Getting money from your corporation

WELLINGTON FINANCIAL

Executive summary

There are numerous ways to take money from corporate earnings while keeping your tax bill to a minimum. Often, business owners opt to receive a portion of corporate earnings through a salary. While others opt to extract profits using a mix between salary and dividends.

Finding the optimal combination to maximize your tax savings depends on many factors including (but not limited to) your cash flow needs, income level, payroll taxes on salary, or the corporation’s income level.

Understanding the tax treatment of payments is important as you want to ensure that the maximum amount of funds is left to be invested back into the corporation.

Earning options

Paid-Up Capital

If you funded your corporation with a large sum of capital, you may be able to extract funds tax-free by reducing the corporation’s paid-up capital; essentially this is the amount of capital contributed in exchange for shares. Typically, you are allowed to pay shareholders any amount less than the corporation’s paid-up capital without tax consequences.

Repay Shareholder Loans

Another option to receive corporate funds is to repay shareholder loans. If you loaned funds to your own corporation, you are entitled to receive any amount of repayment of the loan tax-free. You may also arrange to have the corporation pay you interest on the loan. Taxation of the interest income is about equivalent to the taxes deducted if the corporation paid you a salary.

Passive income

Investment income earned inside your corporation is classified as ‘passive income’ as it is not generated by direct business operations. The combined tax rates are over 50%, depending on your province of residence, on the taxable portion of earnings. In the case of interest, that is the entire earned amount. For capital gains, half of the gain is subject to the combined tax rate and for dividends the rate is 33.33%. All three of these rates are higher than the highest marginal rate for individuals.

Subjecting passive income to higher tax rates within a corporation can lend some benefits like:

- Building your nest-egg inside the business to fund future expansions
- Cover short-comings during difficult periods
- Facilitate borrowing

However, the largest risk with this option lies in losing the capital gains exemption on the sale of shares of a ‘qualified small business corporation.’ As the invested assets build over time, and operating assets decline in value thanks to depreciation, the asset mix could be lopsided. To have the capital gains be exempt, the ‘passive’ invested assets cannot exceed 10% of the fair market value of the corporations’ assets.

Lifetime Capital Gains Exemption (LCGE)
For 2018, the LCGE limit per person is $848,252 and is indexed to inflation. This means a married couple who both own shares and can both utilize the exemption could shelter $1.696 million from taxes. Farms and fishing operations that qualify have the individual limit of $1 million per person, allowing a couple to shelter a maximum amount of $2 million.
Depending on your goals, a short-term increase in tax and the professional fees associated to establishing the appropriate corporate structure could save you significant amounts of tax in the long run.

Maximizing Capital Dividend Payments
When you have a capital gain, the untaxed portion (one half of the gain) is added to its capital dividend account. The corporation can pay any amount from this account to your client without attracting personal tax. Although this is likely your best option, you must ensure that you make the appropriate tax deductions and remember to file the directors' resolutions with the CRA.

The bottom line

Every corporation is going to present varying degrees of needs. When it comes to determining how to pay yourself, be sure to be well informed before making any final decisions. Of course, consulting with a financial expert, like myself, can prove helpful. I encourage you to get in touch with any questions or concerns or to simply learn more.

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