Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

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Employee compensation — bonus

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 a bonus.

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?

A bonus is generally an annual or quarterly lump-sum cash payment that your employer provides to you in addition to your base salary. The amount of bonus paid by your employer can be discretionary but is typically related to how well the company has performed and how well you have performed during the current or previous year.

How is it taxed?

To the individual

A bonus is taxed like regular employment income at your graduated tax rates in the year of receipt. A bonus will be reported on a T4 slip. A bonus is subject to payroll withholdings for income taxes and government benefit programs such as Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) and Employment Insurance (EI) contributions. The amount of payroll withholding is typically determined by your average tax rate and the required contributions for the various government benefits programs applicable in your province/territory of residence.

Some employers will allow you to defer the receipt of a bonus to the following tax year. If you do not need the money currently, deferring your year-end bonus to the next year may be beneficial to you if you expect to be in a lower tax bracket the following year.

Bonuses cannot be deferred indefinitely due to the Salary Deferral Arrangement (SDA) rules in the Income Tax Act. The SDA rules are complex but essentially have been put in place to prevent you from deferring the receipt and taxation of your bonus or other taxable benefits by having your employer defer your compensation earned in a current year to a future year. If the SDA rules are triggered, you will have to pay tax on the compensation in the current year, even if you receive the compensation in a future year.

In general, the SDA rules are not triggered if the compensation is paid within three years following the end of the year the bonus was payable. Due to this rule, bonuses are generally not deferred for more than three years.

Your employer is permitted to contribute your bonus payment directly to your Registered Retirement Savings Plan (RRSP) or a spousal RRSP, without withholding tax if you have available RRSP room. However, this option is at your employer's discretion and allowed only if your employer has reasonable grounds to believe that you can deduct the RRSP contribution for the year. Your employer may ask to see a copy of your Notice of Assessment showing that you have adequate unused RRSP deduction room or ask you to complete the Canada Revenue Agency (CRA) Form T1213 to ensure that they have reasonable grounds to believe you can deduct the RRSP contribution.

To the company

A company that pays a bonus to an employee is able to deduct the bonus payment and related payroll expenses from its taxable income as long as the expenses were incurred to allow the company to earn income and the amount paid is reasonable.

Where the bonus is paid to an employee who is also a shareholder of a private corporation, it is key that the shareholder is actively involved in the day-to-day operations of the corporation and contribute to the income-producing activities of the corporation in order for the bonus to be deductible. The CRA will likely question the reasonableness of a bonus if it is paid out to a non-active shareholder/manager, a non-resident shareholder/manager or to a holding corporation.

A corporation can declare a bonus and get a deduction for the current corporate tax year even if it does not payout the bonus immediately. The corporation has up to 179 days after the corporate year-end to pay the bonus if they wish to claim the deduction in the year the bonus was declared. A qualified tax advisor can help you determine the deductibility of a bonus payment made by your corporation.

It is important that the company withholds taxes on the bonus 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 bonus.

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