

HOW SHOULD A BUSINESS OWNER/ MANAGER BE PAID?

Roger Holland and Jacqueline Flett

Singleton Urquhart LLP
1200 – 925 West Georgia Street
Vancouver, BC V6C 3L2
T 604. 682 7474
F 604. 682 1283
su@singleton.com
www.singleton.com

Businesspersons who are both corporate shareholders and managers of their companies can take advantage of tax concessions by carefully planning how they receive their remuneration. An owner/manager who chooses to be paid in the form of salary, bonus or management fees is, in effect, an employee of the business. Receiving a dividend, on the other hand, means an owner/manager is treated as a shareholder of the business. Depending on an individual's circumstances, both means of payment have benefits but choosing the best method demands careful forethought, planning, and execution because the Canadian Revenue Agency (CRA) can challenge your decision.

Circumstances that may lead an owner/manager to take a salary rather than a dividend include:

- If an owner/manager has unused personal tax credits or deductions, a salary can reduce the business's corporate income without imposing additional personal tax liability.
- If an owner/manager has no other significant source of income, a salary may not increase his or her personal tax for income but could reduce the business's corporate tax.
- If the business's corporate income tax obligation is too large to qualify for the small business deduction, taking a salary or bonus can reduce the corporate income tax to a level that ensures the business is eligible for the deduction.
- An owner/manager who wishes to contribute to an RRSP must take a salary to qualify.

Taking dividends instead of a salary is a choice that makes sense in other circumstances. For example, an owner/manager with no other source of income who receives dividends may pay minimal taxes or even none at all. Determining how to withdraw remuneration from a business while receiving the most advantageous tax benefits is a decision best made in conjunction with an accountant. However, categorizing the way one chooses to take remuneration from a business is not the end of the matter for an owner/manager.

While seeking a tax advantage may be attractive, on its own it is an insufficient reason for selecting the means of receiving money from a business. There must be a sound business rationale and process to justify whichever decision is made: otherwise, the CRA may simply reverse the choice made by an owner/manager and find that a dividend is actually a salary or vice versa.

A business can only deduct remuneration paid out as salary, bonus, or management fees if it can demonstrate that the owner/manager has provided services of a requisite value. Factors affecting whether the CRA would permit such a deduction include:

- The reasonableness of a bonus in relation to the profit earned by the company and the services performed by the owner/manager.
- The services provided by an owner/manager must be real and identifiable.
- Any bonuses accrued for a particular year must be established within a reasonable time frame after the company's profit for that year has been determined.

In all such circumstances, it is recommended the business prepare an employment or management agreement which stipulates the owner/manager's entitlement to the bonus, salary, or management fees and details the services provided in exchange for such remuneration.

A different protocol applies if a business pays dividends to an owner/manager. Most importantly, the transaction must be documented as a dividend resolution and entered into the company's record book. (A dividend resolution is a directors' resolution that authorizes a dividend to be paid to a specific class or classes of a corporation's shareholders. In British Columbia the *Business Corporations Act* requires that a dividend resolution must be filed within a company's minutes and all directors' resolutions and minutes must be kept at the company's records office.) The CRA can demand proof that a decision to pay a dividend has been made at a duly constituted directors' meeting. If there is no proper evidence of such a meeting and such a resolution being passed, the CRA can declare the dividends to be a salary instead.

If your corporation remunerates its shareholders with dividend payments, we strongly recommend that your lawyer or accountant prepare appropriate dividend resolutions and that you properly file them in the company's minute book. Failure to do so could have unintended and possibly significant tax consequences for an owner/manager.

If you have any questions about owner/manager remuneration or business law in general, please contact: **Roger Holland** rholland@singleton.com or **Jacqueline Flett** jflett@singleton.com.