Business Matters
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TAXATION

Salary or Dividends?

The way a bonus is paid has a significant effect on corporate and personal after-tax income.

You are an owner-manager and you've just had a really good year. Profits are up significantly and you want to reward your employee shareholders with a bonus. But how? Salary or dividends? The answer to this age-old question is not as simple as it seems. It is even possible to receive remuneration that is a combination of salary and dividends. However, because every company and its shareholders have different needs, a "one size fits all" approach to remuneration is not prudent.

Salary and dividends differ with respect to taxation. A dividend is a per-share payout of retained earnings and is therefore not an expense and thus does not reduce pre-tax income. A salary bonus differs from a dividend in that it is an expense and thus reduces pre-tax income. Corporations, trusts, charities and a wide variety of other entities can also receive dividends.

Different Tax Effects

Distributing a salary bonus effectively reduces pre-tax income by the amount paid. Thus, if a company pays out 100% of pre-tax earnings in the form of a salary bonus, the corporation may not be subject to income tax expense. On the other hand, if a company wishes to distribute the same dollar amount of earnings by declaring a dividend, the company must first pay corporate income tax. Assuming after-tax earnings of $100,000 and a tax rate of 15.5%, the cash outlay would be $118,343 (i.e., the distribution of the $100,000 of earnings in the form of a dividend bonus plus the $18,343 in income tax on those earnings in order to net $100,000 for the dividend payment).

Dividends are often cited as the best means of providing remuneration to the owner-manager since they do not attract as much personal income tax as salary. For example, a salary of $100,000 for a single individual would create a combined federal and provincial tax of $26,466 (Ontario), whereas an eligible dividend of $100,000 from an owner-managed business would generate a personal tax of $9,802; personal tax from an other than eligible dividend would be $16,693.

At first blush, an owner may be tempted to simply pay out all profits by dividend because of the significant personal tax savings. However, since dividends are paid from after-tax earnings, the combined tax in the case of an eligible dividend would amount to $28,145 ($18,343 + $9,802) and in the case of an other than eligible dividend the combined tax would be $35,036 ($18,343 + $16,693). Certainly there are other factors that come into play both on a corporate and personal level, but the example establishes that one should carefully consider the approach to be taken.

Additional Considerations

There are additional considerations that must be factored into the decision as to whether to pay dividends or salary.

- Because dividends are not earned income, they cannot be used to create any RRSP contribution room.
- Because dividends are not earned income, they do not create any requirement for a contribution to the Canada Pension Plan by either the owner-manager or the employee.
- Financial institutions often lend on the basis of earned income believing that salary is the only way to judge an individual's ability to pay. Attitudes in this area are certainly changing, but income based on corporate dividends may impact your ability to obtain personal mortgages or lines of credit.
- If the employee is unable to work because of an accident or some other event, a wage replacement amount may be difficult to calculate because dividends are not earned income.
- Income splitting that is possible by paying salary to family members employed in the business will be hampered if the family members are not shareholders since dividends are paid to shareholders on a pro rata basis.
- Insurance companies may not be willing to support benefit or disability programs if dividends paid to an organization's owner cannot be included in their definition of earned income.
- Receipt of dividends instead of salary may nullify other personal income tax deductions such as child care expense.
- Various provincial bodies may include dividends when calculating the employer's Workplace Safety and Insurance Board (WSIB) or Employer Health Tax liability.

An employee can receive three types of dividends.

Three Types of Dividends

A business must be aware that there are three types of dividends an employee can receive from your corporation:

1. **"eligible" dividend:** (i.e., subject to a dividend gross-up of 38% and a federal dividend tax credit equal to 20.73% of the cash dividend) — as noted above, eligible dividends provide a more beneficial tax rate
2. **regular dividend:** (or an other than eligible dividend) subject to an 18% dividend gross-up and a federal dividend tax credit equal to 13% of the cash dividend — provinces may have their own dividend tax credit rates (Check the rate in your province.)
3. **capital dividend:** (capital dividends are received tax free) — this dividend is paid from the company's capital dividend account, which includes the non-taxable portion of capital gains, life insurance proceeds, and capital dividends received from other corporations

Other Concerns

Eligible dividends cannot exceed the balance in the General Rate Income Pool (GRIP). Excess payments from the GRIP can result in penalties.

Talk to Your CPA

Given the complexity of the decision as to whether salary, dividends or a mix of both is the best way to proceed, astute owners should meet with their CPA to discuss corporate and personal needs before a decision is made.

Your CPA understands the share structure of your company, the company's viability, and the overall remuneration needs of the shareholders. This insight, plus knowledge of the tax regulations and the tax software that can be used to simulate various scenarios, enables your CPA to assist you in making the right decisions as to the appropriate mix of salary or dividends.

MANAGEMENT

You're Hired

Human rights legislation governs all hiring practices.

