

Financial Planning Quick Tip

March 10, 2004

SUBJECT: DIVIDEND INCOME – DIFFERENT TAX TREATMENTS

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Dividend income received by an individual Canadian resident is subject to different Canadian tax treatments depending on the type of dividend. The following are the different types of dividends and their tax treatments.

Taxable Canadian Dividends:

Dividends received from a Canadian corporation are grossed up by 25% to arrive at the taxable amount. The taxable amount is subject to a dividend tax credit which reduces the amount of taxes payable on the dividend. The dividend tax credit results in a preferential tax treatment for Canadian dividends. An individual with no other source of income may be able to receive Canadian dividends and not have a tax liability as a result of applying the dividend tax credit and basic personal tax credit. For more information on receiving a tax free dividend, please ask your advisor for the Financial Planning Quick Tip “Taxation of Canadian Source Dividends”.

Foreign Dividends:

Foreign dividends are not subject to the gross up and dividend tax credit treatment. The amount of the foreign dividends converted into Canadian dollars is added to income and taxed at the individual’s marginal rate of tax in exactly the same way that interest is taxed. Foreign dividends received as a result of a foreign spin-off may be non-taxable if certain criteria are met and elections by the investor and the foreign corporation are filed and accepted by CCRA. For more information on foreign dividends, please ask your advisor for the publication “Tax Implications of Investing In the United States”.

Capital Gains Dividends:

Capital gains dividends are usually paid by a Mutual Fund Corporation, an Investment Corporation or a Mortgage Investment Corporation. The capital gains dividends represent a distribution out of the corporation’s pool of realized capital gains. The capital gains dividends are not actual dividends and are not subject to the dividend tax credit. Rather the amount represents capital gains and is subject to the capital gains inclusion rate (currently 50%).

Capital Dividends:

A capital dividend is a tax free dividend received from a private corporation. The capital dividend is paid out of the corporation’s Capital Dividend Account (CDA). In general, the CDA accumulates the nontaxable portion of capital gains less non-taxable portion of capital losses plus proceeds from certain life insurance policies less the ACB of the policy. A positive balance in a CDA represents an amount that may be paid tax free to the shareholder of the private corporation.

Stock Dividends:

Stock dividends result in a dividend equal to the investor's share of the increase in the paid-up capital of the corporation resulting from the payment of the stock dividend. This amount is usually indicated on the T5 issued to the investor. The deemed dividend is grossed up by 25% and is subject to the dividend tax credit treatment if received from a Canadian corporation. Foreign stock dividends are not subject to the dividend tax credit.

Stock dividends accomplished by issuing a stock split:

A stock split is usually not taxable to the investor. However, some stock splits are accomplished by issuing stock dividends. The tax treatment of stock splits achieved through the use of stock dividends is often the same as a regular stock split. However, under certain circumstances, the stock dividends used to achieve a stock split may result in a dividend. For more information on stock splits in the form of stock dividends, please ask your advisor for the article titled "Stock Dividends that Look Like Stock Splits".

If you have any questions or require clarification of any of the issues discussed in this document, do not hesitate to discuss these with your advisor.

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