

# Form of Remuneration

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## Salary v Dividend

### Salary, Dividends or Others

Methodology to approach remuneration strategy

- 1) Determine amount of remuneration needed
  - cover debit balances, personal cash needs
- 2) Determine to whom paid (consider income splitting)
- 3) Determine form of remuneration
  - cheapest form, constraints, AMT, CNIL
- 4) Determine when to pay remuneration
  - deferral, timing differences, higher future tax rates

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## Non-Active Business Income

- CRA will not challenge bonuses paid from “non-active business income” as long as other criteria met
- What is non-active business income?
- Income incidental to active business – active or otherwise including income of specified investment business
- Activity level required – question of fact. [Beware disability deduction see below]
- If only activity is investments managed through third party – shareholder **not** considered active

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## When Are Salaries to Shareholders Deductible?

### Technical News No. 22

1. Paid to shareholders (either direct or indirect shareholders) of a CCPC
2. Shareholders/managers are Canadian residents
3. Shareholders/managers are **actively** involved in day-to-day operations
  - Ownership structure does not impact policy
  - Inter-corporate management fees will continue to be challenged

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## 1) SR&ED

Bonus down income no longer a factor

- ITC general rate 15%; not refundable
- If CCPC, 35% rate on first \$3 million and refundable
- ITC at 35% starts to phase out when prior year taxable capital exceeds \$10 million, eliminated when it reaches \$50 million
- No longer income limit

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## 2) RRSP Contribution

- Tax-free growth
- Consider individual's age
- **If** RRSP contribution can be made
  - better to pay enough bonus to make maximum RRSP contribution
- Contribution limited to 18% of earned income of previous year
- 2022 limit \$29,210
- Need salary of \$162,778 for 2021

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## Bonus or Not

### Consider:

- Tax Rates – tax deferral up to 180 days with bonus; e.g. with July 31<sup>st</sup> year-end can declare bonus on July 31, 2020 and pay it in early January 2021 / no corporate deferral
- RRSP Contribution – needs salary in prior year (18% of earned income)
- Ultimate capital gain to consider if funds left in corporation for tax deferral
- Do not pay bonus late. 180 days is always slightly less than 6 months. If late, no deduction for current year.

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## Observations

- The cost of not bonusing is not very large and in some cases negligible
- Need to look at cash needs of shareholders
- Significant deferral of personal taxes if funds are left in the corporation
- What is return on investment for business assets if funds are left in the business?
- What if retained earnings becomes a capital gain ultimately?
- EHT on bonus, paid by corporation, deductible, at 1.95%. Adds to cost of paying salary.

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## Ultimate Capital Gain

- The premise is to keep annual after tax funds in the company to defer the personal tax arising on extracting the funds to the individual shareholder
- Funds will accumulate in company, increasing value of shares
- On death, shares deemed disposed of, triggering tax at capital gains rate (e.g., 26.5%), significantly lower than rate on dividend (e.g., 39% / 47%)
- Funds can then be extracted using a pipeline strategy without further tax
- Useful if shareholder does not require all the funds in the company

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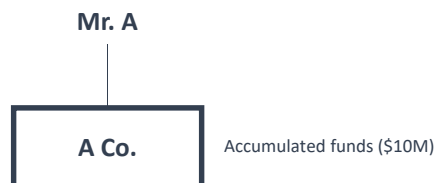
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## Ultimate Capital Gain Example

- Mr. A leaves funds to accumulate in A Co.
- A Co. grows in value (since assets are not distributed)
- Mr. A will pay capital gains tax upon death



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# Ultimate Capital Gain

Cash accumulated in corporation

Sell corporation with Cash

Result capital gain (but may lose access to capital gains exemption)

Could trigger capital gains exemption before adopting strategy

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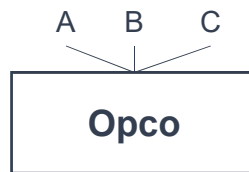
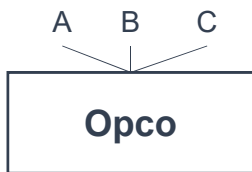


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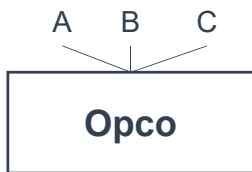
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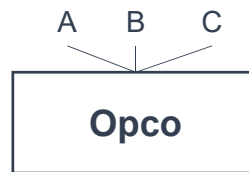
# Ultimate Capital Gain



Lock in capital gains exemption



Accumulate Cash each year



Sell shares to 3<sup>rd</sup> party

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# Forms of Remuneration

Salary

Ineligible dividend

Eligible dividend

CDA

Interest on shareholder loan

Capital gains

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# Forms of Remuneration

## Salary

- Needed for RRSP
- Effective if AMT sensitive
- No impact on CNIL
- Payroll tax and EHT
- Withholding, so net amount offsets debit balance
- Can accrue, pay within 180 days

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# Forms of Remuneration

## Ineligible dividend

- High tax rate, especially in higher brackets
- Offsets CNIL
- Not effective in eliminating AMT
- Gross-up pushes up tax brackets(115%)
- Triggers dividend refund, ERDTOH and NERDTOH
- TOSI sensitive
- Effective to offset debit balance

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# Forms of Remuneration

## Eligible dividend

- High tax rate, especially in higher brackets
- Good result at taxable income under \$150,000
- Preferred to ineligible dividend
- Best offset for CNIL as 145% gross-up
- Gross-up pushes up tax brackets
- Triggers dividend refund only in ERDTOH
- More AMT sensitive
- TOSI sensitive
- Effective to offset debit balance

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# Forms of Remuneration

## CDA

- Tax-free
- No impact on CNIL or AMT
- Not TOSI sensitive
- Always pay out
- Make sure you can confirm CDA balance
- Very effective against debit balance
- Pay to TOSI sensitive shareholder

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# Forms of Remuneration

## Interest on shareholder loan

- Limited to reasonable interest
- Make sure legal obligation to pay interest or not deductible to corporation
- Effective for CNIL and AMT
- Should not be TOSI sensitive but be careful of income attribution if loan gifted to spouse

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# Forms of Remuneration

## Capital gain

- Lower tax overall
- CDA not TOSI sensitive
- Could be aggressive, depends on situation (see later section)

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# Forms of Remuneration

## Combination

- Don't overlook possibility of combination of alternatives
- Generally clients prefer to pay corporate tax v personal tax even if same result (Why? Easier to finance the tax, not viewed as personal money)

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# Forms of Remuneration

## Summary

Unless very low rate taxpayer, pay eligible dividend before ineligible dividend

IF RDTOH and active sources, trigger RDTOH by dividend.

If ERDTOH pool, pay out (minimal cost at top bracket, savings if below)

For RRSP, need bonus (earned income) for 2021 to make 2022 contribution (\$162,778 for 2021 for \$29,210 maximum contribution in 2022)

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# Forms of Remuneration

## Summary Cont.

Consider capital gains strategies (see next section)

Always pay out CDA (no tax)

Income split (subject to TOSI). Even small payments (up to \$50,000) produce large savings. See income splitting materials in later section

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