Finding good employees is a tough job at any time but especially when you are seeking those with special skills and the right attitude. You have to ask a job candidate a lot of questions, not only to determine their qualifications and experience, but also to understand the individual's character and personality. Can this person work with our team?

Comply with Legislation

The hiring process must, however, comply with the *Canadian Charter of Rights and Freedoms* section of the Constitution as well as other federal and provincial *Acts*. But human rights legislation makes many questions illegal. The purpose behind these *Acts* is to ensure all individuals have an equal opportunity to live their lives as they see fit, free from discrimination based on the general categories of age, sex, marital/family status, race, colour, ancestry, place of origin, creed, religion, citizenship, nation or ethnic origin, sexual orientation and handicap/disability. In fact, rejection of a job applicant for any reason that contravenes legislation could lead to an embarrassing investigation by the Canadian Human Rights Commission.

Types of Questions to Avoid

The following categories must be avoided:

- age
- country of birth
- nationality
- first language
- race.

Age

In 1971, Robert Neil Butler coined the term "ageism" to describe discrimination against seniors that arose from what he noted as a prejudice toward older people, old age and the aging process in general. Over time, the term has come to identify a prejudice against the young as well as the elderly. Thus, interviewers should avoid asking questions that lean toward determining age, such as:

- How old are you?
- When did you graduate from high school/university?
- When were you born?

Family

Questions about living arrangements or family issues are also taboo. It is not good form to ask the following questions:

- Are you married, have a partner, live common-law?
- How many children do you have?
- Are children expected in the near future?
- Do you plan to have more children?
- Do you have child care in place?

Memberships

Determining whether an individual is "the wrong type" can possibly be determined by asking questions about clubs and associations. Such questions in the first instance may provide answers that create a predetermined bias or prejudice. We all draw conclusions about a person if we discover they like horses, motorcycles or wear high heels. To avoid the appearance of prejudicial enquiry avoid asking:

- Are you currently a union member?
- Are you a member of any social clubs?

Depending on the answer, the interviewer may automatically infer the individual is of a certain ethnic, religious, political or other background, and then stereotype the person.

Profile Prejudice

Roger Ailes, author of *You Are the Message*, is quoted as saying; "You've got just seven seconds to make the right first impression." Whether in seven, 10 or 30 seconds, first impressions are formed rather quickly because it is easy to fall back on past experience, stereotypes and prejudices. These can be difficult to overcome since no one can function without some preconceived idea of how the world around them should look and behave. But asking questions that imply a prejudiced profile is not permissible:

- What is your weight?
- How tall are you?

Drug or alcohol dependence are disabilities.

Disability Discrimination

Article 25 of the *Canadian Human Rights Act* defines disability as "any previous or existing mental or physical disability and includes disfigurement and previous or existing dependence on alcohol or a drug". Nevertheless, there may be lingering displays of disability discrimination that may offend should an interviewer ask:

- Do you have a disability?
- Do you mind filling out this medical history?
- Do you party a lot?
- Is there a history of (mental) illness in your family?
- Have you seen a doctor in the last year?
- When did you lose your thumb?
- Do we need to modify chairs, washrooms, desks etc. to accommodate you?

Criminal Record

Many employers need to ensure employees are bondable and insurable. However, an employer should be cautious about asking:

- Have you ever been arrested?

Gender

Gender-based hiring is discriminatory. Although an applicant's gender may seem obvious to the eye, it is not always. Employers may not ask:

- Are you male or female?
- What are your cohabitation arrangements?
- What is the name of the person you live with?

Racial Profiling

Race may be defined as a human group sharing distinct physical features such as skin colour, skin tone, eye and hair colour, as well as a tendency to develop certain diseases and cannot be changed or disguised. Don't ask:

- What is your race?
- What is your skin colour?
- What colour are your eyes?
- Do you have black, blonde, brown hair?

Equality

Section 15 (1) of the *Canadian Charter of Rights and Freedoms* states that every individual is "equal before and under the law and has the right to the equal protection and equal benefit of the law without discrimination and, in particular, without discrimination based on race, national or ethnic origin, colour, religion, sex, age, or mental or physical disability".

Religion

Interviewers must not ask about religious affiliation:

- What is the name of your Imam?
- What religious holidays do you observe?
- Do you go to church?

Exceptions

There are some apparent exceptions to this legislation under special circumstances (i.e., if there is a "bona fide occupational requirement" to do the job). For example, the owner of a Greek restaurant would be allowed to hire Greek-speaking wait staff to the exclusion of other applicants. In other cases, it must be established that it would cause undue hardship and be financially prohibitive to accommodate the worker and still maintain health and safety in the workplace.

