Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

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# Employee compensation — base salary

**As an employee, you may be compensated in a number of ways. Your remuneration could include salary, a bonus, and/or shares of the company you work for. This article discusses the taxation and implications of receiving salary compensation.**

**The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax advisor before acting on any of the information in this article.**

## What is it?

Your base salary is probably your main form of compensation. The amount of your base salary may be indicated in an employment contract or employment letter. Base salary is typically paid in cash on a biweekly, semi-monthly or monthly basis.

The amount of your base salary is generally fixed for the year but with an annual review. Increases are generally based on individual performance or cost of living increases.

## How is it taxed?

### To the individual

Base salary is taxable to you personally at graduated tax rates as employment income. It is generally reported to you on a T4 slip. Before your base salary is paid to you, your employer is required to withhold income tax at source as well as certain amounts for government benefit programs such as Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) and Employment Insurance (EI) contributions.

The amount of income tax withheld on base salary is typically based on your average tax rate for the year. Your employer will only take into account the employment income and taxable benefits you earn from them to determine your average tax rate. Therefore, if you have other sources of income, such as investment income, you may want to consider asking your employer to withhold more income tax on your salary payments to avoid having to pay quarterly instalments and having the peace of mind that you will have little to no tax owing at the end of the year. Alternatively, if you are eligible for other tax deductions during the year, such as alimony, child care expenses or contributions to your own RRSP, you can make a request to the Canada Revenue Agency (CRA) on Form T1213 to instruct your employer to withhold less income tax at source on your base salary. The income tax withheld from your salary is credited towards your income taxes payable for the year. If too much tax is withheld from your salary, you will receive a refund from the CRA.

The other amounts withheld from your salary that are contributed towards government benefits are based on legislated rates and are limited to a maximum amount depending on the government program. It is possible that you will reach these limits before the end of the year. Once the limits are reached, you will notice that these deductions are no longer be taken from your pay.

Your contributions to a company registered pension plan (RPP), group registered retirement savings program (group RRSP) or share purchase plan may also be deducted from your base salary. There will be no income tax withheld on the portion of your base salary that is used to make contributions to a company RPP or group RRSP.

## To the company

The company paying your salary is able to deduct the salary payments and related expenses (gross salary and applicable employer portion of EI and CPP/QPP contributions) from its taxable income as long as they can prove that the salary payments were incurred to allow the business to earn income.

If you are the owner of a private corporation and you employ your spouse or family members to work for your corporation, it is important that the amount of salary you pay them is reasonable in the circumstances, otherwise the corporation may be denied the deduction.

In determining what is reasonable in the circumstances, you must consider the duties performed by the individual, as well as the time spent carrying out those duties. Also, you should compare the amount paid to the individual and the amount paid to employees who perform similar services for you or for employers of similar size in a similar business. Speak with a qualified tax advisor to ensure the base salary you are offering to your employees are reasonable and deductible to your corporation.

It is important that the company withholds taxes on the salary payment and remits the proper amounts to the CRA on a timely basis. A qualified tax advisor can help you determine the amounts that should be withheld from an employee's salary.

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