TD Wealth

Canadian Eligible Dividends:
Generating Income and Tax Efficiency

Investors may choose dividend-paying investments for a variety of reasons, including asset diversification and steady income creation. However, for Canadian resident investors, there are also potential tax efficiencies from receiving "eligible dividends" from Canadian public corporations (i.e., companies traded on a Canadian stock exchange). These dividends, which can also be paid from Canadian-controlled private corporations (CCPCs), offer more favourable tax rates when compared to interest income when received through a non-registered account.

Tax-efficient investment income

Eligible dividends received by Canadian resident investors from Canadian public corporations and CCPCs receive favourable tax treatment as these dividends are paid with after-tax corporate funds (i.e., corporate tax has already been paid on the funds).

Table 1 shows the combined federal/provincial marginal tax rates on interest, capital gains, and eligible dividend income for an investor who is at the top marginal tax rate.

As you can see, the tax rates applied to interest income are higher than those on eligible dividends, nearly twice as high in some cases, for an investor at the top tax rate.

The "interest equivalent factor" column in Table 1 provides the rate of equivalent interest that a top tax-rate investor must earn to equal those received from eligible dividends on an after-tax basis.

Table 1 – 2018 Top Combined Federal/Provincial Tax Rates on Investment Income

	Interest	Capital Gains	Eligible Dividends	Interest Equivalent Factor
AB	48.00%	24.00%	31.71%	1.31
BC	49.80%	24.90%	34.20%	1.31
MB	50.40%	25.20%	37.79%	1.25
NB	53.30%	26.65%	33.51%	1.42
NL	51.30%	25.65%	42.62%	1.18
NT	47.05%	23.53%	28.33%	1.35
NS	54.00%	27.00%	41.58%	1.27
NU	44.50%	22.25%	33.08%	1.21
ON	53.53%	26.76%	39.34%	1.31
PE	51.37%	25.69%	34.23%	1.35
QC	53.31%	26.65%	39.83%	1.29
SK	47.50%	23.75%	29.64%	1.34
YK	48.00%	24.00%	28.93%	1.37

Table produced by: TD Wealth. Table reflects tax rates in effect as of January 1, 2018.

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Potential benefits for investors with little to no taxable income

Eligible dividend income can also be tax efficient for investors with low taxable income. As a result of the “gross-up” and “dividend tax credit” mechanisms associated with Canadian-based dividend income, Canadian resident investors in many provinces and territories with little or no other income can earn over $50,000 of eligible dividend income before they are subject to Canadian tax, when the investment is held in a non-registered, and therefore taxable, account.

Table 2 shows the maximum amount of eligible dividend income an investor with no other income may earn in 2018 before they have to pay tax on the eligible dividend income received.

Table 2 – Maximum tax-free eligible dividend income assuming no other income – 2018

Province/Territory	Actual $ Amount
Alberta	$51,810
British Columbia	$51,810
Manitoba	$24,935
New Brunswick	$51,810
Newfoundland & Labrador	$17,675
Northwest Territories	$51,810
Nova Scotia	$32,410
Nunavut	$51,810
Ontario	$51,810
PEI	$45,660
Quebec	$39,405
Saskatchewan	$51,810
Yukon	$51,810

Table produced by: TD Wealth. Table reflects tax rates in effect as of January 1, 2018. Tax calculation includes surtaxes and Alternative Minimum Tax, but does not include provincial health premiums.

Dividend Reinvestment Plans

Some companies offer a Dividend Reinvestment Plan (DRIP). A DRIP allows shareholders the opportunity to automatically reinvest the company’s dividend proceeds towards the purchase of additional shares or in some instances fractional shares without having to pay brokerage commissions.. Depending on the company’s DRIP policy, the additional shares may be purchased at a discount from the current share price. This can help save investors transaction costs while potentially benefiting from the compounding effects of the reinvested dividends over time.

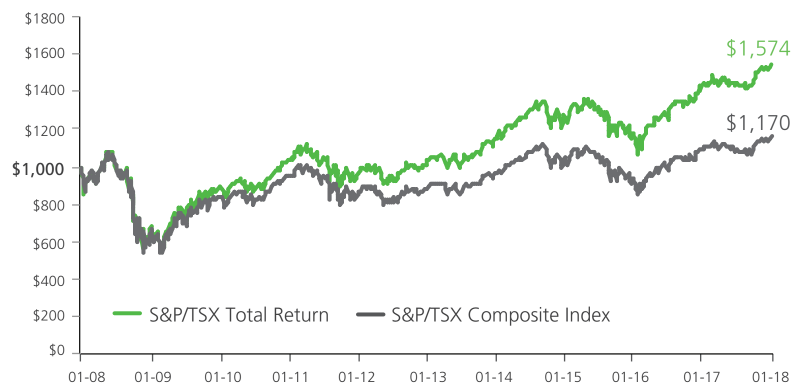
Impact of Reinvested Dividends

The example below illustrates the impact of dividend reinvestment and the compounding impact it can have on a portfolio. The S&P/TSX Composite Index measures the performance of Canadian stock market. While the S&P/TSX Total Return Index measures the performance of the market, and includes the impact of reinvested dividends on returns.

The grey line in **Graph 1** illustrates the growth on a $1,000 initial investment in the S&P/TSX composite index on January 1, 2008 which would be worth approximately **$1,170.00** as of January 1, 2018. If the dividends paid from companies listed on the S&P/TSX composite index are reinvested (the green line), the value would be approximately **$1,574.00**. In other words, dividend reinvestment can have a positive compounding effect to capital appreciation.

Investors will need to be aware that when utilizing DRIP in a Non-Registered investment account, the taxpayer will still be required to pay income tax on the dividends received so the taxpayer will need to have sufficient cash for that payment.

Graph 1 - S&P/TSX Composite Index vs. Total Return for 10 year period ending January 1, 2018



Conclusion

It is important for Canadian resident investors to understand the taxation of Canadian dividends as it can assist with their financial and tax planning. Please consult your TD advisor and tax specialist before making an investment decision to ensure it aligns with your goals and objectives.

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