Eligible Dividend Legislation

by David Louis, B. Com., J.D., C.A., Tax Partner
Minden Gross LLP, a member of MERITAS Law Firms Worldwide.

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The taxation of dividends paid by Canadian-resident corporations has been altered by the eligible dividend legislation, enacted early in 2007. Such dividends will be subject to lower federal tax rates than ordinary (ineligible) dividends, as well as further reductions in most provinces.

The regime was originally announced in November of 2005 by the former Liberal government, in an unsuccessful attempt to stem the tide of income trusts. The changes were confirmed in the Conservatives' 2006 federal budget with details of the legislation originally released in June of 2006.

While the eligible dividend regime is directed largely toward public corporations, eligible dividends will generally include dividends paid after 2005 by Canadian-controlled private corporations ("CCPCs"), to the extent that their income (other than investment income) is subject to tax at the general corporate income tax rate (currently 22.12% at the federal level; 36.12% in Ontario). Also eligible are non-CCPCs that are resident in Canada. Thus the proposals will also be of interest to private corporations, particularly those with "high-rate" business income (i.e., income which is not eligible for the small business deduction).

The design of the eligible dividend regime is to provide "integration" in respect of high-rate business income, so that the combined corporate and personal tax rate would be more or less equal to the tax rate that would apply if the income had been earned directly by an individual in the top tax bracket (a degree of double-taxation is referred to as "underintegration" and combined personal/corporate tax at less than personal rates, "overintegration"). In fact, with the eligible dividend regime in effect, the Canadian tax system is now designed so that there is integration (more or less) of all types of Canadian source income earned by private corporations, but with substantially different levels of deferral where earnings are retained at the corporate level.

Integration and Deferral:
General Comments on Types of Income Earned by Private Corporations

Type of Income	How Integration is Achieved	Comments
Income eligible for small business deduction (CCPCs)	- low corporate tax rate (20% or less, depending on the province) - ineligible dividends	- high degree of deferral at the corporate level - tendency towards overintegration
Income eligible for refundable tax treatment (CCPCs)	- high corporate tax rate, usually close to 50% - refundable corporate tax - ineligible dividends	- little or no deferral at the corporate level - tendency for integration
General "Business rate" income	- medium corporate tax rate, usually mid-30% range, depending on the province - eligible dividends	- material degree of deferral at the corporate level - may be a tendency for a certain amount of underintegration (depending on the province)

However, the foregoing assumes that there are analogous provincial tax reductions, as well as the phase-in of certain tax rates toward the end of the decade. While most provinces have followed the federal rules, more or less, some provinces have not[1]. (As a rough rule of thumb, the farther east the province, the higher the tax rate on eligible dividends: At time of writing, the top tax rate for eligible dividends in various provinces in 2010 will range from lows of 14.55% and 18.47% for Alberta and B.C., respectively, to 22.38%, 29.69% in Ontario and Quebec, to 28.35% and 32.52% in Nova Scotia and Newfoundland.)

Effects of Eligible Dividends

The eligible dividend regime will have some fairly significant results. Notably, if they have not already done so, owner-managers should reconsider the practice of bonusing-out income in excess of the small business limit (as of 2007, $400,000 per associated group of corporations). In general, it can be said that, at worst, the ultimate burden when profits are taxed in the corporation and paid to the shareholder as taxable dividends may be only modestly higher than the top personal rate applicable to bonuses; in the meantime, there may be a significant element of deferral resultant from corporate tax rates which are lower than top personal rates.[2] To the extent that the Ontario clawback applies, the deferral will be reduced and the underintegration increased; however, as profit increases over the clawback ceiling, this will be less of a factor. (For further discussion, see "Some Planning Points", below.) Also, retention of profits at the corporate level could mean the loss of refundable investment tax credits.

