Eligible Dividends

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Introduction

- GRIP
- LRIP
- Compliance Issues
- Some Planning You Might See

Eligible Dividend Rules

- Problem – disparity between total tax paid by public corporations and their shareholders compared to that paid by income trusts (nil!) and their unitholders
- Solution – reduce the federal income tax imposed on 'eligible dividends' paid to individuals

Eligible Dividend Rules

- SIFT rules → reduce gross-up and dividend tax credit (DTC)? Eliminate eligible dividends?
- The 2009 Budget significantly changed the rates for dividends
- For ineligible dividends, the top rate is 31.34% in 2009 and will be 32.57% after 2009

Eligible Dividend Rates

Year	Top rate
2009	23.06%
2010	26.57%
2011	28.19%
>2011	29.54%

Integration

- Complex calculation that will change as dividend rates and corporate tax rates change
- In 2009, $500M of ABI eligible for SBD paid as bonus incurs 48.04% of tax overall (includes EHT) but if that same income is paid as dividend, the overall rate is only 42.66%.

Integration

- $1MM of ABI not eligible for any SBD: bonus 47.72%; dividend 51.72%
- $500M of ABI eligible for Ontario but not federal SBD: bonus 47.88%; dividend 42.53%
- Years-to-defer calculation wrong? See paper by Gabriel Baron, Canadian Tax Foundation 2009 Ontario Conference

Legislation

- Corporation’s ability to pay eligible dividends
  - “GRIP”
  - “LRIP”
- Must designate eligible dividends
- Penalties for excess designations
- Complex rules for reorganizations

Eligible dividends

- "Eligible dividend"
  - taxable dividend
  - received by a person resident in Canada
  - paid after 2005
  - paid by corporation resident in Canada
  - designated as eligible per 89(14)

Excess designation

- Corporation must pay penalty tax on excess eligible dividends
- Excess dividend
  - For CCPC: Total eligible dividends in the year exceeds GRIP
  - Non-CCPC: Any eligible dividend paid when there is LRIP
- Excess designation for CCPC is pro-rated across all eligible dividends paid in a year

Excess designation

- Entire dividend will be excess

"if it is reasonable to consider that the 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 to artificially maintain or decrease the corporation's [LRIP]"

LRIP

- LRIP = low rate income pool
- Income earned by a non-CCPC that has been subject to tax at less than the full corporate rate
- Point-in-time calculation, like safe income. Must compute LRIP before paying an eligible dividend

GRIP

- GRIP = general rate income pool
- Income earned by a CCPC that has been subject to tax at the full corporate rate
- End-of-the-year calculation
- GRIP = A – B

GRIP (for CCPCs)

- A = C + D + E + F – G
- C is GRIP at previous year-end
- D is the product of the “rate factor” and “adjusted taxable income” for the year (ie taxable income less the total of investment income and active business income for which SBD claimed)

GRIP (for CCPCs)

- E is the total of dividends received that were eligible dividends or dividends from foreign affiliates
- F is an adjustment amount for reorgs
- G is an adjustment for excess dividends paid in the previous year

GRIP (for CCPCs)

- B (remember B?) is supposed to account for losses or other carrybacks (“specified future tax consequences”) deducted in prior years

GRIP (for CCPCs)

- A in the formula can be a positive or negative amount
- The result of A minus B can be positive or negative

Compliance – Notification

- How to designate a dividend?
- 89(14): "by notifying in writing *at that time* each person or partnership to whom it pays all or any part of the dividend that the dividend is an eligible dividend" [emphasis added]

Compliance - Notification

- Must notify before or at the time the dividend is paid using an ‘acceptable method’ (CRA technical 2006-0217891Z0)
- Notice must specify a dollar amount (2008-030031C6)
- Cannot use T5 slip as notice

Compliance - Notification

- ‘Acceptable methods’:
  - letter to shareholders
  - notation on dividend cheque stubs, or
  - where all shareholders are directors of the company, a notation in the minutes (or obtaining signatures in the minutes from all shareholders even if not all directors)

Compliance

- Must notify *all* shareholders including non-residents (but, perversely, an eligible dividend rec'd by a non-resident does *not* reduce GRIP – see 2008-0284951C6)
- Per CRA, a designation cannot be made on part of a dividend
- Designation must apply to all shareholders of a particular class of shares

