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Pay Thyself!
Comparing Salaries vs. Dividends

You've incorporated your small business; that's great! You now have three options to pay yourself for all your hard work: salary, dividends, or a mix of both. So which choice is best? The answer is: it depends. But if I help you go through some pros and cons of dividends and salaries, it might give you a better understanding of what will work best for you.

Receiving dividends

the good:

- ✓ You will get more after-tax cash
- ✓ Your corporation pays the taxes at the lower corporate tax rate
- ✓ The CRA will not require monthly source deduction remittance, and so there are no penalties for failing to remit on time
- ✓ You will not be required to pay into the CPP which could put a little more jingle in your pocket

the bad:

- ➢ Dividends are investment income and do not create RRSP contribution room
- ➢ You will not be eligible for CPP disability without contributing something to the CPP plan over a three year period
- ➢ You would likely need to make personal income tax installments
- ➢ Can make borrowing funds tricky as some banks may consider dividend income to be discretionary and not guaranteed
- ➢ There must be corporate profits and no debt to the crown to declare a dividend

Receiving a salary

the good:

- ✓ You get RRSP contribution room
- ✓ You would benefit from regular cash flow
- ✓ You are eligible for CPP benefits
- ✓ Your source deduction remittance means your taxes are paid monthly
- ✓ Income splitting possible
- ✓ Banks are more likely to lend when you can show a regular and consistent wage
- ✓ Your employment income is verifiable for things like accident or disability insurance claims, loans, or divorce settlements
- ✓ When compensation is north of $100K, a payout in salary is more tax efficient than in dividends

the bad:

- ➢ A salary means taxable personal income and that could increase your tax load
- ➢ You would need to pay CPP x 2 (as an employee and as an employer)
- ➢ Paying yourself a salary means a payroll account and associated paperwork (ie., T4's)

Combining the two

A mix of dividends and a salary allows you to customize your compensation to best suit your business needs, cash flow requirements, and retirement strategy. It is also a good tool to help keep you under the small business limit for corporate taxes and within the lower level tax rate.

To determine the right blend, timing, and extent of your compensation method, you will need to consider your personal life factors and long-term plans. It then becomes s a cost-benefit analysis exercise. Remember, though, tax laws change year to year and so could your payment strategy. If you’re in doubt, it’s best that you book an appointment and we can have a chat about it. After all, paying yourself for your labours should not only be gratifying, it should be strategic too.