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Deferred Salary Fact Sheet

Q. What is a deferred salary?
A. A deferred salary is a simply an unpaid salary recorded on a company's books at a corporation's year-end. In order to be tax deductible to a corporation in a given year, a deferred salary must be paid out within 180 days of the corporation's fiscal year end.

Q. Why are deferred salaries used?
A. A deferred salary will allow a corporation to deduct an unpaid salary in its current year-end (as long a s payment is made within 180 days). If the payment of the salary to the individual takes place in the next calendar year, the salary is taxed in the individual's next year. For corporations with fiscal year-ends between July 5 and December 31, this allows tax-planning flexibility for owner/manager personal tax amounts as well as other employees.

Q. How do I pay out a deferred salary?
A. There are several ways that a deferred salary can be paid to an employee. The most common ways are to pay the amount as part of a regular payroll, as a lump-sum payment, or a combination of these. It is important to remember that an employee is subject to tax on their income on a "cash received basis." This means the owner/manager of a business will pay taxes on their salary in the year they receive the salary payment. If the intention of the owner/manager is to have an amount included in their personal income in a future year, payment of the salary cannot take place until that time.

Q. What if I cannot pay the deferred salaries?
A. In order to be deductible in a corporation, the deferred salaries must be paid within 180 days. If your corporation does not have the funds to pay, a cheque from the corporation to the employee/manager can be issued and immediately deposited into the corporation's account. This provides proof of payment of the bonus, and protects the corporation from the deduction for the deferred salary from being disallowed. If payments are not made by cheque, we ill record the payment with a journal entry at the end of the year. Payment by "journal entry" can be disputed by Canada Customs and Revenue Agency (CCRA).

Q. How are taxes paid on deferred salaries?
A. CCRA considers "deferred salaries" to be employment income of the owner/manager. Accordingly, source deductions (income tax, CPP and EI if applicable) should be remitted to CCRA by the 15th of the month following the payment of the salary.

Q. What if I cannot pay the taxes on deferred salaries?
A. CCRA's can charge penalties and interest on late or under-remitted source deductions. If full payment cannot be made, the corporation risks being assessed penalties and interest.