In addition, the rules may lead many corporations, such as those involved in real estate rental businesses, to consider restructuring so that income is taxed based on corporate tax rates applicable to business income, rather than as investment businesses, which are subject to higher corporate tax rates, coupled with the RDTOH system. (Restructuring would be possible where the more-than-five-full-time-employee test can be met.) The reason is that, under the eligible dividend regime, there would be a significant reduction of corporate tax rates (e.g., from about 50% to 36% in Ontario), while the loss of RDTOH may have little or no material adverse effect if eligible dividends can ultimately be paid instead.

Another interesting result of rules is that they also level the playing field between the taxation of eligible dividends and capital gains. While the precise level of tax will depend on provincial tax rates, and in particular the extent to which a province matches the federal eligible dividend rates, the taxation of these types of income should typically be pretty close. In Ontario, the tax rate for eligible dividends will drop from about 25% in 2006 (compared to about 31.3% for ineligible dividends) to about 22.4% in 2010. This rate will actually be lower than a personally-realized non-exempt capital gain, taxable at about 23.2%.

The following is a comparison of the eligible and ineligible dividend calculation at the federal level:

	Ineligible	**Eligible**
Dividend	$100.00	$100.00
Gross-up*	25.00	45.00
Total	125.00	145.00
Federal tax at 29%	36.25	42.05
Dividend Tax Credit**	16.67	27.50
Net federal tax	$19.58	$14.55

* For ineligible dividends, 25% of the actual dividend; for eligible dividends, 45% of the actual dividend.

**For ineligible dividends, 2/3 of the 25% gross-up; for eligible dividends, 11/18 of the 45% gross-up.

Taxation of Types of Income – March 31, 2007

	Individuals	
		Dividends

	Ordinary Income	Capital Gains	Eligible	Non-Eligible
British Columbia	43.70%	21.85%	18.47%	31.58%
Alberta(1)	39.00%	19.50%	17.45%	25.21%
Saskatchewan	44.00%	22.0%	20.35%	30.83%
Manitoba	46.40%	23.20%	23.83%	36.75%
Ontario(2)	46.41%	23.2%	24.64%	31.34%
Quebec	48.22%	24.11%	29.69%	36.35%
New Brunswick	46.95%	23.48%	23.18%	37.4%
Nova Scotia	48.25%	24.13%	28.35%	33.06%
Prince Edward Island	47.37%	23.69%	24.44%	33.61%
Newfoundland	48.64%	24.32%	32.52%	37.32%

(1) The rate for eligible dividends will decrease to 14.55% and the rate for ineligible dividends will increase to 27.71% by 2009.

(2) The rate on eligible dividends will decrease to 22.38% by 2010.

Overview of Rules

From the standpoint of an individual taxpayer, an eligible dividend receives a 45% gross-up (as opposed to 25% for other dividends from taxable Canadian corporations)[3] and a federal tax credit equal to 11/18 of the 45% gross-up (as opposed to 2/3 of the 25% gross up in respect of ineligible dividends)[4]. As mentioned previously, similar rules apply in respect of provincial tax in most provinces.

A dividend is an eligible dividend if the dividend-paying corporation has given the recipient written notice to that effect.

With respect to the dividend-paying corporation, an eligible dividend is any dividend that a corporation designates to be one. However, some corporations will have a limited capacity to pay eligible dividends. If the designations exceed that capacity, they are liable for a special tax pursuant to Part III.1 of the Act, which can apply to the excess amount. However, if the corporation can reasonably be considered to have attempted to artificially increase its capacity to pay eligible dividends, penalties apply to the full amount of the eligible dividend. (For further discussion, see “Excessive Eligible Dividends”, below.)

A corporation’s capacity to pay eligible dividends depends mostly on its status. If the corporation is a Canadian-controlled private corporation,[5] it can pay eligible dividends only to the extent of its “General Rate Income Pool” (“GRIP”). This is a balance generally reflecting taxable income that has not benefited from the small business deduction or any other special tax rates, as well as eligible dividends received from other corporations.

