Weekly Updates Issue # 616

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1. Weekly Markets Changes

[June 3, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,442.75 +25.82 +0.17%	2,439.07 +23.25 +0.96%	21,206.29 +126.0 +0.60%	6,305.80 +95.60 +1.54%	$0.7413	$1,281.50 +11.40 +0.90%	$47.74 -2.13 -4.27%

2. Canada's exports hit record high in April

[June 2, 2017] Statistics Canada says exports hit a record high in April, driven by shipments in cars, trucks and commodities including energy and forestry products.

Exports rose to $47.7 billion, a gain of 1.8%, strengthened by a Canadian dollar that was trading between US$0.73 and US$0.75 for the month.

Shipments of motor vehicles and parts were up 4.4% to $8.1 billion, while exports of energy products increased to $8.8 billion, up 2.5%.

The country's trade deficit narrowed to $370 million, down from a revised shortfall of $936 million for March. But economists had expected a razor-thin deficit of $70 million, according to Thomson Reuters.

Imports hit $48.1 billion, a fifth consecutive monthly increase and also a record high.

3. CMHC CEO dismisses risk of mortgage fraud, but stresses housing troubles

[June 2, 2017] For the past couple months, Home Capital Group has been making headlines–and last week was no different.

On June 1, Canadian Mortgage and Housing Corporation chief executive Evan Siddall spoke to reporters about the domestic mortgage industry in relation to what Financial Post calls "Home Capital's current liquidity crisis." FP notes that CMHC has known about "potential documentation fraud at the alternative mortgage lender since at least 2015," but that CMHC insists "mortgage fraud in Canada is rare." Siddall said such fraud isn't a "pervasive problem in Canada."

Canada's housing strategy

Also on June 1, Siddall delivered a speech on the federal government's national housing strategy, which was discussed in this year's federal budget.

In that speech, Siddall said the strategy is being created "to diminish the inequity that we see growing in our communities daily – to close the gap between the 'haves' and 'have nots.'" He underlined this point several times, noting, "Research suggests that housing values exacerbate the gap between rich and poor."

The objective of the overall strategy, he added, is not just to build more houses to help meet demand and deal with housing affordability challenges. On top of that, people must be shown "that affordable housing is essential to a growing economy and to a healthy society."

For example, Siddall said, "When people have good housing, they tend to have better health. And healthy children and teens living in stable home environments have better educational outcomes."

This is why the bulk of the funding the government is dedicating to housing– $5 billion out of $11.2 billion over the next 11 years – "will be devoted" to the new National Housing Fund.

About the economy, Siddall said: "Economists looked at the experience of 54 economies from 1990 to 2015 and found that every 1% increase in the household debt-to-GDP ratio tended to lower growth in the long run by 0.1%."

He added, "While household debt provides a temporary boost in consumption–mostly for less than a year–the negative long-run effects on consumption tend to intensify as household debt-to-GDP exceeds 60%. The overall drag on GDP growth tends to intensify when the ratio exceeds 80%," and Canada sits above both thresholds.

4. IMF draws red flag on Canadian housing, household debt

[June 1, 2017] The International Monetary Fund is warning about the risks to the Canadian economy due to a possible correction in the housing market and urged governments to do more to protect against them.

In the preliminary findings of its annual review of the Canadian economy, the IMF said Wednesday that a further tightening of macroprudential and tax-based measures to mitigate speculative and investment activity should be considered.

It also called for greater co-ordination between federal and provincial regulators as well as government efforts to collect more comprehensive data on real estate transactions.

Finance Minister Bill Morneau said there were no surprises in the IMF warning.

"What the IMF has said is … that there's a level of household indebtedness in Canada that is significant, something for us to watch. The housing market, of course, is something we're paying close attention to," he said.

Ottawa has moved several times in recent years to tighten mortgage lending rules, including expanded stress tests on mortgages.

A foreign buyer tax of 15 per cent was implemented in the Vancouver region last summer, while Ontario recently announced plans for a similar levy for the Greater Toronto Area.

Moody's Investors Service recently downgraded Canada's six big banks amid concerns about consumer debt and housing prices that could leave them vulnerable.

Cheng Hoon Lim, the IMF's mission chief for Canada, said there are a few policies that could help deter speculation in the housing market and alleviate concerns about rising debt burdens.

"Among these measures, a cap on household debt to income or more stringent qualification criteria for household debt above a certain threshold will go directly to addressing household indebtedness," she said.

The IMF also encouraged B.C. and Ontario to replace their foreign buyer taxes.

"This could include a combination of prudential and tax-based measures that discourage speculative activity without discriminating between residents and non-residents," it said.

5. GDP grows 3.7% in Q1, revised upward for Q3 and Q4

[May 31, 2017] The pace of Canada's economic growth picked up steam in the first quarter of this year, helped by continued household spending and a turnaround in business investment.

