

*In the 2006 Federal budget, a new type of Canadian dividends was introduced: eligible dividends. Effective January 2006, Canadian investors may be in receipt of both eligible dividends and non-eligible dividends (similar to Canadian dividends received prior to 2006).*

It's important for physicians to be aware of the potential tax implications resulting from the changes and how they may affect their investments or even their professional corporations.

#### **Non-eligible dividend tax credit**

When a Canadian corporation pays out non-eligible dividend income to an individual resident in Canada, the amount is "grossed up" by 25% and recorded as taxable income. Individual investors are then allowed to claim a federal tax credit of 13.33% and a provincial tax credit of about 6% (depending on the province) of the grossed-up dividend amount on their personal tax return. The 2007 top combined federal/provincial marginal tax rate on non-eligible dividends ranges between 25% and 37% (depending on the province).

#### **New enhanced dividend tax credit**

Eligible dividends paid to individuals resident in Canada will be grossed up by 45% and the federal tax credit will increase to 18.97%. Eligible dividends will generally include dividends paid by Canadian corporations from income taxed at the general corporate income tax rate. The 2007 top combined federal/provincial marginal tax rate on eligible dividends ranges between 17% and 33% (depending on the province). Canadian dividends, other than eligible dividends, will continue to be grossed-up by 25% and will be subject to the non-eligible dividend tax credit (as indicated above).

The net effect of the enhanced dividend tax credit is that, in some provinces, eligible dividend income earned by individuals will

be more favourably taxed than capital gains.

#### **Impact on professional corporations**

Canadian Controlled Private Corporations (CCPC), as are most professional corporations, are now required to track the income from which they can pay eligible dividends. This income will be tracked in a new notional account referred to as the General Rate Income Pool (GRIP). Basically, the GRIP will track the corporation's income that was taxed at the general corporate rate (as opposed to the small business tax rate) and will also include eligible dividend income received by the corporation. Overall, a professional corporation will only be able to pay eligible dividends from its GRIP account. Eligible dividends paid after February 21, 2007

must be designated as eligible at the time the dividend is paid.

Clearly, the eligible dividend rules may create some additional administrative work for owners of professional corporations, however, they also create some interesting planning opportunities. For example, the introduction of eligible dividends may reduce the need for professional corporations to pay out bonuses in order to reduce taxable income to the \$400,000 federal small business limit. Eligible dividends may also create new tax deferral and income splitting opportunities for incorporated physicians operating in partnerships, with respect to corporate income taxed at the general corporate rate.

In addition, the legislation includes several other related measures including transitional rules, anti-avoidance rules, certain elections that may allow for other tax planning opportunities, and a different set of rules for non-CCPC corporations. Physicians should discuss the above issues with their tax advisor.

#### **What do you need to know about eligible dividends?**

Generally, professional corporations may pay eligible dividends to the extent of their GRIP account, which essentially tracks the corporation's income taxed at the general rate.

Eligible dividend income earned within your professional

corporation will be added to the corporation's GRIP account. While your MD representative can discuss how these changes may impact your personal and corporate investment accounts, the corporation's GRIP account should be calculated by your tax advisor.

**Contact your MD representative if you have any questions about the enhanced dividend tax credit.**

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