Compliance - Excess Divs

- A corporation is liable to a special tax for paying excess eligible dividends
- Part III.1 tax of 20% of the excess amount
- If GRIP/LRIP is artificially manipulated then additional Part III.1 tax of 10% (total 30%) applicable

Compliance - Excess Divs

- Curing provision – similar to excessive CDA election
  - Elect within 90 days of Part III.1 reassessment
  - Treats one dividend as two, one eligible and the other non-eligible
  - Part III.1 does not apply to “elected amount”
  - Shareholders deemed to receive ordinary dividends (for elected amount)

Compliance - Excess Divs

- *No cure* for excess dividends subject to 30% penalty
- A non-arm's length shareholder who receives an excessive eligible dividend is jointly liable with the corporation for Part III.1 tax

Planning

- Ordering of dividends
- GRIP Strips
- Bonus vs. No Bonus
- Shareholder Agreements

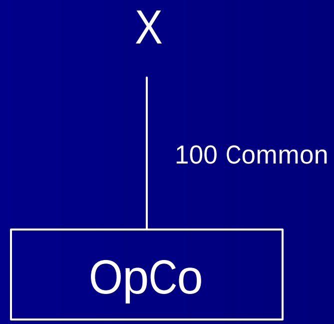
Ordering

CCPC with positive GRIP and RDTOH:

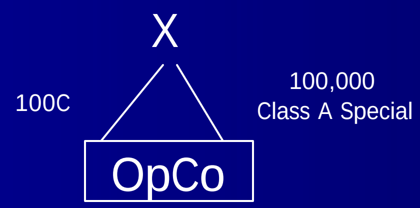
1. Eligible dividends triggering RDTOH;
2. Ineligible dividends triggering RDTOH;
3. Eligible dividends not triggering a dividend refund;
4. Ineligible dividends not triggering a dividend refund.

“GRIP Strip”

(i)



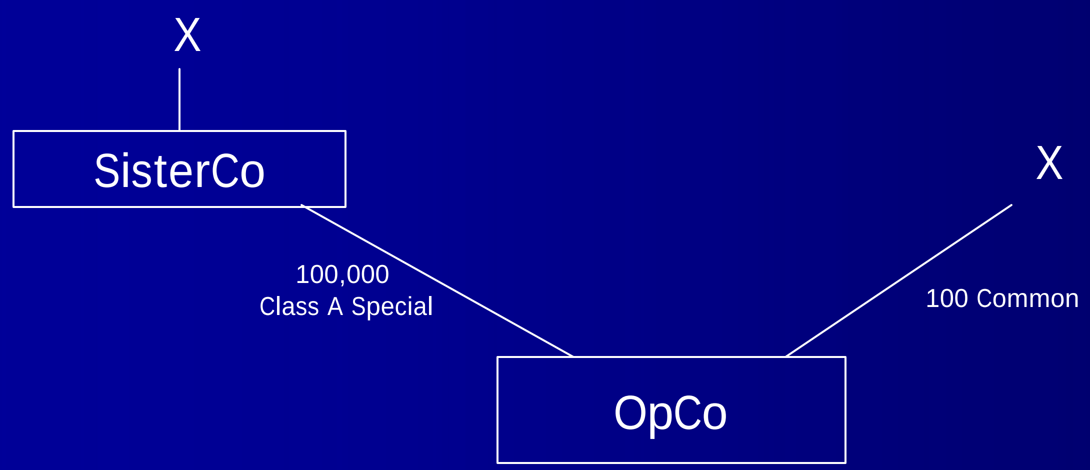
(ii)



- OpCo – 100,000 excess cash
- OpCo declares dividend satisfied by stock – (Hi-Lo shares) equal to amount of excess cash
- Amount of dividend $100 to X (taxable), however, fair market value of 100,000 Class A Special Shares $100,000

“GRIP Strip”

(iii)



- X creates SisterCo
- X transfers 100,000 Class A Special to Sisterco – s. 85 election
- OpCo redeems 100,000 Class A Spcial designates 84(3) dividend as “eligible dividend”

"GRIP Strip"

(iv)

- Preserves $100,000 GRIP in SisterCo;
- Purifies OpCo – QSBC definition (but beware 55(2))
- Creditor Proofing – OpCo
- If OpCo subsequently suffers a loss – no effect on GRIP in SisterCo (GRIP preserved and parked)
- BUT should pay GRIP sooner than later given increasing rates