

Eligible Dividends

With the recent implementation of significant changes to the taxation of dividend income, it's a good time to revisit the taxation of all investment income, including interest, dividends and capital gains. If you compare the different tax rates on these sources of investment income, it's clear that not all investment income is equal on an after-tax basis. Even tax-conscious investors may not appreciate how the changes to the taxation of eligible dividends may impact their after-tax returns.

In the past, capital gains have been taxed at lower rates than other types of investment income such as interest and dividends. In 2006, when the federal government reduced its tax rate on "eligible" dividends, the preferential tax treatment of capital gains versus dividends substantially narrowed. (Eligible dividends include taxable dividends that are received by a Canadian resident individual paid after 2005 by public Canadian corporations and designated as an eligible dividend – which encompasses most dividends from Canadian public corporations.)

The new dividend tax regime increased the dividend gross-up from 25% to 45% and increased the dividend tax credit from 13 1/3% of the grossed-up dividend to 18.966%. As a result, if you receive an eligible dividend of \$100, you would report \$145 as the taxable amount on your tax return (versus \$125 for non-eligible dividends). Dividends received which are not "eligible" dividends will remain subject to the prior 25% gross-up and 13 1/3% credit mechanism. The Combined Top Marginal Tax Rates table opposite compares specific tax rates by province for each type of investment income.

As outlined in this table, the tax rate for eligible dividends will depend on the province in which you reside. In the provinces of British Columbia, Alberta, Saskatchewan, Ontario and New Brunswick, eligible dividends incur a lower top rate of tax than capital gains in 2009. In all the

other provinces, the tax differential between dividends and capital gains has been greatly reduced.

However, one often over-looked implication of the new dividend tax regime is the impact that the higher gross-up of eligible dividend income can have on taxable income, particularly for individuals who receive income-tested benefits or credits. Although the dividend and gross-up tax mechanism can result in very low effective tax rates for individuals in the lower marginal tax brackets, the impact on the calculation of their taxable income resulting from the higher dividend gross-up can negatively affect income-tested benefits and tax credits, such as Old Age Security (OAS), Guaranteed Income Supplements (GIS), the age and medical tax credits and other provincial benefits.

Combined Top Marginal Tax Rates - 2009⁽¹⁾

	Salary and Interest	Capital Gains	Non-Eligible Dividends	Eligible Dividends
British Columbia	43.70%	21.85%	32.71%	19.92%
Alberta	39.00%	19.50%	27.71%	14.55%
Saskatchewan	44.00%	22.00%	30.83%	20.35%
Manitoba	46.40%	23.20%	38.21%	23.83%
Ontario	46.41%	23.20%	31.34%	23.06%
Quebec	48.22%	24.11%	36.35%	29.69%
New Brunswick	46.00%	23.00%	34.21%	21.80%
Nova Scotia	48.25%	24.13%	33.06%	28.35%
Prince Edward Island	47.37%	23.69%	38.15%	24.44%
Newfoundland	44.50%	22.25%	32.71%	22.89%
Yukon	42.40%	21.20%	30.49%	17.23%
NWT	43.05%	21.53%	29.65%	18.25%
Nunavut	40.50%	20.25%	28.96%	22.24%

⁽¹⁾ As of April 13, 2009.

Note: Earning additional eligible dividends could reduce OAS benefits and may result in Alternative Minimum Tax. The information in the table should be used for illustration purposes and should not be relied on for tax purposes.

Eligible Dividends

For these individuals, an understanding of any potential impact on income-tested benefits would be required for full analysis of the tax-efficiency of the various sources of investment income.

Future Tax Rates

As a result of recently-enacted reductions in the federal general corporate income tax rate, the 2008 federal budget introduced reductions to the gross-up and tax credit mechanism annually from 2010 to 2012 on eligible dividends, thereby increasing the effective future tax rate on eligible dividends. This change was introduced since the dividend tax credit is intended to compensate individual taxpayers for the income tax paid by the corporation paying the eligible dividend, thus a reduction in corporate tax leads to a reduced dividend tax credit. In theory, lower corporate tax should lead to higher dividend payments (or higher share valuations) thereby offsetting the effect of the increased personal tax on eligible dividends. The table opposite illustrates the effect of these federal changes and any provincial responses to-date to these changes by reflecting the proposed combined top dividend tax rates by province for 2010 to 2012, although further changes may be announced prior to implementation.

Because of the previous and forthcoming changes to the taxation of eligible dividends, this is an ideal time to discuss the types of investment income your investment portfolios earn to understand and consider the potential impact of these tax changes to your portfolio. Recognizing your investment objectives, your BMO Nesbitt Burns Investment Advisor will review your current portfolio with a view towards maximizing

its after-tax return. After all, at the end of the year, it's important to understand what's left in your portfolio after taxes.

For more information or to discuss your personal situation, please contact your BMO Nesbitt Burns Investment Advisor.

Wealth Group

Combined Top Marginal Tax Rates on Eligible Dividends - 2010 to 2012

	2010	2011	2012
British Columbia	21.45%	23.91%	26.11%
Alberta	15.88%	17.72%	19.29%
Saskatchewan	21.64%	23.36%	24.81%
Manitoba	25.09%	26.74%	28.12%
Ontario	26.57%	28.19%	29.54%
Quebec	30.68%	31.85%	32.81%
New Brunswick	19.46%	19.77%	21.16%
Nova Scotia	29.80%	32.00%	33.94%
Prince Edward Island	25.95%	28.36%	30.50%
Newfoundland	24.37%	26.68%	28.75%

The information in the table should be used for illustrative purposes only and should not be relied on for tax purposes.

Based on proposed announcements in the 2009 federal and provincial budgets as of April 21, 2009. Some of the provincial tax rates incorporated above are not yet law and further changes may be announced in the future.



® "BMO (M-bar roundel symbol)" is a registered trade-mark of Bank of Montreal, used under licence.

® "Nesbitt Burns" is a registered trade-mark of BMO Nesbitt Burns Corporation Limited, used under licence.

BMO Nesbitt Burns Inc. and BMO Nesbitt Burns Ltée (collectively "BMO Nesbitt Burns") provide this publication to clients for informational purposes only. The comments included in the publication are not intended to be a definitive analysis of tax law: The comments contained herein are general in nature and professional advice regarding an individual's particular tax position should be attained in respect of any person's specific circumstances. BMO Nesbitt Burns Inc. and BMO Nesbitt Burns Ltée are indirect subsidiaries of Bank of Montreal and Member CIPF.