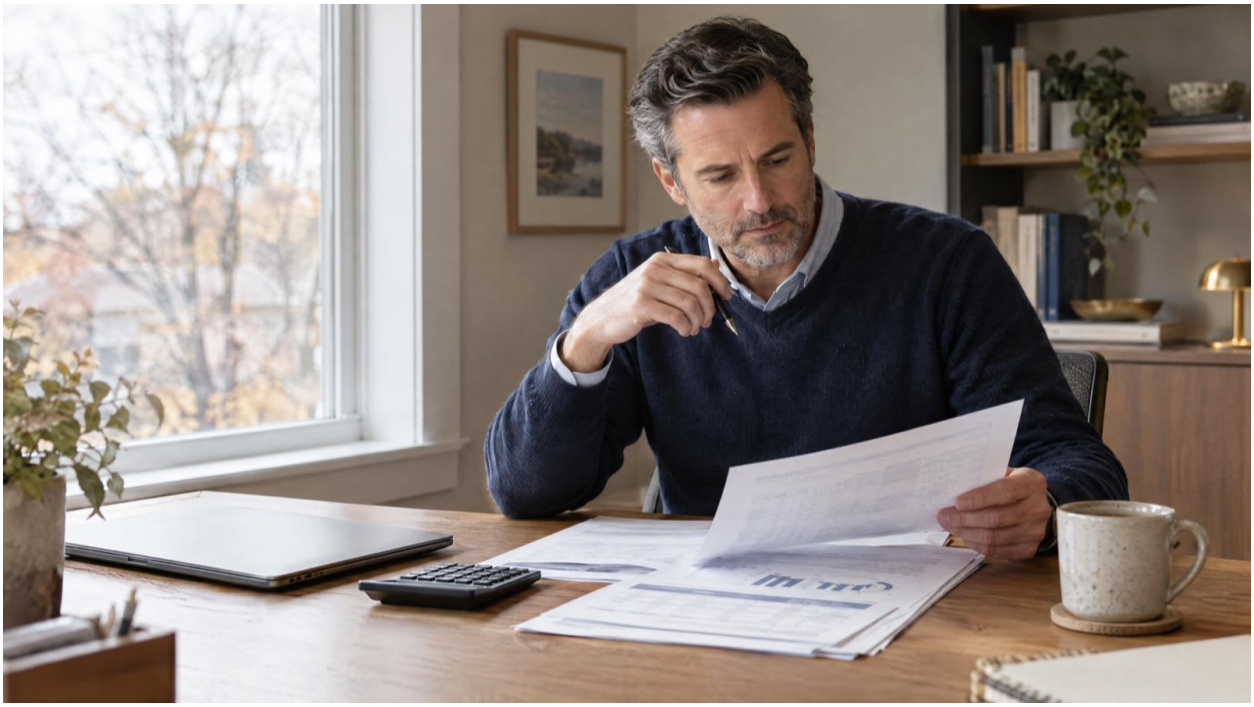
Salary or Dividends? Why Most Incorporated Business Owners Have Never Done the Math

By Joshua Kalyta, CFP®



Most incorporated business owners in Ontario settled the question of how to pay themselves once, in the year they incorporated, and have not revisited it since. That is understandable, as the structure their accountant set up worked, and the same payroll or dividend declaration has repeated itself every year without anything appearing to go wrong.

In our experience, however, how you take money out of your corporation is one of the most consequential financial decisions you make each year, and a choice that suited your circumstances five years ago may well be costing you money today.

There is no universal answer to the salary versus dividends question, as the right mix depends entirely on your specific financial position and financial objectives, both of which change over time.

What salary gives you

Paying yourself a salary requires running payroll, with source deductions and the associated filings, and in return it provides four distinct advantages.

RRSP contribution room. Salary generates RRSP contribution room while dividends do not, which means that if registered accounts form part of your retirement strategy, salary is what creates the capacity to fund them.

CPP entitlement. Salary requires contributions to the Canada Pension Plan, meaning both the employer and the employee portions are paid. Some owners view this as an additional cost, while others view it as an indexed, government-backed income stream in retirement. Which view applies to you will depend on your age and on what else your retirement plan contains.

Predictable personal income. Lenders understand salary, and where a mortgage renewal or business financing is anticipated within the next few years, a consistent salary history generally makes that conversation considerably easier than a variable dividend record.

A reduction in corporate taxable income. Salary is a deductible expense to the corporation, which may reduce the corporation's overall tax payable.

