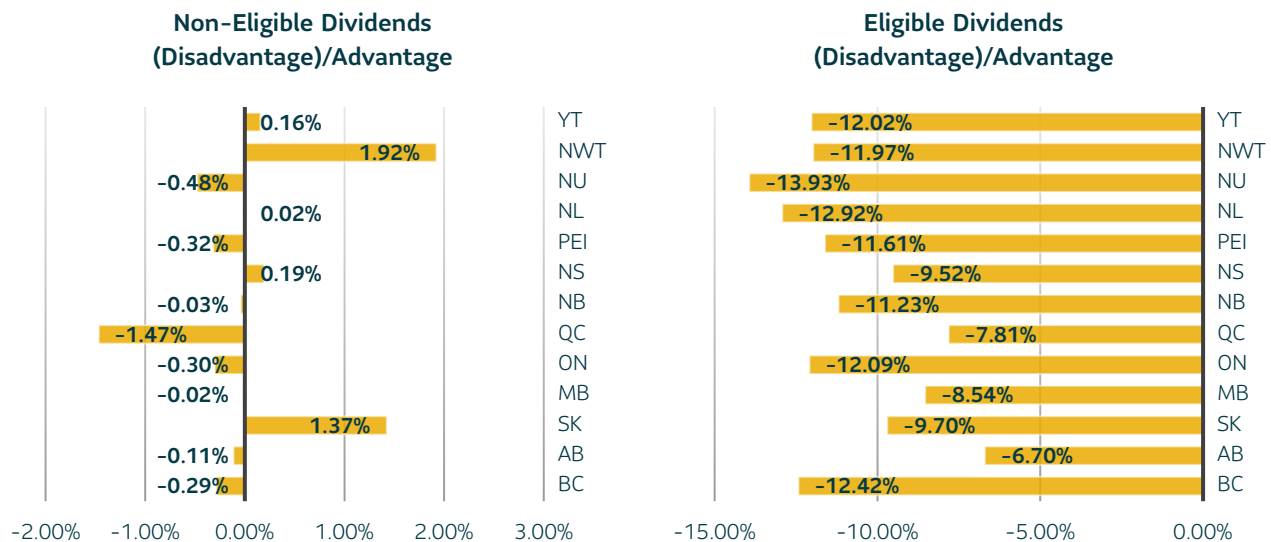
- Non-eligible dividends: Saskatchewan has a slight advantage for non-eligible dividends over salary. Only Northwest Territories has a noticeable advantage for non-eligible dividends over salary. In all other provinces and territories, salary results in less income tax than non-eligible dividends.
- 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.¹⁰ The analysis reflects the following:



- Non-eligible dividends: at \$50,000, Northwest Territories and Saskatchewan have an advantage for non-eligible dividends over salary. Yukon, Newfoundland and Labrador, Nova Scotia, New Brunswick, Manitoba, and Alberta have almost perfect integration. In all other provinces and territories, salary has an advantage.
- 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%.

Combined corporate and personal taxes generally result in salary providing more on an after-tax basis to Sarah. Similar results occur if the total before-tax corporate profit is \$100,000.¹¹

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.¹² 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 for the corporation 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 of these 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 in this article 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.¹³

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;
- Corporate structure/other shareholders that may restrict dividend payment; and
- Personal borrowing/credit considerations.

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.

Disclaimer

This article provides general information only. Sun Life Assurance Company of Canada does not provide legal, accounting or taxation advice to advisors or clients. Before you act on any of the information contained in this article make sure you seek advice from a qualified professional, including a thorough examination of your specific legal, accounting and tax situation. Any examples or illustrations in this article are included solely to help clarify the information presented in this article, and should not be relied on in any transaction.

Published and revised by: Estate & Financial Planning Services

Last revised: January 2023

© Sun Life Assurance Company of Canada, 2023.

Sun Life Assurance Company of Canada is a member of the Sun Life group of companies.

¹ 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.

² 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 15% for ABI between \$500,000 and \$600,000 in Saskatchewan.

³ Paid from after-tax corporate profits subject to the SBD tax rate.

⁴ Paid from after-tax corporate profits subject to the general ABI tax rate.

⁵ Gross up is 15% for non-eligible dividends and 38% for eligible dividends.

⁶ 53.53%.

⁷ Resulting in a 47.74% personal tax rate when the gross-up and DTC is applied.

⁸ Assuming the full amount is credited to the general rate income pool and allowing for the full amount to be removed as an eligible dividend.

⁹ Resulting in a 39.34% personal tax rate when the gross-up and DTC is applied.

¹⁰ Taxes under each scenario assume no other taxable income in the year and reflect only the personal basic credit against graduated marginal tax rates for the province/territory in question.

¹¹ In Saskatchewan there a slight advantage for non-eligible dividends over salary at \$100,000. There is a noticeable advantage in Northwest Territories for non-eligible dividends over salary at \$100,000. Newfoundland and Labrador, Nova Scotia, and New Brunswick continues to have almost perfect integration on non-eligible dividends at \$100,000. Eligible dividends continue to have a disadvantage in all provinces and territories at \$100,000 other than Alberta. Alberta is almost perfectly integrated at \$100,000 with a slight advantage for salary over eligible dividends.

¹² At 5.95% each (2023) for CPP and 6.40% each (2023) for QPP, this can result in a combined outlay of \$7,508.90, or \$8,076.80, respectively.

¹³ CPP/QPP benefits include potential for retirement, disability, orphan's, survivor's and death benefits during your lifetime. Note that employment insurance is generally not a consideration for owners as they would be considered non-arm's length and therefore not insurable under the Employment Insurance Act