Statistics Canada says real gross domestic product grew at an annualized rate of 3.7% in the first three months of the year.

That was short of expectations. Economists had estimated the growth rate for the quarter would be 3.9%, according to Thomson Reuters.
However, the last month of the quarter was stronger than expected.
Growth in March came in at 0.5%, which was higher than the estimate of 0.2%.
The boost in March was helped by manufacturing, which had a strong gain of 1.6%.
"The Canadian economy continues to demonstrate a breadth of expansion," says senior economist Brian DePratto of TD Bank, in an economics report. "80% of Canadian industries, representing approximately 90% of output, expanded in March, the best performance since May 2014."
But, going forward, a large contribution in Q1 from inventory rebuilding could adversely affect Q2 production, says Avery Shenfeld, managing director and chief economist at CIBC Capital Markets, in an industry note. That's because half the rebuilding came from manufacturing.
On the other hand, "Q1 also saw a surge in imports (up 13.7% annualized), which might also have been part of that inventory build and which therefore would not be a Q2 drag," he says.
He further notes that household consumption, which was a brisk 4.3%, came in part from a drop in the savings rate, suggesting a slower pace for Q2.
Bottom line: GDP is up 3.2% in the past year, a big step toward narrowing economic slack, "and that's the most important takeaway for investors," says Shenfeld.
Results for the second half of 2016 were also revised higher as the figures for third and fourth quarters were increased to 4.2% and 2.7%, compared with earlier readings of 3.8% and 2.6%, respectively.

6. Ontario's minimum wage to reach $15/hour by 2019, and more labour changes

[May 30, 2017] Ontario is raising its minimum wage to $15 an hour by 2019. It also plans to ensure equal pay for part-time workers and increase the minimum vacation entitlement as part of a major labour overhaul.
Premier Kathleen Wynne made this announcement Tuesday in response to a government-commissioned report released last week that included 173 recommendations addressing precarious work.
"Change in the workplace isn't just on the horizon; it's here," Wynne said on May 30. "People are working longer, jobs are less secure, benefits are harder to come by and protections are fewer and fewer. In a time of change like this,

when the very nature of work is being transformed, we need to make certain that our workers are treated fairly."

The Changing Workplaces review concluded that new technology, a shrinking manufacturing sector and fewer union jobs, among other factors, have left approximately one-third of Ontario's 6.6 million workers vulnerable.

The report didn't examine the minimum wage–which is currently indexed to inflation and had been set to rise from $11.40 to $11.60 in October–but Wynne said raising it will make a difference in millions of people's lives.

The minimum wage will rise to $14 an hour on Jan. 1, 2018, and is set to increase to $15 the following year. About 10% of Ontario workers are currently making minimum wage, but about 30% are making less than $15 an hour–the majority of them women.

"It has always been a challenge to raise a family on a minimum-wage job," Wynne said. "But in recent years, it has become almost impossible. And the reality is more and more people are having to do it."

Lower minimum wages for students under 18 and liquor servers will also rise during the same time frame, but those exemptions to the minimum wage will not be eliminated, as the report had recommended.

Wynne also announced that part-time workers will get equal pay for doing work equal to full-time staff, and that the minimum vacation entitlement will be increased. Instead of getting two weeks of vacation, workers will be able to get three weeks of paid vacation a year after five years with a company.

The changes to workplace laws will also establish fairer rules for scheduling, including making employers pay three hours of wages if they cancel a shift with fewer than 48-hour notice.

Personal emergency leave would also be expanded. Currently it is only available to employees at companies with more than 50 people, but proposed legislation would ensure all employees in the province get 10 days per year, two of them paid.

7. Bank of Canada maintains overnight rate target at 0.5%

[May 24, 2017] The Bank of Canada is maintaining its target for the overnight rate at 0.5%. The Bank rate is correspondingly 0.75%, and the deposit rate is 0.25%.

In a release, the Bank says recent economic developments reinforce its view that growth will gradually strengthen and broaden. But, while the U.S. is expected to rebound following weak Q1 growth that was anticipated, Canada will see the opposite in the near term.

For Canada, the Bank expects very strong growth in the first quarter will be followed by some moderation in the second quarter.

The upside is the Canadian economy has nearly finished adjusting to lower oil prices, and recent economic data have been encouraging, including indicators of business investment. On top of that, consumer spending and the housing sector continue to be robust on the back of an improving labour market, across all regions.

The downside, says the Bank, is the domestic housing market has yet to cool, despite measures that have contributed to more sustainable debt profiles. Plus, export growth remains subdued; this was anticipated in the April MPR, in the face of ongoing competitiveness challenges.

