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Salary versus Dividends

For small businesses, a major tax-planning area is how to extract the profits of the company in the most tax-effective manner. In choosing the best method for your company it is important to correctly identify your objectives along with any possible limitations for your situation, for example:

- Do you as the shareholder wish to receive all of the corporation's annual income personally or do you wish to receive sufficient income in order that you have a certain amount of after-tax cash personally?
- Do you merely want to borrow funds from the corporation temporarily and need to determine the most effective manner of arranging for repayment?
- Do you wish to make maximum RRSP contributions?
- Do you wish to maximize the amount of cash that may be reinvested in the corporation's business activities?
- Do you want flexibility in remunerating different shareholders or managers in different ways?

One personal goal can be to maximize after-tax cash, but the routes travelled to that point can be very different, depending on the other considerations listed. What works for one company and its shareholders many not be the best for the next company!

The two alternatives for extracting funds from a corporation are salary and dividends. Depending on your objectives, as noted above, either a choice between one and the other, or a combination of the two, can be considered. The following considerations will come into play when determining the appropriate amount of salary and/or dividends:

- Salary is fully tax deductible by the corporation, provided that amounts paid are reasonable and for individuals who did work for the corporation.
- Dividends are not tax deductible by the company, they are paid with after-tax cash flows.
- Salary is earned income for both RRSP and child-care expense purposes. Dividends are not.