

Tax Free Dividends?

Impossible, you say! Well, believe it or not, for an individual without any other taxable income it is possible to receive approximately \$29,284 in dividends from Canadian public companies without having to pay any income tax at all.

Why is This Possible?

There are four distinct tax principles that when put together, make it possible to receive tax-free dividend income. They are:

- ⊘ An individual in the lowest tax bracket only has to pay 16% federal tax on their first \$32,183 in income.
- ⊘ Dividends received from a Canadian corporation must be grossed up by 25% when reported on your Canadian tax return.
- ⊘ Individuals receiving Canadian dividend income are eligible for a dividend tax credit equal to 13.33 % of the grossed-up dividend which helps to reduce the amount of federal tax that would otherwise be payable on that income.
- ⊘ Every individual has access to a basic personal tax credit which eliminates the federal tax payable on the first \$7,756 of income.

How Much Tax is Due?

For purposes of our illustration, let's assume that an individual receives Canadian dividend income totaling \$29,284 and no other taxable income. The grossed-up dividend (otherwise known as the taxable dividend) would therefore equal \$36,605 ($\$29,284 \times 1.25$). The dividend tax credit in this example is \$4,881 ($\$36,605 \times 13.33\%$). Also for the year 2003, the basic personal tax credit is equal to 16% of \$7,756 or \$1,241.

Below is an example that will help illustrate how these various tax provisions work together.

Using a Taxable Dividend (Grossed-Up) of \$36,605:

Federal Tax on the first \$32,183 (16% x \$32,183)	\$5,149
Federal Tax on the next \$4,422 (22% x \$4,422)	\$973
Total Federal Tax Owing	\$6,122
Less: Federal Dividend Tax Credit (13.33% x Grossed-up amount)	\$4,881
Net Federal Tax Owing on Dividend Income	\$1,241

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Less: Basic Personal Tax Credit (16% x \$7,756)	\$1,241
Total Federal Tax Owing	\$ (0)

It is important to understand that the tax-free income is the result of both the dividend tax credit and the basic personal tax credit. Without either one of these, receiving \$29,260 of Canadian dividends tax-free, would not be possible.

The amount of taxable dividend that can be earned tax-free varies by province.

The following table shows each province's dividend tax credit rates. The rates indicated in the table are applied to the grossed-up dividend.

Alberta	6.4%
British Columbia	6.6%
Manitoba	6.0%
New Brunswick	3.7%
Newfoundland	5.0%
Nova Scotia	7.7%
Ontario	5.13%
Prince Edward Island	7.7%
Quebec	10.83%
Saskatchewan	8.0%

The following is an example of the Ontario provincial tax calculation on dividends of \$29,430.

Using a Grossed-up (Taxable) Dividend of \$36,788:

Provincial Tax on the first \$32,435 (6.05% x \$32,435)	\$1,962
Provincial Tax on the next \$4,353 (9.15% x \$4,353)	\$398
Total Provincial Tax Owing	\$2,360
Less: Provincial Dividend Tax Credit (5.13% x Grossed-up amount)	\$1,887
Net Provincial Tax Owing on Dividend Income	\$473
Less: Basic Personal Tax Credit (6.05% x \$7,817)	\$473
Total Provincial Tax Owing	\$ (0)

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Summary

For individuals with no other taxable income, it can be a wise investment decision from a tax perspective to hold investments in dividend paying Canadian companies. However, the trade-off between the appropriateness of the investment (risk, etc.) and the tax benefits must always be considered before structuring a portfolio tailored to meet an individual's needs.

Note: The above article is for information purposes only and should not be construed as offering tax advice. Individuals should consult with their personal tax advisors before taking any action based upon the information in this article.

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