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TAX LETTER

Shareholders' Remuneration
September 2007

It is common practice for a private company to employ its shareholders and related persons to carry out duties for the corporation, particularly in management capacities. Canada Revenue Agency will often carefully review remuneration paid to shareholders and related persons. For such remuneration to be deductible by the company, it must be incurred for the purpose of earning income and the amounts must be reasonable.

Canada Revenue Agency has established certain guidelines for the evaluation of salaries and bonuses paid to shareholders and related persons:

1. Amounts paid to shareholder/manager of a Canadian-controlled private corporation carrying on an active business:

   - Active in day-to-day operations?
   - Resident of Canada?
   - Funds not from dividends flowed through a complex corporation structure?
   - Funds not derived from management fee?
   - Funds not derived from income realized from sale of asset?
   - Supporting evidence available?

   If "yes" to all of above, remuneration will generally not be challenged.

2. Amounts paid to shareholder/manager of a Canadian-controlled private corporation carrying on an inactive business:

   - Active in the business?
   - Resident of Canada?
   - Funds not from dividends flowed through a complex corporation structure?
   - Funds not derived from management fee?
   - Funds not derived from income realized from sale of asset?
   - Supporting evidence available?

   If "yes" to all of above, remuneration will generally not be challenged.

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3. Amounts paid to shareholder or related person who is not a manager of the business:

    - Resident of Canada?
    - Basic issues: Adult? Paid regularly? Work in office? Working hours? Fair hourly rate? Reasons for higher pay (e.g. special skills/knowledge/connections)? Past remuneration history?
    - Bonus appears reasonable?
    - Supporting evidence available?

    If "yes" to all of above, remuneration will generally not be challenged.

The issue of fair market value of the remuneration is quite subjective and a frequent cause of disagreement between Canada Revenue Agency and the taxpayer. The onus of proof is on the taxpayer to show that the remuneration is reasonable.

If salaries and bonuses are disallowed, the corporation and the individuals will face the burden of double-taxation: the recipient is still taxed on the remuneration while the corporation is denied a deduction. Furthermore, a reassessment will often involve more than one taxation year, possibly resulting in significant outstanding taxes as well as interest charges.

We hope that this letter serves to provide useful general information to private enterprises in setting remuneration to be paid to shareholders and related persons.

The material in this tax letter is intended to be general information and not specific advice for any particular individual or entity. Readers are cautioned that they should seek appropriate professional advice from an accountant or tax lawyer on their specific situation. We would be pleased to be of further assistance.