SALARY vs DIVIDEND

Understanding the distinction can empower business owners to make informed decisions and potentially save money on taxes.

Example Scenarios: When Salary or Dividend Is a Better Tax Strategy

Understanding when to pay yourself a salary or a dividend can help you maximize your after-tax income and meet your financial goals. Here are some example scenarios to illustrate when each option might be more advantageous for Canadian small business owners:

Scenario 1: Building Retirement Savings and CPP Benefits

Situation:
Maria is 35 and wants to maximize her retirement savings. She plans to contribute to her RRSP and wants to build up her Canada Pension Plan (CPP) benefits for the future.

Best Strategy: Salary

- **Why:** Salary income creates RRSP contribution room and requires CPP contributions, which will increase her future CPP retirement benefits.
- **Result:** Maria pays herself a regular salary, allowing her to contribute more to her RRSP and build a larger CPP pension.

Scenario 2: Maximizing Immediate Cash Flow and Simplicity

Situation:
Alex is 55, has already built up significant RRSP savings, and is not concerned about CPP benefits. He prefers a simple approach with less paperwork.

Best Strategy: Dividend

- **Why:** Dividends do not require CPP contributions or payroll administration, and can be paid out flexibly as needed.
- **Result:** Alex pays himself dividends, saving on CPP costs and simplifying his bookkeeping.

Scenario 3: Keeping Personal Income Below a Certain Tax Bracket

Situation:
Priya wants to keep her personal taxable income below a certain threshold to qualify for government benefits or avoid higher tax brackets.

Best Strategy: Mix of Salary and Dividend

- **Why:** By carefully balancing salary and dividends, Priya can control her total taxable income and optimize her tax situation.
- **Result:** Priya pays herself a modest salary to create RRSP room and the rest as dividends to stay within her desired tax bracket.

Scenario 4: Corporation Has Taxable Losses or Low Profits

Situation:
Sam's business had a tough year and has little or no profit.

Best Strategy: Salary

- **Why:** Salary is a deductible expense for the corporation, which can help reduce or eliminate corporate taxes in a low-profit year.
- **Result:** Sam pays himself a salary, reducing the corporation's taxable income and possibly creating a loss to carry forward.

Scenario 5: Corporation Has Large Retained Earnings

Situation:
Jasmine's corporation has accumulated significant after-tax profits from previous years.

Best Strategy: Dividend

- **Why:** Dividends can be paid out of retained earnings without affecting the current year's corporate tax situation.
- **Result:** Jasmine pays herself dividends, taking advantage of the dividend tax credit and accessing the corporation's retained earnings.

Scenario 6: Qualifying for Certain Personal Tax Credits

Situation:
David wants to maximize personal tax credits that are only available to employment income (such as child care expenses or certain deductions).

Best Strategy: Salary

- **Why:** Some personal tax credits and deductions are only available if you have employment income.
- **Result:** David pays himself a salary to qualify for these credits and deductions.

Note:
These scenarios are for illustration and idea generation. The best strategy depends on your unique circumstances, income needs, and long-term goals. Always consult a Canadian tax professional for personalized advice.