

TAX GUIDE

DIVIDEND





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CHAPTER ONE:

COMPREHENSIVE GUIDE TO DIVIDEND TAXES IN CANADA

Most investors know that dividends are a part of taxable income in Canada. The dividend amount is established by the company's board of directors, and if there are profits allocated for shareholders, they are disbursed on a quarterly basis. The dividends you receive are contingent upon the number of shares you possess and the company's revenue. When you receive your dividends, they can be provided either as cash or in the form of additional stock. If you receive dividends in cash, you will be obligated to pay taxes on that income.

Dividend income is commonly generated through the ownership of shares in publicly traded corporations that distribute a portion of their earnings to their stockholders. Typically, it is only the more substantial and established companies that engage in dividend payouts as a means of distributing profits to their investors. Conversely, newer and growing enterprises tend to reinvest their earnings in their expansion efforts.



Types of dividends

There are two types of dividends – eligible and non-eligible.

- **Eligible dividends**

Eligible dividends are a specific type of dividend income in Canada that receives preferential tax treatment. They are typically distributed by Canadian corporations that have met certain criteria and have paid taxes at the general corporate tax rate. Here are some key points about eligible dividends –

- **Source:** Eligible dividends are usually paid out by Canadian public corporations or private corporations that meet specific requirements related to their tax status and income.
- **Tax Advantage:** One of the primary advantages of eligible dividends is the lower tax rate applied to them for individual shareholders. The tax rate on eligible dividends is typically lower than the rate applied to other forms of income, such as interest or employment income.
- **Enhanced Dividend Tax Credit:** To encourage investment in Canadian corporations and stimulate economic growth, the Canadian government provides an enhanced dividend tax credit for eligible dividends. This credit reduces the amount of taxes owed by individual shareholders, effectively reducing their overall tax liability.



- **Corporate Tax Criteria:** For a corporation's dividends to be considered eligible, the corporation must pay taxes at the general corporate tax rate. This means that they haven't benefited from certain tax deductions or preferential tax rates.
- **Reporting:** Eligible dividends are reported separately on an individual's tax return, and the tax credit associated with them is used to offset the individual's tax liability.

- **Non-eligible dividends**

Non-eligible dividends, also known as "other than eligible dividends" in Canada, are a type of dividend income that does not receive the same preferential tax treatment as eligible dividends. Here are some key points about non-eligible dividends that you should know –

- **Source:** Non-eligible dividends are typically paid out by Canadian corporations that have not met the specific criteria for eligible dividends. These criteria are related to the corporation's tax status and income.
- **Tax Treatment:** Non-eligible dividends are subject to a higher tax rate for individual shareholders compared to eligible dividends. This means that individuals who receive non-eligible dividends will generally pay more in taxes on this income.
- **Corporate Tax Criteria:** To be considered eligible dividends, a corporation must pay taxes at the general corporate tax rate and meet other specific requirements. Non-eligible dividends are paid by corporations that may have taken advantage of certain tax deductions or enjoyed preferential tax rates.
- **Reporting:** Non-eligible dividends are reported separately on an individual's tax return, and they are taxed at the applicable tax rate for non-eligible dividends.
- **Purpose:** The Canadian tax system differentiates between eligible and non-eligible dividends to encourage investment in corporations that meet certain tax and income criteria. The preferential tax treatment of eligible dividends is designed to promote investment in Canadian businesses that have paid taxes at the general corporate tax rate.
- **Impact on Shareholders:** Shareholders who receive non-eligible dividends may have a higher tax liability compared to those receiving eligible dividends, as they are subject to a higher tax rate.

What are foreign dividends?

Apart from these two main types of dividends, there is a third type which is quite important but is overlooked a lot of times. Those are foreign dividends.

Foreign dividends are dividends paid by companies that are located in a foreign country or are not incorporated in the recipient's home country. When individuals or entities invest in foreign companies and receive a share of those companies' profits, they may receive foreign dividends. Here are some key points about foreign dividends-