A Canadian-resident corporation that is not a CCPC can pay eligible dividends in any amount; however, it has a “Low Rate Income Pool” (“LRIP”), which essentially blocks the ability to pay eligible dividends until the account is cleared-out by ineligible dividends payable by the corporation.**[6]** (For further discussion on GRIP and LRIP, see “Components of GRIP/LRIP”, below.)

When an existing corporation ceases to be or becomes a CCPC[7], there is a deemed taxation year, which is intended to simplify calculations of the GRIP/LRIP accounts. Special rules apply to the computation of a corporation’s GRIP or LRIP, as the case may be, when it becomes or ceases to be a CCPC and when it has been a party to an amalgamation or wind-up.

Rather than get into complicated legislation dealing with corporate groups, the GRIP and LRIP accounts are calculated on an unconsolidated basis. There is no consolidation or related group concept other than the result that an eligible dividend received enlarges a corporation's GRIP and an ineligible dividend received enlarges a corporation's LRIP.

Special GRIP Addition for 2006

There is a special addition to GRIP for a corporation that was[8] throughout its first taxation year that includes January 1st, 2006, a CCPC[9]. The addition to GRIP is equal to 63% of earnings of the corporation that were subject to the general corporate tax rate for years of the corporation ending after 2000 and before 2006, provided that the earnings have not been paid by the corporation as taxable dividends.[10]

Generally, dividends received by a corporation are not included in this calculation; however, an exception is made in respect of dividends received from a connected corporation, or through a chain of connected corporations, in circumstances where the dividend may reasonably be considered to be attributable to income that was subject to tax at the general corporate rate.

Income qualifying for the Manufacturing & Processing deduction for a taxation year ending after 2000 and before 2004 will not qualify for the GRIP addition. However, for taxation years ending after 2003 and before 2006 – when the M&P deduction did not make a difference in corporate tax rates because of the full phase-in of the 7% general tax reduction – the special addition is available[11].

Because of the simplicity of addition for pre-2006 income, there are a number of issues in respect of the addition to GRIP. For example, it appears that the GRIP on an amalgamation occurring within the stub period is lost; a similar issue results from a winding-up of a corporation.[12]

Notification of Eligible Dividend

A corporation that designates an eligible dividend it pays at any time by notifying in writing <u>at that time</u> each person to whom the dividend is paid.[13] This appears to require a contemporaneous notification. However, late in 2006, the CRA clarified a number of issues re notification. Starting in 2007, the CRA's policy in this regard is that all corporations other than public corporations may identify an eligible dividend through letters to shareholders, dividend cheque stubs, or where all of the shareholders are directors of the corporation, a notation in the minutes[14]. A dividend received by a non-resident shareholder cannot qualify as an eligible dividend. Nevertheless, notification of an eligible dividend designation must be made to all shareholders who receive a dividend, including those whose mailing address is outside of Canada, even if tax has been withheld (the address of record is not conclusive proof of residency).[15]

The CRA's view is that, since all shares of a class have the same attributes, a designation of eligible dividends must include all of the shareholders of the particular class. The CRA also indicated[16] that a designation cannot relate to part of a dividend.

Note: a timely designation of an eligible dividend can be made within 90 days of Royal Assent to the eligible dividend legislation[17], which occurred on February 21, 2007 - i.e., the deadline is May 22, 2007. There are no "fairness provisions" for late designations.

Change of Status

When the status of a corporation changes to/from a Canadian controlled private corporation, subsection 249(3.1) calls for a deemed year-end immediately before the change of status[18]. When this occurs, the opening GRIP/LRIP account will be calculated as of the end of the preceding taxation year[19]. In essence, the opening accounts are measured on a tax balance sheet approach[20]. (The opening LRIP account blocks the ability to pay eligible dividends until it is "cleared out".)