Inflation is broadly in line with the projections in the April monetary policy report (MPR). While food prices continue to decline–mainly because of intense retail competition, pushing inflation temporarily lower–the Bank's three measures of core inflation remain below 2%, and wage growth is still subdued, consistent with ongoing excess capacity in the economy.

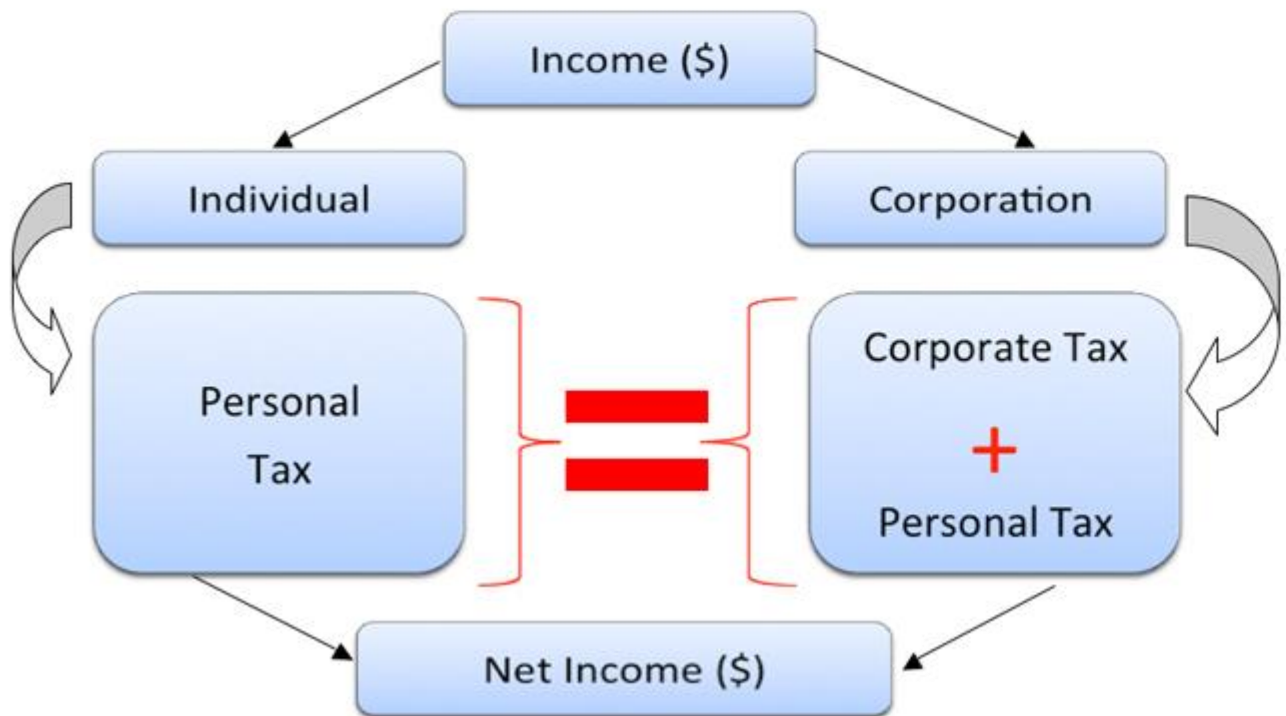
In an industry note, Avery Shenfeld, managing director at CIBC Capital Markets, says the Bank's announcement offers nothing surprising for markets. "Look for the first hikes to come in early 2018, a delay designed to keep the [loonie] in check," he says. Shenfeld adds the risk of doing this is "the central bank can't always choose how we get back to full employment, and with growth looking to easily top 4% in the first quarter, the market is understating the path for Canadian rates over the next few years."

8. Salary or dividends: Which is better for business owners?

[May 24, 2017] All incorporated small business owners eventually must decide how to pay themselves: by salary or dividends. There's no simple response, so let's unpack the process to answer that question.

Theory of integration

No discussion about an incorporated business owner's compensation can start without introducing the theory of integration. The idea behind that theory is simple: regardless of whether you earn income personally (salary) or through a combination of corporately and personally (dividend) taxed income, the net income after all tax is paid should be the same.



But this theory doesn't always hold in reality. As a result, it's a good idea to run the numbers for a business owner's specific situation to see if one method of compensation is more tax efficient than another. Let's do that.

Example: Roberto

Roberto is single and owns a profitable Ontario corporation. He's trying to determine the best way to compensate himself. His corporation generates $200,000 a year in active business income, and the money he will pay himself from his corporation will be his only source of income for the year.

If he goes the salary route, he wants to maximize his contributions to CPP and his RRSP. If he goes the dividend route, he wants to have the same after-tax income as the salary option for living expenses, so any surplus above that would be invested.