- **Source:** Foreign dividends originate from companies that are incorporated and operate in a foreign country. These companies could be publicly traded or private.
- **Currency:** Foreign dividends are typically paid in the currency of the foreign country where the company is based. This means that recipients of foreign dividends may need to deal with currency exchange when converting the income to their home currency.
- **Taxation:** Tax treatment of foreign dividends can vary significantly depending on the tax laws of both the recipient's home country and the country where the dividend-paying company is located. Some countries have tax treaties in place to mitigate double taxation.
- **Withholding Tax:** Many countries impose a withholding tax on foreign dividends paid to non-resident investors. The withholding tax rate can vary from country to country and may be reduced if there is a tax treaty in place between the two countries.
- **Reporting:** Individuals or entities receiving foreign dividends are often required to report this income to their tax authorities in their home country. Compliance with tax reporting requirements is essential to avoid potential penalties.
- **Investment Diversification:** Foreign dividends can be a way for investors to diversify their investment portfolios by gaining exposure to companies in different countries and industries.
- **Risk:** Investing in foreign companies and receiving foreign dividends can come with additional risks, including currency risk, political risk, and regulatory risk.
- **Legal and Regulatory Considerations:** It's important for investors to understand the legal and regulatory requirements related to investing in foreign companies and receiving foreign dividends. This may include compliance with foreign investment laws and regulations.
- **Tax Credits and Deductions:** Some countries provide tax credits or deductions to offset taxes paid on foreign dividends. These provisions can vary widely, so it's essential to consult with tax professionals or experts familiar with the tax laws in both the home country and the foreign country.

Is dividend income taxable in Canada?

If your shares are held in a non-registered (taxable) account, dividends will be liable to taxation in the year you receive them. (Registered accounts such as RRSPs and TFSAs have different tax rules, which will be discussed below.) Fortunately, Canadian residents receiving dividends from Canadian companies benefit from a unique provision known as the dividend tax credit.

Conversely, dividends received from foreign corporations are subject to taxation at your highest marginal tax rate. Additionally, many countries impose a withholding tax on dividends paid to foreign investors, with the 15% foreign withholding tax on U.S. dividends being one of the most notable examples.

When are dividends paid out in Canada?

In Canada, the typical dividend distribution schedule for most corporations, whether they issue eligible or non-eligible dividends, is on a quarterly basis. However, Real Estate Investment Trusts (REITs) follow a distinct pattern, as they distribute dividends on a monthly basis.



Real Estate Investment Trusts (REITs) in Canada are investment vehicles that specialize in owning, operating, and often financing income-generating real estate properties. They are designed to provide investors with an opportunity to invest in a diversified portfolio of real estate assets without having to purchase and manage properties themselves.

Although payments from REITs are technically categorized as dividends, they are more accurately referred to as "distributions." This terminology reflects the fact that these payments can consist of various components, such as capital gains, dividends, return of capital, or other forms of income. It's important to note that each of these components is subject to different tax rates. This complexity often leads individuals to opt for investing their REIT earnings in registered accounts, a strategy that simplifies the taxation process and provides some tax advantages.

What is dividend tax credit?

A dividend tax credit is a tax incentive provided by some governments, including Canada, to encourage individuals to invest in stocks or shares of corporations. In the context of Canada, the dividend tax credit is designed to reduce the overall tax liability of individuals who receive eligible dividends from Canadian corporations.

As of 2018, eligible dividends received by an individual from Canadian corporations undergo a "gross-up" of 38%. To be officially classified as eligible dividends, the company distributing the dividend must designate them as such. In the case of non-eligible dividends as of 2019, the gross-up rate is 15%. Think of a gross-up as an adjustment to account for the relevant taxes that apply.

Provincial dividend tax credit

When claiming dividends in Canada, your eligibility for additional dividend tax credits is contingent on your province of residence and the year in which you received the dividend. Below are the 2023 rates for reference.

Province	Dividend tax credit
British Columbia	Eligible – 12% Non-eligible – 1.965
Alberta	Eligible – 8.12% Non-eligible – 2.18%
Saskatchewan	Eligible – 11% Non-eligible – 2.105%
Manitoba	Eligible – 8% Non-eligible – 0.7835%
New Brunswick	Eligible – 14% Non-eligible – 2.75%
Newfoundland	Eligible – 6.3% Non-eligible – 3.2%
Nunavut	Eligible – 5.51% Non-eligible – 2.61%

Ontario	Eligible – 10% Non-eligible –2.9863%
PEI	Eligible – 10.5% Non-eligible – 1.3%
Quebec	Eligible – 11.7% Non-eligible –3.42%
Yukon	Eligible – 12.02% Non-eligible –0.67%

Can dividends be tax free?

Yes, dividends can be tax free. But it depends on certain factors. Primarily it depends whether dividends are your only form of income or not. If yes, and you are an individual with no other form of income you can receive up to \$65,061 in eligible dividends before becoming liable for federal taxes. Nonetheless, it's worth noting that once your eligible dividend income reaches \$54,403, an alternative minimum tax (AMT) comes into play. The specific thresholds for provincial taxes differ.

Regarding non-eligible dividends, if they comprise your exclusive income source, you can earn up to \$31,361 before federal taxes become applicable. These conditions apply solely when dividends are your solitary income stream. Provincial tax thresholds vary, and non-eligible dividends do not incur AMTs.