A change of status could occur, for example, if control of the corporation is acquired by a public company or a non-resident[21]; a change of status could also occur if the corporation itself becomes public or the controlling shareholder ceases to be a Canadian resident. Thus, a company which goes public may have an LRIP account which would prevent it from paying eligible dividends until the account is cleared out.[22]

“Change-of-Status Election”

A special election is available (under subsection 89(11) of the Act) whereby a would-be CCPC can give up its status for certain purposes, notably, eligibility for the small business deduction. In exchange, it is treated for the purposes of paying eligible dividends as a non-CCPC, so that it can pay eligible dividends “by default” - subject only to “LRIP blockage”.[23] Generally, other than loss of the small business deduction, other aspects of CCPC status remain, e.g., the refundable-dividend-tax-on-hand regime[24].

Where a corporation makes a change-of-status election, the opening LRIP account will be calculated as of the end of the preceding taxation year (unlike a true change of status, the election does not in itself change the year end of the corporation). The election must be on or before the filing due date for the particular year. It is possible to revoke an election, by filing a revocation on or before the filing due date for a particular year.[25]

Needless to say, where the loss of the small business deduction is relevant, it may not make sense to make a change-of-status election. However, in other cases, the election may be considered when the future appreciation of the corporation will exceed the build-up of GRIP which would have been generated if there had been no change of status. One example of this could be where the income of the corporation is tax-sheltered. Another could be if there is a Canadian holding company with foreign affiliates; although foreign affiliate dividends may increase the corporation’s GRIP, the foreign jurisdictions may extract high withholding tax, or the dividend might increase the recipient corporation’s income under the taxable surplus rules. Another promising situation is where a corporation may have assets which are appreciating in value but the generation of GRIP is unlikely, e.g., a corporation with investment real estate (which would not generate GRIP if sold), or even an active business company with untaxed goodwill (i.e., which may not be sold to begin with).[26] It should be noted that the ability to pay dividends will be depleted (i.e., from a corporate law standpoint) by the payment of an eligible dividend, so that it may not be possible to pay future dividends when special surplus accounts such as RDTOH or capital dividend accounts are generated in the future. However, if there is a long-term deferral of the generation of such accounts, eligible dividends may make sense.

Of course, the change-of-status election may generate an opening LRIP account based on tax carrying values; however, this may be reduced by GRIP.[27]

Excessive Eligible Dividends

Where a corporation is a CCPC, the amount of an excessive eligible dividend designation[28] is determined by identifying the amount by which the aggregate of all eligible dividends paid in a taxation year exceeds the corporation’s GRIP at the end of the year; the excess is then pro-rated on the eligible dividend relative to all eligible dividends paid in the year. (For a non CCPC, the amount of an excessive eligible dividend designation is based on the LRIP or the eligible dividend if greater, i.e., the LRIP will effectively block eligibility of the particular dividend.)[29]

Part III.1 of the Act imposes a tax on excessive eligible dividend designations[30]. The mechanics of Part III.1 are reminiscent of the Part III tax on excessive capital dividends.

Part III.1 imposes 20% tax on excess designations, which applies if a CCPC has designated an amount that exceeds the corporation’s GRIP at the end of the year, or to a non-CCPC to the extent of a positive balance in its LRIP.

Similar to Part III of the Act, a corporation that is subject to Part III.1 tax at the 20% rate can elect to treat a part of the excess designation as a separate non-eligible dividend to which Part III.1 tax will not apply. The election must be made within 90 days after the date of notice of assessment dealing with the Part III.1 tax.[31]

Elections made within 30 months of the payment of the excess dividend require the consent of all shareholders who were entitled to receive any portion of the original dividend and whose addresses were known to the corporation. Elections made after this deadline require the consent of all shareholders who were entitled to receive any portion of the dividend, regardless of whether the corporation knew their addresses.[32]

The foregoing rules do not apply where an anti-avoidance rule in Paragraph (c) of the “excessive eligible dividend designation” definition[33] applies. In this case, the penalty tax is 30% of the excessive eligible dividend designation, and there is no ability to elect to have a portion of the excessive dividend treated as an ineligible dividend, as described above. The anti-avoidance rule will apply if it is reasonable to consider the eligible dividend was paid in a transaction, or as part of a series of transactions, one of the main purposes of which was to artificially maintain or increase the corporation's GRIP, or maintain or decrease its LRIP. At time of writing, there is little guidance as to when the CRA might seek to impose this provision.