It's the Law

The purpose of human rights legislation is to prevent discrimination based on what people cannot change about themselves: gender, age, skin colour, ethnicity, etc. Laws and regulations remove prejudicial selection and base hiring on the qualifications of education and experience. As such, the hiring process must be designed to select employees on the basis of genuine qualifications relevant to job performance and on the basis of individual merit rather than group generalizations or stereotypes.

MONEYSAVER

Improve the Bottom Line

Increasing revenue is not the only way to improve the bottom line.

Businesses are constantly trying to improve the bottom line. Better profits usually reflect good cash-flow management, cost control, incentivized employees and loyal, hard-working management. Profit growth also enables the business to build cash reserves for future expansion, investment, or the proverbial rainy-day fund.

Little Things Mean a Lot

When trying to pare costs, management usually looks first at the big-ticket items such as labour and machinery because they create more visible and measurable dollar amounts. There are, however, a number of other areas where small savings can add up to large savings and an improved bottom line over time.

Insurance Coverage

Automatic renewal for office, equipment or fleet ensures you will always pay more than you need. Brokers have little incentive to find the lowest rates if they know you will accept the yearly invoice.

Travel

Frequent travellers should consider booking well in advance of the trip, or booking flights later in the day if reduced rates are available.

Zero-Based Budgeting

Budgets are often prepared by simply adding a percentage to last year's items. Many things can change in a year and you may be budgeting more than you need. Try to start from scratch and have preparers justify each cost. For instance, last year's fuel costs may be budgeted when fuel prices were higher or more work was being done.

Credit Cards

Ensure credit cards are cleared monthly. Arrange a line of credit that can be used to pay off the high-interest credit cards in times of poor cash flow.

Withholding Taxes

Pay withholding taxes on time. Penalties and interest add up if a business is a repeat offender.

Tax Installment Payments

Canada Revenue Agency charges interest if corporations do not pay their taxes according to the installment schedule. Review the requirements for the current year using last year's numbers. If budget forecasts expect taxable income will be down, consider reducing installment payments to moderate the cash outflow and perhaps reduce interest costs on the business line of credit.

In-House Kitchen

Consider having a small in-house kitchen for staff coffee breaks and brown-bag lunches. The cost of establishing the facility and providing beverages for staff and guests could well be offset by reducing the cost in both money and the time for employees to leave the premises for their regular run to the local restaurant.

Traffic Laws

Obeying the speed limit and all other traffic laws reduces the cost of driving. Fines incurred by an employee while driving a company vehicle may be an additional cost for the company, particularly with respect to increased insurance premiums.

Off-Hours Deliveries

If possible, arrange to make service calls or deliveries before or after peak travel time. Not only will there be savings in fuel as well as in the wear and tear on the vehicle, but staff will also be more productive: they are being paid to provide the service, not to sit in traffic.

Track equipment and vehicle costs on a per-unit basis.

Equipment Costs

Tracking the purchase price and depreciation of equipment and vehicles on a per-unit basis along with insurance, fuel, repairs and maintenance provides insight into the true cost of the unit. These costs can be compared to the charge-out rate to determine whether the unit is paying its way.

Communication Costs

At least once a year inventory all communication devices and review their carrying costs and the cost of the separate fax lines, long distance plans and Internet. It is worth investigating whether SKYPE could cut the cost of meetings and training.

Invoicing

Use email to send invoices and encourage payment with debit cards or email transfers. The increased speed of payment available with modern technology improves cash flow and reduces interest costs.

Project Management

If you manage each job as a project, resources such as material, equipment and labour, can be allocated to that specific job. Budgets are thus better controlled and benchmarks are established to measure costs and avoid overruns on future jobs. Cost-to-job monitoring of individual employees allows evaluation of skills and efficiencies for training and remuneration.

Reduce the Number of Accidents

Accidents are costly for companies. Losses to employee productivity and increased business insurance costs, in addition to costly Workplace Safety and Insurance Board (WSIB) claims and legal fees, can be reduced by ongoing safety training and education. It’s well worth the effort.

Energy Audit

An energy audit will show you where savings can be achieved by installing insulation, replacing older equipment or something as simple as using timers, motion detectors and LED lighting for the factory and office.

End of the Day

Encourage staff that need personal time during the week to do so at the end of the work day rather than in the morning or during lunch break. If their appointment is later, the additional time spent waiting in the doctor's office is not company time. Such an approach reduces lost time and increases productivity.

8:45

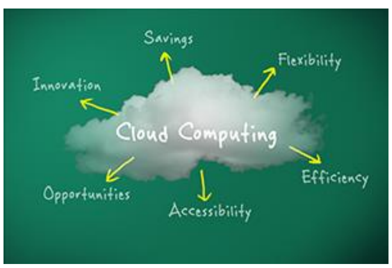
Suggest that staff arrive 15 minutes before their shift starts. This allows time to get a coffee, use the facilities and exchange the usual niceties that cut into productivity. Fifteen minutes a day for 10 employees working 250 days is 625 hours. At $20 per hour the cost is $12,500.

