FINANCIAL POST

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How to pay yourself while incurring a minimum of taxes

By Peter Bangs, KPMG Enterprise

On Tax: There are several ways to take some of your hard-earned money out of your company and pay a minimum of taxes. Paying yourself a salary is only...

For owners of an incorporated operating business or an investment holding company, one of the most basic concerns is how to pay themselves from their corporate earnings and assets in the most tax-effective manner.

Simply taking profits out of the business could result in significant tax charges, which is why it is good to have a strategy for extracting profits that will put more money in your pockets.

There are several ways to take money from the corporate earnings while keeping your tax bill to a minimum. Sometimes, you can even access corporate earnings tax free.

Often, business owners (and family members) opt to receive a portion of corporate earnings through a salary for services provided to the business, just like other employees. Tax savings may be available if a salary is paid to a family member for work performed and the family member is in a lower tax bracket than the corporation. Tax savings can also be achieved if you distribute the money as dividends to yourself or other family members either directly or through a family trust.

Many business owners extract profits using a mix of salary and dividends to maximize their tax savings. Finding the optimal combination depends on your cash flow needs, your income level, the corporation's income level, payroll taxes on the salary, and many other factors.

If your corporation was originally funded with a substantial amount of capital, you may also be able to extract funds tax free by reducing the corporation's paid-up capital - essentially the amount of capital contributed to the corporation in exchange for its shares. Generally, you're allowed to pay shareholders any amount less than the corporation's paid-up capital without tax consequences, where you also reduce the paid-up capital by that amount. Just make sure you keep enough capital to satisfy any creditor or banker requirements.

Another way to get earnings and assets out of your business is to repay shareholder loans. If you loaned funds to the corporation at any time, say for expansion of the business, you can receive any amount of repayment on these loans tax free. You could also arrange to have the corporation pay you interest on your loan, which is generally taxable to you as investment income. Using this method, you should pay about the same amount of personal tax on the interest income as if the corporation paid you that amount in salary.

The most tax-effective and often overlooked strategy may be to maximize the company's capital dividend payments. When a private corporation realizes 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 its shareholders without attracting personal tax, as long as you make the appropriate tax elections and file the directors' resolutions with the Canada

Revenue Agency.

So if the corporation has realized any capital gains (excluding any realized losses, which reduce the amount of the account), you should look at having it pay out capital dividends. And there's a bonus: paid out capital dividends cannot be reduced by subsequent capital losses.

Beyond those more common ways to get corporate earnings and assets out of your company, depending on your situation, there may be other options you can take advantage of.

For example, you could transfer a capital asset you personally own that has an accrued gain, such as stock, to the company through a tax-free rollover. That allows you to effectively receive tax-free funds from the corporation equal to the basis of the asset you transferred to it.

It could also be beneficial to sell corporate assets in the market (or an internal sale) that have accrued capital gains to create a capital dividend account in the company. That would allow you to pay out this capital dividend account as a tax-free dividend to shareholders.

You may also be able to extract funds from your corporation by transferring certain types of life insurance policies to your corporation for consideration equal to fair market value. However, these types of transactions are often complicated and require professional assistance.

You work hard for your money, so it's important to consider all options for accessing some of it. However, it's always a good idea to consult a tax advisor to ensure your plan is properly implemented, allowing you to manage your tax bill and keep as much as possible of your hard-earned profits.

Peter Bangs is a partner with KPMG Enterprise in Ottawa.

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