Where a CCPC pays an eligible dividend, non-arm's length recipients are specifically jointly and severally liable for the Part III.1 tax, based on the proportionate dividends received.[34]

Components of GRIP/LRIP

A detailed analysis of the components of the GRIP/LRIP are beyond the scope of this discussion; reference should be made to the legislation[35].

Generally, however, the following are components of the GRIP account[36]:

GRIP at the end of the preceding taxation year[37].

- **Add** 68% of taxable income for the year[38], less income subject to the small business deduction[39] and investment income[40] for the particular year.
- **Add** eligible dividends received by the corporation, dividends which are deductible under section 113 (e.g., dividends from exempt surplus)[41], and GRIP additions on becoming a CCPC or in respect of amalgamation or winding-up[42].
- **Less** eligible dividends paid in the preceding taxation year (net of excessive eligible dividend designations)[43].

Subsequent years' losses that are carried back to a particular year, do not reduce that year's GRIP, but instead reduce GRIP at the end of the year in which the loss arises[44] (otherwise, the reduction of the prior year's GRIP could result in excessive eligible dividends)[45]. As stated previously, a CCPC may qualify for an addition to GRIP in respect of years prior to its 2006 taxation year, by virtue of subsection 89(7).

The following are the components of LRIP of a non-CCPC[46]:

- LRIP at the end of the preceding taxation year[47].
- **Add** ineligible dividends payable to the non-CCPC from a corporation resident in Canada[48].
- **Add** LRIP additions on ceasing to be a CCPC or in respect of an amalgamation or winding-up[49].
- **Add** 80% of investment income if the corporation would be a CCPC but for a change-of-status election[50].
- **Less** eligible dividends payable in the taxation year before the particular time[51] (net of excessive eligible dividend designations)[52].

Since the LRIP applies only to a non-CCPC, income eligible for the small business deduction does not specifically increase the LRIP account. Unlike GRIP, which is a year-end calculation, LRIP is a point-in-time calculation.

Some Planning Points

As mentioned previously, eligible dividends may have a fundamental impact on the decision as to whether to bonus or retain earnings at the corporate level; in addition, where possible, the eligible dividend regime may encourage the conversion from specified investment business income[53].

The following are some additional planning points:

1. RDTOH and Eligible Dividends

It is possible for a dividend to result in a dividend refund and be an eligible dividend at the same time. For a CCPC, the latter will occur if a dividend-paying corporation has GRIP balances.

This could be the case, for example, if a CCPC ("Holdco") holds the shares of both an investment corporation ("Investco"), i.e., that generates refundable dividend tax on hand ("RDTOH"), and a corporation which generates GRIP, e.g., from high-rate business income ("Opco"). Investco could pay dividends which would result in a dividend refund to it and Part IV tax/RDTOH increase to Holdco. If Opco pays eligible dividends, Holdco will have both RDTOH and GRIP so that "dual status" can be achieved. (This could be particularly advantageous in an estate freeze structure.)

It should be noted that if Holdco pays a "dual status" dividend, it would deplete both its RDTOH and GRIP, leaving surplus which if paid out as a dividend, may not be eligible for special status on either account, unless Holdco's RDTOH/GRIP were replenished.

The following is the descending order of preference of dividends:

- eligible dividends that trigger a dividend refund (i.e., a refund of RDTOH);
- ineligible dividends that trigger a dividend refund;
- eligible dividends that do not trigger a dividend refund;
- ineligible dividends that do not trigger a dividend refund.

