



## Compensation planning

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As we approach the end of the calendar year, it may be worth taking some time before Dec. 31 to review the compensation plans of your incorporated business. After all, if you operate a business — such as retail, manufacturing, operating or consulting — through a corporation, there is flexibility in how you can be remunerated. The same holds true if you are a professional, such as a doctor, lawyer or accountant, who has incorporated your practice.

This flexibility stems from how a corporation distributes its income to the shareholder who is also an employee: either as salary or dividends.

If corporate business income is paid to you as salary (or bonus), your corporation (employer) can claim an income tax deduction for the salary (and applicable payroll taxes), which reduces its taxable income. You then include the salary in your taxable income and pay tax at personal graduated tax rates.

As an alternative to distributing income as salary, your corporation can pay tax on its corporate income. In the year the income is earned or a future year, the corporation can then distribute its after-tax corporate income to you as dividends. You will then pay a lower tax rate (than for salary) on eligible and non-eligible dividends due to the dividend tax credit, which is meant to compensate for taxes paid by your corporation.

As a general rule-of-thumb<sup>1</sup>, if you need to receive funds from your corporation, perhaps to pay personal expenses, you should consider salary to create RRSP contribution room. Receiving salary of up to \$171,000 in 2022 would create RRSP contribution room in 2023 of up to \$30,780 (the 2023 maximum), as described in the report [RRSPs: A Smart Choice for Business Owners](#)<sup>2</sup>. An RRSP can effectively provide a tax-free rate of return on investments (as described in the report [Just do it: The case for tax-free investing](#)<sup>3</sup>.)

If, on the other hand, you do not need funds from your corporation, you may still wish to receive sufficient funds to maximize contributions to your TFSA, as described in the report [TFSAs for Business Owners... A Smart Choice](#)<sup>4</sup>.

Finally, it may be worth considering leaving any after-tax business income in your corporation to benefit from the significant tax deferral, which may provide more investment income in the long run than personal investing in non-registered plans. Your company can then distribute its after-tax income to you as dividends in a future year, perhaps even into your retirement. For 2022, the tax deferral among the provinces ranges from a low of 37% in Alberta (because of its relatively low top marginal rate) to as high as 43% in Newfoundland and Labrador on income eligible for the small business rate. The report [Bye-bye bonus! Why business owners may prefer dividends over a bonus](#)<sup>5</sup> discusses this compensation decision in greater detail.

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<sup>1</sup> Assuming you pay tax at the highest marginal federal / provincial or territorial tax rate.

<sup>2</sup> The report "RRSPs: A Smart Choice for Business Owners" is available online at [cibc.com/content/dam/small\\_business/advice\\_centre/business-reports/RRSPs-for-business-owners-en.pdf](https://cibc.com/content/dam/small_business/advice_centre/business-reports/RRSPs-for-business-owners-en.pdf).

<sup>3</sup> The report "Just do it: The case for tax-free investing" is available online at [cibc.com/content/dam/personal\\_banking/advice\\_centre/start\\_savings\\_plan/pdfs/case-for-taxfree-en.pdf](https://cibc.com/content/dam/personal_banking/advice_centre/start_savings_plan/pdfs/case-for-taxfree-en.pdf).

<sup>4</sup> The report "TFSAs for Business Owners... A Smart Choice" is available online at [cibc.com/content/dam/personal\\_banking/advice\\_centre/tax-savings/tfsas-for-business-owners-en.pdf](https://cibc.com/content/dam/personal_banking/advice_centre/tax-savings/tfsas-for-business-owners-en.pdf)

<sup>5</sup> The report "Bye-bye bonus! Why business owners may prefer dividends over a bonus" is available online at [cibc.com/content/dam/personal\\_banking/advice\\_centre/tax-savings/jq-dividends-bonus-en.pdf](https://cibc.com/content/dam/personal_banking/advice_centre/tax-savings/jq-dividends-bonus-en.pdf).

You should take time to discuss this information with your tax and legal advisors well in advance of year end, so you'll have enough time to put your compensation plan into effect.

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