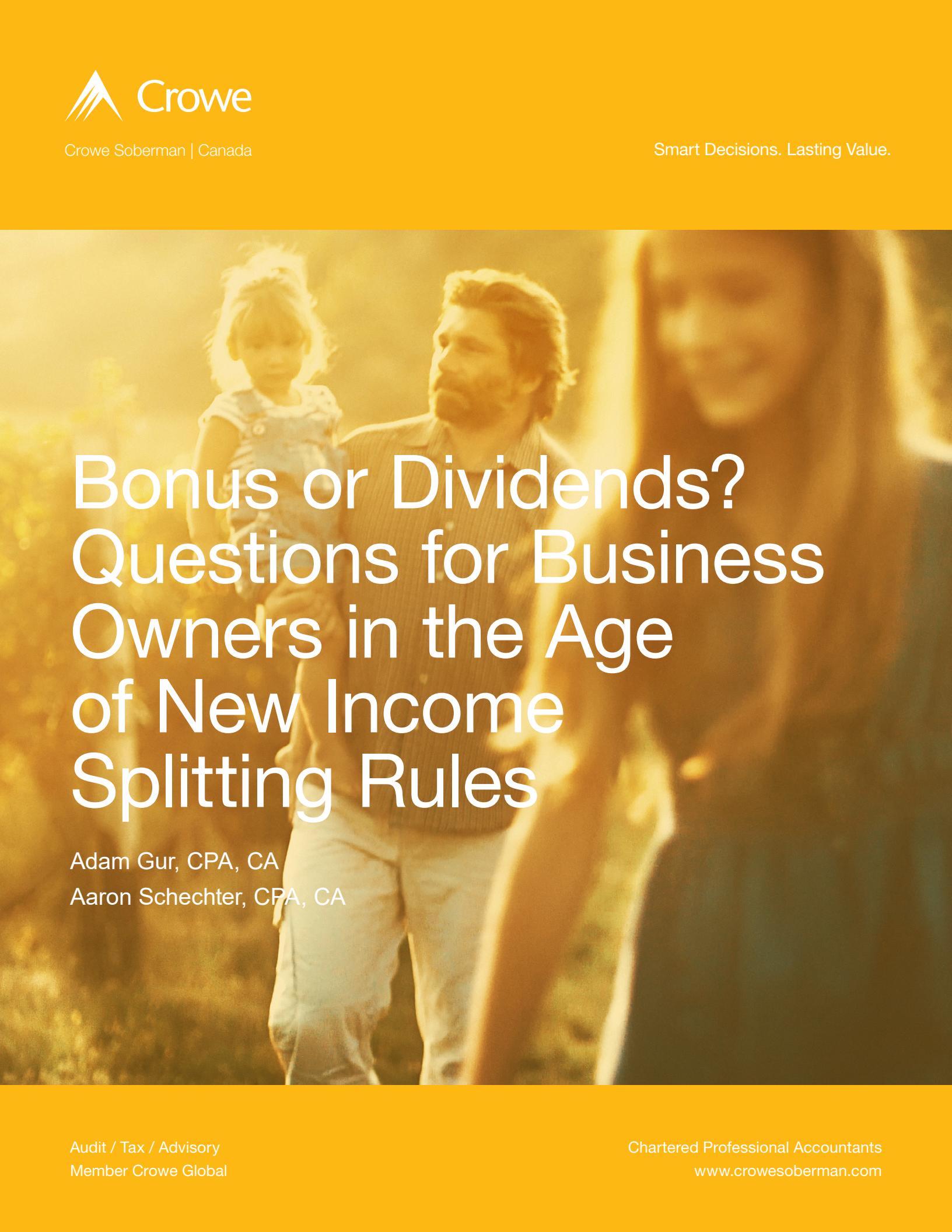




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A large, semi-transparent photograph of a man and a young girl walking through a field of tall grass. The man is in the foreground, carrying the girl on his shoulders. The background is blurred, creating a soft, golden glow.