2. Income Splitting

The general taxation of eligible dividends will make it possible to earn increased amounts of dividends without attracting tax. For an individual with no other income, this could be in excess of $65,000 per year (however at these levels, minimum tax in the $2,500 range would apply). Of course, "kiddie tax" is still potentially applicable.

3. Part IV Tax – Portfolio Dividends

The eligible dividend rules were designed to avoid becoming overly-complex. As a result, the rules do not deal with such things as having a lower Part IV tax rate for eligible dividends. As a result, a holding company which receives eligible dividends must pay refundable Part IV tax at the rate of $33^{1/3}$%, which would exceed the tax on eligible dividends to an individual shareholder. Accordingly, the holding company should, in turn, pay eligible dividends to its individual shareholders.

4. Safe Income Strips

If a corporation has taxed retained earnings ("safe income"), it is advantageous to pay to distribute this as a tax-free dividend to a holding company prior to sale of the company's shares. This will reduce capital gains tax to the holding company. Previously, the disadvantage would be that, if these safe income dividends were distributed to individual shareholders, the tax rate would be higher than the capital gain. However, if the safe income qualifies as an eligible dividend, this disadvantage may all but disappear.

5. Asset Sales

Eligible dividend status may alter the preferences in respect of whether assets or shares are sold. The sale of shares generates capital gains tax rates (about 25% at the corporate level and about 23% at the individual level, in Ontario). If there is a corporate-level sale of goodwill or other eligible capital property, the tax rate will be one-half of normal business rates, which is considerably less than the applicable capital gains rates (about 18% in Ontario). Like a capital gain, one-half of the gain in respect of the eligible dividend can be paid as a tax-free capital dividend. The taxable portion will typically generate GRIP and therefore can be paid out as eligible dividends. Until this is done – i.e., the profits are retained at the corporate level - taxes can be deferred, since they are based on one-half of the business rates. To the extent there is integration on eligible dividends, there will be no increase in the ultimate combined personal/corporate tax, relative to capital gains which generate refundable tax balances.

6. *Post-Mortem* Planning

The ability to pay eligible dividends may alter *post-mortem* estate planning strategies. Depending on the province, the taxation of eligible dividends may approximately equal or be less than applicable capital gains rates. Consider the following:

- If access to corporate-level cash and other assets is desired, prior to the eligible dividend regime, the most tax-efficient method would generally be the "pipeline" strategy, whereby the terminal period capital gain would bump the acb of the shares of the decedent's corporation, so that the increased cost base could be used to access corporate-level assets. (For example, the shares of the deceased's corporation could be transferred into a holdco in exchange for a note equal to the increased cost base; tax-free intercorporate dividends could be paid to the Holdco, which could pay down the note, again without tax.)

If, however, eligible dividends are taxed more favourably than capital gains, it may make more sense to effect a "subsection 164(6)-type" procedure, whereby a *post-mortem* deemed dividend/capital loss is created and the latter is applied to the terminal period gain.

- Subsection 164(6)-type procedures where there is a capital dividend account will become more efficient. For example, where there is non-grandfathered corporate-owned life insurance, death taxes can be minimized by the so-called "50% solution", which involves the repurchase of the decedent's corporation's shares held by the estate for a 50% capital dividend/50% taxable dividend[54]. Prior to the eligible dividend rules, the "50%" solution was, in reality, more like a "one-third solution", because of the relatively high tax rate attaching to non-eligible dividends. However, the tax rate on taxable dividends will be reduced to the extent that eligible dividends can be paid.

