

The Salary Dividend Dilemma

The decision for an owner-manager of how to take funds out of a Canadian-controlled private corporation, in the most tax effective way, has always been a difficult one. This is generally coined the salary-dividend decision. The current cash needs of the owners are paramount in determining the amount of funds to be paid out.

Traditionally, small business owners have been advised to pay a salary or bonus to bring the corporate income down to the small business deduction level (currently \$500,000 in Ontario) to avoid the high corporate tax rates on income not eligible for the preferred small business tax rates.

The New Position

Changes to corporate tax rates have challenged this point of view. Several recent articles have been written and mass-distributed showing the advantages of paying funds out of the corporation as dividends over salaries. This argument cannot be immediately refuted as there is over-integration on the first \$500,000 earned within the corporation due to the changes in the tax rates. Over-integration in this situation occurs when the tax a business owner pays on income earned personally is actually higher than the sum of the corporate income tax and the personal income tax paid by the shareholder on income earned through the corporation and paid out as dividends.

Caution should be exercised though when regarding this option as other considerations must be reviewed...

Other Considerations

To the owner/manager receiving income, dividend income is considered investment income while salary is considered earned income. There are many Canadian income tax measures which are based on this earned income concept, including:

- earned income is necessary to create room for contributions to a Registered Retirement Savings Plan;
- earned or contributory earnings are required for purposes of determining Canada Pension Plan (CPP) benefits (retirement and disability);
- the deduction for child care expenses is limited to two-thirds of earned income, as defined, of the lower income spouse, as applicable;
- salaries are required to be paid to benefit from Scientific Research and Experimental Development credit claims;
- contributions to an Individual Pension Plan relate to past years' employment income; and
- moving expenses are deductible against employment income at a new work location.

Other considerations when paying a salary include costs related to CPP contributions, Employment Insurance premiums, Employer Health Tax, and the inherent costs of administration of the payroll.

In certain situations, dividends could also increase an owner-manager's alternative minimum tax exposure.

Another important consideration is when lending institutions are looking at income-tested guarantees on loans and bank financing, dividend income may not be regarded as favourably as salary income.

If the decision is to remunerate an owner/manager only by dividends, consideration should be made to pay at least a nominal salary to gain access to the CPP disability benefits. In 2012, a salary of just over \$5,000 is sufficient to be able to allow claims for disability benefits through the CPP.

Finally, U.S. citizens resident in Canada must be cognizant of U.S. tax implications of receiving dividend income as the U.S. does not have the same system regarding the taxation of dividends as in Canada.

Considerations for Seniors

As you may be aware, Canadian source dividends are grossed up when being reported on a Canadian personal income tax return (currently 25% or 38% depending on the dividends). This gross-up is part of the system of taxation of dividend income, which notionally attempts to reconcile pre-tax corporate income, corporate income tax, and integration between income earned through a corporation and that earned by an individual. An individual receives income tax credits to offset the gross up of dividend income. However, the gross up results in a higher amount of net income for tax purposes, which represents an income test for the following:

- Clawback of Old Age Security benefits;
- Loss of or reduction to:
 - Guaranteed Income Supplements;
 - Harmonized Sales Tax Credit;
 - Age credits; and
- Higher nursing home payments if the rent calculation is geared to income.

Considerations for Students

Caution should be taken when paying dividends to students. One should ensure that the student has sufficient income to utilize the combination of the tuition, education and textbook credits and the dividend tax credits. Otherwise the available dividend tax credits can be lost as the ordering of claiming credits causes the dividend tax credits to be claimed after the claim for the education amounts. Moreover, the aforementioned dividend "gross-up" represents an artificial increase to income which could affect student assistance benefits.

Our Solution

In conclusion, although there can be distinct tax savings through dividend-based remuneration to individuals, the overall long term optimum approach could be to pay a combination of dividends and salary, thereby benefiting from the items noted above. We emphasize that in all cases, the salary paid must be reasonable for the services rendered. Each particular situation and scenario must be analysed on its own merits with a professional advisor.

Canada Summer Jobs 2012

Canada Summer Jobs is a Government of Canada initiative that provides funding to help employers create summer job opportunities for students. It is designed to focus on local priorities while achieving tangible results for both students and their communities. Canadian not-for-profit organizations, public-sector employers and small businesses with 50 or fewer employees can apply for funding through Canada Summer Jobs. Employers can begin to apply for Canada Summer Jobs on February 1, 2012 and the deadline for applications is February 29, 2012.

For more information, visit <http://www.servicecanada.gc.ca/eng/epb/yi/yep/programs/scpp.shtml> or call 1-800-935-5555.

New 30% Off Ontario Tuition

The Ontario government has introduced new legislation to help families by keeping the cost of postsecondary education affordable with a new 30% Off Ontario Tuition grant.

Who Is Eligible

Students are eligible for the new 30% Off Ontario Tuition grant if:

- They are a full-time student at a public college or university in Ontario;
- It's been less than four years since they left high school;
- They are in a program that they can apply to directly from high school;
- Their parents' gross income is \$160,000 or less;
- They are a Canadian citizen, a permanent resident or a protected person, as defined; and
- They are an Ontario resident.

Starting in January, eligible university or college degree students will receive \$800 and college diploma and certificate students will receive \$365 — an amount pro-rated for one semester, covering the second half of the school year.

In September 2012, students in a university or college degree program will save \$1,600 and students in college diploma and certificate programs will save \$730.

Students may receive the new 30% Off Ontario Tuition grant for up to four years of study in an undergraduate program. Students with disabilities may receive the grant for up to six years of study.

Application

Students who already receive funding from the Ontario Student Assistance Program (OSAP) will be automatically considered. If eligible, the grant will be deposited directly into their account or otherwise be mailed to their school-year address.

Students who do not currently receive OSAP must apply directly to Ontario Ministry of Training, Colleges and Universities. March 31st, 2012 is the deadline to apply to receive the grant for this semester.

Visit <https://osap.gov.on.ca/OSAPportal/en/PostsecondaryEducation/Tuition/index.htm>

This 'n That at Logan Katz

Breakfast Seminar

Once again we will be presenting our Federal Budget breakfast seminar, when a date has been selected for it to be tabled we will provide you with our venue details. We look forward to seeing you there!!!

New and Returning Faces at Logan Katz

Logan Katz welcomes Jessie Luo, Christelle Kampire, Jahangir Qazi, Joshua Schram, and Taylor Servais, students from the University of Waterloo and University of Ottawa. They will be with us until April 2012. We also celebrate the return of Adam Bleackley and David Hamilton for another co-op term, as well as the arrival of Sophie Guo and Luke Hudson who have accepted a permanent full-time position with our firm.

December On-Line Poll

The Logan Katz December on-line poll asked what are your business's or place of employment's plans in terms of hiring for 2012. Our results revealed that 22.2% Significant new hires are planned; 55.6% Minimal new hires are planned; 22.2% No changes are planned; 0% Minimal or significant staff reductions are planned.