

*Corporate Commercial Law Seminar:  
Practical Advice for Business Lawyers*

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# Eligible Dividends

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## **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

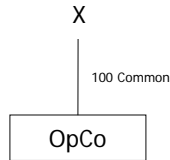
## Ordering

CCPC with positive GRIP and RDTOH:

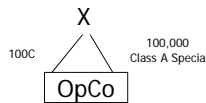
1. Eligible dividends triggering RDTOH;
2. Ineligible dividends triggering RDTOH;
3. Eligible dividends not triggering a dividend refund;
4. Ineligible dividends not triggering a dividend refund.

## "GRIP Strip"

(i)



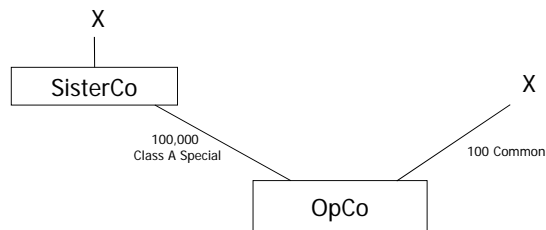
(ii)



- 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"

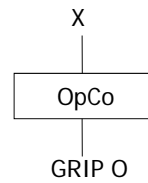
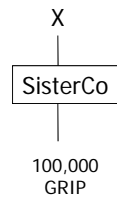
(iii)



- X creates SisterCo
- X transfers 100,000 Class A Special to Sisterco – s. 85 election
- OpCo redeems 100,000 Class A Special 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