Greater Productivity

Improving the bottom line does not mean that employees and management have to make costly changes or sacrifice existing working arrangements. As illustrated, instituting small measures will not only strengthen the bottom line but will also undoubtedly improve productivity.

TECHNOLOGY

Metamorphosis



"A change would do you good." — Sheryl Crow

The software industry is in the midst of a revolutionary change. Change is sometimes considered a constant in the world of IT; however, the model of the industry itself has only shifted a few times and each shift has changed the way people work with technology.

Early programmable computers were huge and expensive – what we may now think of as mainframes. By modern standards, these early machines were difficult to use and their resources were not easily shared by large numbers of people. The next major era in computing was the transition to stand-alone, personal computers (PCs); everyone could have one on their desk for productivity-boosting applications such as word processing and spreadsheets. The ability to network PCs together led to the client-server era; computing work was split between the PC as client and centralized servers. Email, the "killer app" of the networked PC, revolutionized the way people communicate at the office.

The Cloud

The next step, Cloud computing, is not substantially different from the client-server model we've come to know, save for a key detail: ownership. Infrastructure, platforms, and applications are changing from something that was once purchased and installed to a service, with a monthly or annual fee instead. In the Cloud-based model, computing is a utility, much like hydro, water or the Internet.

Pros and Cons

Pros:

Based on your business needs, the Cloud model may have some compelling advantages:

- **increased productivity:** simplified processes and easy sharing of information
- **lower capital costs:** infrastructure, hardware, and software costs are all shifted to the cloud provider(s)

- **reduced overhead:** easy information sharing and "accessible anywhere" architecture means your workforce could log on from Trois-Rivières or Tahiti just as easily as they could from their desk in Toronto
- **expanded hiring pool:** knowledgeable people are all over the globe; Cloud-based technology provides the opportunity to tap into this expertise without the costs associated with relocating workers and family members to a central location
- **improved knowledge sharing:** even if your staff are all located within the same office, they may benefit from the quick accessibility of Cloud-based software that's always up to date
- **more time:** day-to-day minutiae such as running the servers and backing up data are handled by someone else as part of the package.

Cons:
The Cloud is not a magic bullet and has some potential disadvantages to consider:

- **geographical implications:** servers are physically located elsewhere; your data may be subject to the laws of the country in which it is stored, and this may not be the same country in which you or your business operate
- **loss of control:** a vendor manages the system, its functionality, and your data
- **potential security risk:** online applications, regardless of whether hosted under your desk or in a data centre by a Cloud provider, are always "on" and theoretically could be hacked.

Things to Consider

Financial Information Management
Cloud-based accounting services allow multiple users to enter financial data such as expenses, sales and deposits, anytime, from anywhere, and from almost any device. From a management point of view, it is important to ensure that every transaction can be traced to the individual who made the entry. Without this safeguard, accountability could go out the window.

The ability to connect your financial platform to your bank removes barriers; the ability to create invoices from literally anywhere, and enable customers to pay them seamlessly and instantly simplifies billing. Easy collaboration is another big advantage that allows your accountant or bookkeeper access to your books remotely.

Get to know conventional records management practices.

Record Retention
Modern financial systems may allow or even encourage storing digital versions of documents. Businesses must be sure they are following CRA and other regulatory authorities' retention policies. Get to know conventional records management practices so you will understand which documents must be kept in original paper format, for example, or the length of time digital and/or physical records must be retained. Redundancy is also essential. Most Cloud-based servers back up the data to other sites. If you need to keep an in-house backup copy of your data, make sure your Cloud provider has this ability.

Integrity of Data
Consider what happens if you decide to change your Cloud-based service:

- Will you be able to transfer the data from one provider to another?

- Do you retain ownership of your data?
- In what country is the data stored?
- Can I make backup copies on my own server?
- Can I recover my files if I decide to terminate the service and what is the cost?

Hiring, Communication and Collaboration

Communication and collaboration can be difficult in any company. In a digital world without physical boundaries, whether you are working together in the office or with your team at a distance, modern collaboration tools offer more features than mere meeting facilitation through screen, document, and digital whiteboard sharing, and more than simple chat, such as web, telephone, and video conferencing. There are even some collaboration tools that encompass all of these features, and more!

Understand and Adapt

The availability of Cloud-based applications and platforms will require owner-managers to adapt their businesses to embrace the virtual world. As with many other technological advances, however, the previous foundational technology never went away. We're seeing the beginning of a trend: client-server-based computing is giving way to a Cloud-based model. Stand-alone and client-server applications will continue to become more and more specialized, serving niche markets, as Cloud-based computing becomes the norm. While this metamorphosis is taking place, the challenge for business is to understand and adapt to the changing technological world.

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