What dividends give you

Dividends are paid out of the corporation using after-tax corporate dollars and are then taxed at preferential rates personally, and they bring a different set of advantages.

Lower personal tax on eligible dividends. The dividend tax credit exists specifically to account for the tax the corporation has already paid on those earnings.

No payroll administration. Declaring dividends avoids source deductions, remittance schedules and the associated payroll filings entirely.

Flexible timing and amount. Dividends can be declared when it suits the corporation's cash position, rather than on a fixed payroll cycle.

A route into income splitting. Where family members hold shares, dividends can be an effective income splitting tool, although this sits squarely within the tax on split income rules, which are strict. We would caution against assuming that a structure which worked before those rules came into effect still works today.



Blending the two together

Set out this way, the two options can appear to be a straightforward choice between one and the other. In practice, we find that the most tax-efficient approach is usually a deliberate combination of both, recalculated each year rather than established once and left alone.

The appropriate blend will depend on your age, the RRSP room available to you, provincial tax rates, whether you have a spouse or family members who could receive dividends, your long-term retirement plan, and both the level and the type of income your corporation earns.

Changing any one of these variables will move the answer. A 38-year-old with a mortgage, young children and two decades of accumulation ahead of them is in a very different position from a 58-year-old with a paid-off home, a full RRSP and a business sale on the horizon, and the same individual will require a different answer at each of those stages.

In our experience, many business owners default to a single approach simply because it is what they have always done, and in doing so they may be missing thousands of dollars in potential tax savings each year.

An academic exercise

Salary and dividends cannot be answered in isolation. How much you take out determines how much stays in, and what stays in gets invested, which brings the passive income rules into play.

In Ontario, the small business deduction allows the first $500,000 of annual active business income to be taxed at a combined federal and provincial rate of 11.2%,[1] which represents a significant deferral advantage.

Where a private corporation earns investment income above the passive income threshold of $50,000 per year, it begins to lose access to the small business deduction on its active income, with every additional dollar of passive income reducing the small business deduction threshold by five dollars.

A decision that appears to be purely personal, namely how much to pay yourself, therefore feeds directly into the rate your corporation pays on its operating profit. Retaining more inside the corporation is not automatically the more efficient choice once that retained money begins generating investment income, particularly given that investment income inside a corporation is taxed at a combined federal and provincial rate of approximately 50% in Ontario.[1]

Compensation questions must be answered alongside corporate investment questions to create a holistic view.

Signs your approach needs revisiting

There are a few practical indicators that suggest the current arrangement may no longer be the right fit:

- Your corporate bank balance consistently exceeds six months of operating expenses
- Most of your corporate investments sit in savings accounts, GICs or money market funds
- You have never had a formal conversation about corporate investment allocation
- Your passive investment income is approaching or exceeding $50,000 a year

Any one of these would suggest that your extraction strategy and your corporate investment strategy are not currently working together.



Where to start

If you have not recalculated your salary and dividend mix within the last two years, that is where we would suggest beginning, and it is a conversation best had with your accountant and your financial planner together rather than with either one in isolation.

An accountant and a financial planner specialize in different topics. For example, your accountant specializes in corporate tax returns while your financial planner specializes in linking these aspects to your retirement. Two professionals working together eliminates a silo mentality and brings people together under one common goal: providing excellent service to their clients.

Salary versus dividends is one of seven areas in which we commonly see incorporated business owners go wrong. The others include over-investing inside the corporation, holding operating company shares within a holding company in a manner that can forfeit the Lifetime Capital Gains Exemption, holding the wrong assets in the wrong entity, and paying insurance premiums personally when the corporation should be paying them.

All seven are covered in our commentary, The Costliest Corporate Mistakes. To request a copy, email Chanelle Lindegaard at chanelle.lindegaard@sunlife.com.

If you would prefer to talk it through, we offer a complimentary 45 minute discovery call. We will identify which of the seven areas apply to your situation, and you will leave with actionable insights regardless of whether we end up working together.

To arrange one, contact Chanelle Lindegaard at chanelle.lindegaard@sunlife.com or call the Ajax and Toronto office at 905-428-9996 ext. 2229.

Sources

1. Investment income for CPCCs and ABI federal and Ontario rates. BDO Canada, Corporate Income Tax Facts. https://www.bdo.ca/insights/corporate-income-tax-facts

Figures in this article are drawn from The Costliest Corporate Mistakes, Kalyta Financial Solutions, 2026. Rates cited are Ontario combined federal and provincial rates as stated in that commentary.

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