7. Ontario: Effect of the "Clawback"

Ontario has followed the federal proposals, and has announced specific details of its provincial dividend tax credit rates in respect of eligible dividends.[55] As stated previously, eligible dividends will encourage the retention of profits at the corporate level as opposed to paying out bonuses to owner-managers, by reducing the double tax ("underintegration") which occurs where the profits are eventually distributed as dividends. In Ontario, the degree of underintegration compared to a top-bracket taxpayer receiving the profits as a bonus will drop from nearly 6% in 2006 to just over 1% in 2011, when the federal corporate tax rate reductions and provincial eligible dividend proposals are fully phased-in.[56] (For corporations qualifying for the M&P rates, underintegration would disappear in 2010.)

However, the foregoing ignores the Ontario "clawback" of the provincial small business deduction, which may undermine this result, as it increases corporate tax by 4.67% between $400,000 and the clawback income ceiling (about $1.1M). The effect of the clawback is to increase corporate rates to about 40.8% in 2006, dropping to about 37.2% in 2011, compared to top personal rates of about 46.4%. Therefore, in the income zone where the clawback applies, the approximate deferral will drop from 10.3% to 5.6%, for 2006, and from 13.9% to about 9.2% in 2011, when the federal corporate rate decreases are phased-in. Where the clawback applies, underintegration is in excess of 9.2% in 2006, dropping to about 4.8% in 2011. As profit increases over the clawback ceiling, the foregoing will be less of a factor.

8. Other Effects of Eligible Dividends

Eligible dividends may increase exposure to minimum tax; as well, it may increase the OAS "clawback". Capital gains crystallizations may become more important since the retention of profits at the corporate level (rather than the payment of bonuses to owner/manger) may mean that the corporation's assets are no longer devoted to qualifying active business use, so that the exemption may be jeopardized in the future.

The eligible dividend regime may make it more important to effect estate freezes, because the increased retention of income at the corporate level value may well increase eventual exposure to death tax. The generation of GRIP will facilitate the redemption of freeze shares to freezor/surviving spouse, as well as *post-mortem* reorganizations after the deemed disposition occurs.

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[1] At time of writing, Nova Scotia and Newfoundland.

[2] In addition, if the corporation subsequently incurs tax losses, carrybacks (with the normal three year period) should be more tax effective, since corporate losses cannot shelter income bonused out to the owner-manager.

[3] See subsection 82(1) of the *Income Tax Act* (hereinafter the "Act").

[4] See section 121 of the Act.

[5] Or a "deposit insurance corporation", which will hereinafter be ignored in order to simplify discussion.

[6] The foregoing rules apply to deemed and actual dividends. A capital dividend cannot be an eligible dividend.

[7] Other than by filing a subsection 89(11) election.

[8] Or would have been absent an election under subsection 89(11).

[9] See Subsection 89(7).

[10] The "throwback" rule in proposed subsection 89(7) is based on a notional 37% rate whereas GRIP for years ending after 2005 is based on an assumed 32% rate.

[11] Similar rules apply to the 7% electrical energy and steam deduction.

[12] There appears to be a gap for dividends received prior to January 1, 2006 but after a corporation's 2005 year end. Paragraph 89(7)(c) allows dividends for taxation years ended before 2006, if reasonably attributable to subsection 89(7) GRIP. Otherwise, however, an eligible dividend can only be received after 2005.

[13] See subsection 89(14).

[14] The CRA indicated that, for 2006, it would accept designations based on identification of eligible dividends on the T3 and T5 slips. Other acceptable methods are posting a notice on the corporation's website, and in corporate reports or shareholder publications.

[15] The CRA also clarified that, if a corporation pays a dividend to a non-resident shareholder that would otherwise be an eligible dividend if paid to a resident shareholder, there is no impact on the eligibility of the dividends paid to other resident shareholders.

For further details in respect of notification of eligible dividend, including for public companies, see the release dated December 12, 2006 on the CRA's website (www.cra-arc.gc.ca)

[16] For dividends paid after 2006.

[17] Bill c-28.

[18] Except where the change of status is solely because an 89(11) election is made.

[19] I.e., immediately before the year end that occurs by virtue of the change of status.

[20] See subsections 89(4) and 89(8).