Bonus or Dividends? Questions for Business Owners in the Age of New Income Splitting Rules

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As we approach the end of the year, owners of private companies often ask, “If I need to take money out of my corporation, should I pay myself a bonus or a dividend?” Though it seems straightforward, recent restrictions under the new “tax on split income” rules have complicated the matter.

Currently in Ontario, when the income earned by a corporation is under \$500,000, the combined corporate and personal income taxes on the dividend payment are similar to the personal income tax that would be paid on a bonus. However, if the pre-bonus income is greater than \$500,000, there is a slight tax advantage to paying a bonus instead. Since the net tax is not materially different under either situation*, we must consider the implications of several qualitative factors.

RRSP Room?

Unlike the payment of a dividend, the payment of a bonus may generate Registered Retirement Savings Plan (RRSP) contribution room. In order to maximize the yearly RRSP contribution room

for the 2019, an individual must receive no less than \$147,222 of salary in calendar 2018 (representing the minimum gross salary required to reach the maximum RRSP contribution). Investing in an RRSP is one of the most common reasons to choose a bonus instead of a dividend.

Future Pension Plans?

Even if generating RRSP contribution room is not a priority for the individual, they may still wish to pay themselves a bonus if they wish to consider establishing a future corporate Individual Pension Plan/ Personal Pension Plan (IPP/ PPP). Individual Pension Plans and Personal Pension Plans are excellent ways for owners to fund their own retirement if

they have a small RRSP or have seen a decrease in their RRSP as a result of an investment downturns. Similar to an RRSP, an IPP/PPP is a function of the salary or bonus received by an individual. A dividend only remuneration strategy will not create the pension room required for an IPP/PPP.

Child Care Expenses?

Lastly, if a taxpayer has children under the age of 17 and pays for daycare, before and/or after school care or nanny services, remuneration in the form of a salary or bonus is a prerequisite to deducting child care expenses. The Income Tax Act provisions stipulate that the deduction of the expenses above are generally only available to the extent both parents have “earned income”

(i.e., employment income, (salary, or a bonus), or self-employment income where one spouse carries on an unincorporated business). If one spouse receives their remuneration solely by way of dividends, the deductibility of child care expenses may be limited for personal income tax purposes.

Added Corporate Premiums?

That being said, paying a bonus could impose certain costs on an employer. Corporate premiums for Employer Health Tax (EHT) and possibly Worker Safety and Insurance Board premiums may be applicable when paying a bonus. Canada Pension Plan (CPP) premiums may also be applicable if the maximum contribution limit has not been reached.

Paying a dividend is administratively simpler than a bonus since there are no source deductions required when paying the dividend to a Canadian resident individual. When a bonus is paid, payroll source deductions (including the employer and employee CPP contributions, EHT and personal income taxes) may have to be

calculated, withheld and remitted to the Canada Revenue Agency (CRA) on a timely basis to avoid penalties and interest.

Tax Deferral Opportunities?

Paying a dividend may also confer an opportunity to defer personal income taxes for a period of time. If a corporation has a December 31, 2018 year-end, and declares and pays a bonus on December 31, 2018, the related payroll source deductions, including the personal income tax withholdings, would be due in January 2019. If, instead, a dividend was paid one day later on January 1, 2019, the personal income taxes on the amount would only be due no later than April 30, 2020.

Tax Refund Opportunities?

Finally, if a corporation has a balance in its Refundable Dividend Tax on Hand (RDTOH) account (occurs when a Canadian controlled private corporation pays tax on its investment income), paying a dividend would result in a recovery of all or a portion of this corporate tax, whereas the payment of a bonus would not result in a refund of these taxes.

The decision to pay a dividend or a bonus is a complicated one and should be discussed with your professional advisor to ensure that you make the right decision based on your specific circumstances, objectives and preferences.

This article has been prepared for the general information of our clients. Specific professional advice should be obtained prior to the implementation of any suggestion contained in this article. Please note that this publication should not be considered a substitute for personalized tax advice related to your particular situation.

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