Remuneration Planning

December 31, 2017 is fast approaching…see below for a list of tax planning considerations. Please contact us for further details or to discuss whether these may apply to your tax situation.

SOME 2017 REMUNERATION PLANNING TIPS INCLUDE:

Higher levels of personal income are taxed at higher personal rates, while lower levels are taxed at lower rates. Therefore, individuals may want to, where possible, adjust income out of high income years and into low income years. This is particularly useful if the taxpayer is expecting a large fluctuation in income, due to, for example,

- taking maternity/paternity leave;
- receiving a large bonus/dividend; or
- selling a company or investment assets.

In addition to increases in marginal tax rates, individuals should consider other costs of additional income. For example, an individual with a child may lose financial support in the form of reduced Canada Child Benefit (CCB) payments. Likewise, excessive personal income may reduce receipts of OAS, GIS, GST/HST credit and other provincial/ territorial programs.

There are a variety of different ways to legally smooth income over a number of years to ensure an individual is maximizing access to the lowest marginal tax rates. For example,

- In owner/managed companies, owners may take more, or less, earnings out of the company.
- Realizing investments with a capital gain/loss.
- Deciding whether to claim RRSP contributions made in the current year, or carry-forward the contributions.
- Withdrawing funds from an RRSP to increase income. Care should be given, however, to the loss in RRSP room based on the withdrawal.
- Deciding on whether or not to claim CCA on assets used to earn rental income.

While the above is generally true, in certain cases some individuals may wish to pay out additional dividends in 2017. Effective in 2018, there are proposals to increase the tax cost of dividends paid out to shareholders of a corporation that do not "meaningfully contribute" to the business. As such, individuals who may be subject to this higher tax rate in future years may consider increasing dividend payments in 2017. Details on this proposed change are expected to be released late December 2017.

Prior to paying increased dividends, consideration should be given to a number of factors (in addition to the items noted above related to increases in income), such as the impact on the business operations, cashflow, and other agreements (like bank covenants), and whether the dividend can be paid under corporate law.

Three different types of dividends can be paid from a corporation depending on the attributes and earnings of a corporation: eligible, non-eligible and tax-free capital dividends. Due to tax rate changes, the tax cost of non-eligible dividends will likely be increasing in 2018 and 2019. As such, some may consider declaring non-eligible dividends in 2017 to access current tax rates. Changes in provincial/ territorial rates may also impact the above decision.

Year-end planning considerations not specifically related to changes in income levels and marginal tax rates include:

1) Corporate earnings in excess of personal requirements could be left in the company to obtain a tax deferral (the personal tax is paid when cash is withdrawn from the company).

The effect on the "Qualified Small Business Corporation" status should be reviewed before selling the shares where large amounts of capital have accumulated.

2) Consider paying taxable dividends to obtain a refund from the "Refundable Dividend Tax on Hand" account in the Corporation.

3) Individuals that wish to contribute to the CPP or a RRSP may require a salary to create "earned income". RRSP contribution room increases by 18% of the previous years' "earned income" up to a yearly prescribed maximum ($26,010 for 2017; $26,230 for 2018).

4) Dividend income, as opposed to a salary, will reduce an individual's cumulative net investment loss balance thereby possibly providing greater access to the capital gain exemption.

5) Proposed changes to the tax regime will likely require more careful tracking of an individual shareholder's labour and capital contribution to the business, as well as risk assumed in respect of the business. Inputs should be tracked in a permanent file.

6) If you are providing services to a small number of clients through a corporation (which would otherwise be considered your employer), CRA could classify the corporation as a Personal Services Business. There are significant negative tax implications of such a classification. In such scenarios, consider discussing risk and exposure minimization strategies (such as paying a salary to the incorporated employee) with your professional advisor.

We recommend that you obtain professional advice before acting on information contained in this newsletter.

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