Chart 1: Ontario corporation (2017 rates)

	Salary	Dividend
Corporate business income	$200,000	$200,000
Less: CPP and EI premiums	($3,735)	N/A
Less: Salary	($55,300)	N/A
Corporate taxable income	$140,965	$200,000
Less: Corporate tax @ 15%	($21,145)	($30,000)
Less: Dividend to shareholder	__N/A__	($55,300)

Retained earnings	$119,820	$114,700

Chart 2: Personal taxes (2017 rates)

	Salary	Dividend
Salary	$55,300	–
Dividend	–	$55,300
Less: RRSP contribution @ 18%	($9,954)	–
Less: Income tax1	($9,954)	($3,688)
Net income	$35,392	$51,612
Difference (to invest)		$16,220

1 Includes CPP and EI premiums

Since Roberto owns an Ontario corporation, the first $500,000 of active business income is taxed at 15% (combined federal and provincial). His salary, the employer CPP contribution and EI premium are deducted from the corporation's income, leaving it with taxable income of $140,965.

The dividend, on the other hand, is paid with corporate after-tax income, meaning the full $200,000 of active business income is subject to corporate tax.

Roberto's personal tax situation follows a similar pattern. His salary, net of his RRSP contribution is fully taxable income, which leaves him with net income of $35,392. The dividend is subject to a much lower rate of personal tax, thanks to the dividend gross-up and subsequent tax credit. In order to maintain a net income of $35,392, Roberto must set aside $16,220 for personal investment in either a TFSA, non-registered account or some combination of the two.

Chart 3: Summary

	Salary	Dividend
Corporate income tax	$21,145	$30,000
CPP and EI premiums2	$7,135	N/A
Personal income tax	$6,553	$3,688
Total tax and deductions	$34,833	$33,688
Corporate investment	$119,820	$114,700
Personal investment	$9,954	$16,220
Total Investments	$129,774	$130,920

2 Includes both employer and employee CPP and EI premiums

As you can see, the difference in both total taxes (including CPP contributions and EI premiums) as well as total investments (combined corporate and personal) are very similar. It appears the theory of integration holds up quite well in Roberto's case, with dividends providing a slight advantage over the salary option.

Going beyond the numbers

For business owners like Roberto, there are other factors to consider beyond simple arithmetic. When considering paying oneself dividends, there are additional advantages:

1. If the only source of personal income was non-eligible dividends, it is possible to receive up to $33,305 tax-free in 2017, excluding the Ontario Health Premium.
2. Dividends do not require the shareholder to be an employee of the business, whereas salaries do and must be reasonable for the work and role performed.
3. The payment of dividends doesn't require personal taxes to be remitted at source; salaries require income tax and CPP amounts to be withheld by the employer and remitted within days or weeks.

On the flip side, when evaluating the advantages of paying a salary, consider the following:

1. Salaries entitle the recipient to the Canada employment credit.
2. If the company's taxable income exceeds $500,000 in 2017, salaries can reduce exposure to corporate income tax that would be payable at the higher corporate income tax rates.
3. A dividend recipient may be required to remit quarterly personal income tax instalments in future years; this is unlikely for salary since tax is withheld at source.
4. If personal income is so low that the dividend tax credit would be unused, a salary may be more tax-efficient.

CPP and EI

As you saw from Roberto's situation, there's an additional cost under the salary option over dividends to pay both the employer and employee CPP contributions and EI premiums.

These costs come with associated benefits: one is a future, fully indexed pension in retirement and/or in the event of disability, while the second is income insurance in the event of involuntary job loss. Employment Insurance also provides income such as parental, sickness and compassionate care benefits.

The benefits that both of these programs could provide should be evaluated against their annual costs. Someone like Roberto should consider whether he will be able to save enough money to replace the CPP retirement pension if he chooses to compensate himself with dividends, or what he'll do in the event of disability or future child rearing.

Income splitting

Both the salary and dividend options provide for the possibility to income split with other family members. In the case of salary, family members must be employed by the company and paid a reasonable salary for the work performed. With dividends, family members must be shareholders, but there's no requirement for them to be employees.

Note that income splitting using dividends is one aspect of tax planning for business owners that the federal government will be reviewing over the coming months. This review was announced as part of the 2017 Federal Budget. The results of this government review could lead to business owners revisiting their current dividend income-splitting strategy with their tax advisors.

Conclusion

For business owners in most provinces, the method of personal compensation should not change net income after all taxes (i.e., corporate and/or personal) are paid. It's important to confirm this by making the calculations based on the owner's specific circumstances.

As a next step, consider other factors related to salary or dividend income. From there, the compensation decision becomes a cost-benefit analysis where the owner will choose her compensation based on which method provides more benefits and less costs.

Finally, potential tax changes can lead to revisiting the analysis to assess whether the current compensation mix still provides the owner with the desired benefits at an acceptable cost.

Have a nice and fruitful week!

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