Receiving dividends in Canada

In Canada, dividends are subject to the lowest tax rates among various types of investment income. The frequency of income receipt, whether it's monthly or less frequent, depends on your choice of investment and whether dividends constitute your exclusive income source or if you have other sources of income. The tax implications can vary significantly based on these factors.

It's important to note that while some dividends are non-taxable, many of them come in the form of mutual funds or other securities, and they may not provide the same tangible value as standard eligible and non-eligible dividends. Although both types of dividends enjoy lower taxation compared to other investments, eligible dividends typically incur the lowest tax liability.



CHAPTER TWO:

WHAT IS ELIGIBLE DIVIDEND IN CANADA?

In the previous chapter we understood all the details about dividends and how do they work in Canada. In this chapter we will discuss in details about eligible dividends. Dividends represent the distributions made to investors from a company's profits. Among these dividends, some are categorized as eligible, while others are termed ordinary or ineligible dividends.

There are two types of dividends – eligible and non-eligible. An eligible dividend is essentially a dividend that a corporation designates as eligible. The category of dividends you obtain can affect your tax return.

A corporation can classify a dividend as eligible by providing written notification to each recipient of the dividend, enabling individuals to claim the corresponding gross-up and DTC benefits. In cases where a corporation has numerous shareholders, like a publicly traded company, it can communicate the eligible dividend status through its website or a press release.



GRIP Accounts

The General Rate Income Pool (GRIP) is a concept in Canadian tax law. It is a notional account that corporations use to keep track of certain investment income, such as eligible dividends received from other Canadian corporations. The purpose of GRIP is to help corporations allocate dividends to their shareholders in a tax-efficient manner. The GRIP balance represents the amount of eligible dividends a corporation has received and retained, on which it has already paid corporate income tax.

When a corporation pays dividends to its shareholders, it can use the GRIP balance to pay out eligible dividends to its shareholders. These eligible dividends are generally taxed at a lower rate in the hands of the shareholders compared to other forms of income. In short, the General Rate Income Pool (GRIP) allows Canadian corporations to distribute eligible dividends to their shareholders in a tax-efficient manner by utilizing the balance of eligible dividends they have received and retained. This helps minimize the overall tax liability for both the corporation and its shareholders.

Notification requirements

A corporation is obligated to inform you of its intention to distribute eligible dividends. This notification can take various forms, such as a written letter or a cheque stub explicitly designating the dividend as eligible. Some public corporations consider all their dividends as eligible unless stated otherwise, which is an acceptable notification method. Additionally, the Canada Revenue Agency (CRA) recognizes other notification methods, including posting information on the corporation's website, including details in quarterly or annual reports, and communicating through shareholder newsletters or other publications.

Ideally corporations should be issuing T5 slips to their shareholders which should be included in their tax return. The information from the T5 slip will help individuals while they are filing their taxes.

Gross-ups and dividend income

Both eligible and ineligible dividends require you to include a gross-up rate on your tax return. A gross-up represents an extra amount added to compensate for taxes. As of 2013, the gross-up rate for eligible dividends stands at 38 percent.

Impact of eligible dividends on tax return

Eligible dividends can have a significant impact on your tax return in Canada, typically in a favorable way. Here's how eligible dividends can affect your tax return –

- **Lower Tax Rates:** Eligible dividends are subject to lower tax rates compared to other types of income, such as interest or employment income. These lower tax rates are designed to encourage investment in Canadian corporations and can result in a reduced tax liability.
- **Dividend Tax Credit (DTC):** When you receive eligible dividends, you are eligible for the dividend tax credit (DTC). The DTC is a non-refundable tax credit that further reduces the amount of tax you owe on your dividend income. The credit is calculated based on the grossed-up amount of the dividend income.
- **Gross-Up and Tax Credit:** When you report eligible dividends on your tax return, you first include a grossed-up amount, which is higher than the actual dividend you received. The tax credit is then applied to this grossed-up amount. While this may appear as a higher income on your return, the tax credit effectively offsets a portion of the tax owed, resulting in a lower overall tax liability.
- **Income Splitting:** Eligible dividends can be an effective way to split income with a spouse or common-law partner. If your spouse or partner is in a lower tax bracket, they may pay less tax on eligible dividends received, leading to overall tax savings for your household.
- **Overall Tax Planning:** Incorporating eligible dividends into your overall tax planning strategy can help you reduce your tax burden. You can optimize your investments to take advantage of the favorable tax treatment of eligible dividends, potentially resulting in significant tax savings.





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