[21] In fact, there could be several deemed taxation years. For example, if there is a binding agreement of purchase and sale entered into with a non-resident or public company, this could trigger a year end (because of paragraph 251(5)(b)), and there would be another deemed year end on a change of control itself.

[22] However, subject to the possible application of anti-avoidance rules, this might not be the case if a "Holdco" is taken public rather than the Opco itself. For some observations on change of status and the potential application of the anti-avoidance provision in paragraph (c) of the "excessive eligible dividend designation" definition in subsection 89(1), see "Eligible Dividends, the Good, the Bad and the Ugly", David Louis, Tax Topics #1795, August 3, 2006.

[23] A subsection 89(11) election will not jeopardize the special addition under subsection 89(7).

[24] For provisions affected by the election, see paragraph (d) of the definition of "Canadian-controlled private corporation" in subsection 125(7).

[25] See subsection 89(12). There is no provision for acceptance of late-filed subsection 89(11) or (12) elections under “fairness rules”. After a revocation, a subsequent election requires the concurrence of the CRA.

[26] Elections may also be considered for holding companies.

[27] Holding company structures might also be used to reduce the adverse effects of LRIP accounts, subject to the possible application of anti-avoidance provisions – see “Excessive Eligible Dividends”.

[28] This term is defined in subsection 89(1) of the Act.

[29] Based on the eligible dividend relative to the total eligible dividends paid at the time.

[30] Per subsection 185.2(1), every Canadian-resident corporation that pays a taxable dividend (other than a capital gains dividend) must file a Part III.1 return containing an estimate of Part III.1 tax payable.

[31] For dividends paid before the legislation received Royal Assent, the deadline is thirty months after Royal Assent is received.

[32] Shareholder consent is not necessary if all affected shareholders are exempt and the election is made within 30 months after the payment of the excess dividend.

[33] In subsection 89(1) of the Act.

[34] See proposed subsections 185.2(3)-(5). While section 160 of the Act might also be applicable, Part III.1 includes specific rules as to the extent of the joint and several liability and the effect of payments by the shareholder and/or the corporation. For example, while section 160 would extend joint and several liability to the extent of the property transferred, subsection 185.2(3) imposes Part III.1 liability based on proportionate dividends received.

[35] These terms are defined in subsection 89(1) of the Act.

[36] GRIP can be a positive or negative amount.

[37] Variable C of the GRIP definition.

[38] Variable D of the GRIP definition.

[39] Variable E of the GRIP definition.

[40] Variable F of the GRIP definition.

[41] Variable G of the GRIP definition. Besides, exempt surplus, dividends deductible under section 113 would also include offsets to taxable surplus inclusions and dividends from pre-acquisition surplus.

[42] Variable H of the GRIP definition.

[43] Variable I of the GRIP definition.

[44] See variable B of the GRIP definition.

[45] It is the carryback of a loss that reduces the corporation’s GRIP.

[46] LRIP is determined at any time in a taxation year; GRIP is calculated at year end.

[47] Variable A of the LRIP definition.

[48] Variable B of the LRIP definition.

[49] Variable C of the LRIP definition.

[50] Variable D of the LRIP definition.

[51] Variable G of the LRIP definition.

[52] Variable H of the LRIP definition.

[53] Particularly where the corporation can meet the more-than-five-full-time-employee test.

[54]The stop-loss rules in subsection 112(3.2) may “force” taxable dividends of magnitude equal to capital dividends; otherwise part or all of the loss will be denied.

[55] The provincial dividend tax credit is to be phased-in as follows:

Year 2006 2007 2008 2009 2010
Dividend tax credit 6.5% 6.7% 7.0% 7.4% 7.7%

The rates are a percentage of the grossed-up dividend. By comparison, the Ontario dividend tax credit for an ineligible dividend is 5.13%.

[56]This ignores Employee Health Tax, which would virtually eliminate underintegration.