

Tax free dividends: One of Canada's best kept secrets

Impossible, you say! Well, believe it or not, for an individual without any other taxable income in 2007, it is possible to receive approximately \$66,460 in dividends from Canadian public companies without having to pay any income tax at all.

How is this possible?

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

- An individual in the lowest tax bracket only has to pay 15.5% federal tax on their first \$37,178 in income.
- Dividends received from a Canadian corporation must be grossed up by 45% when reported on your tax return.
- Individuals receiving Canadian dividend income are eligible for a dividend tax credit equal to 18.97% of the grossed-up dividend.
- Every individual has a basic personal tax credit which eliminates federal tax on the first \$8,929 of annual income.

How much tax is due?

For example, let's assume you receive Canadian dividend income totaling \$66,460 and no other taxable income for the year. Here's how all of the above tax provisions would work together to eliminate your federal tax bill:

Canadian dividends received	\$66,460
Grossed-up amount <i>(145% x \$66,460)</i>	\$96,367
Federal tax on the first \$37,178 <i>(15.5% x \$37,178)</i>	\$5,763
Federal tax on the next \$37,179 <i>(22% x \$37,179)</i>	\$8,179
Federal tax on the next \$22,010 <i>(26% x \$22,010)</i>	\$5,723
Total federal tax owing	\$19,665
Less: federal dividend tax credit <i>(18.97% x Grossed-up amount)</i>	\$18,281
Net federal tax owing on dividend income	\$1,384
Less: basic personal tax credit <i>(15.50% x \$8,929)</i>	\$1,384
Total federal tax owing	\$ (0)



It is important to understand that this tax-free income is the result of both the dividend tax credit and the basic personal tax credit. Without either one of these, it would not be possible to receive \$66,460 of Canadian dividends tax-free. Moreover, this illustration has only calculated the federal tax on \$66,460 of dividends it is important to note that provincial taxes may still be owing as provincial levels for tax-free dividends are lower than federal levels. For example in Ontario an individual earning \$66,460 in dividends and no other income would not pay federal tax but may have to pay provincial tax on any amounts greater than \$50,140.

Weigh the benefits

For individuals with no other taxable income, it can be a wise tax decision to hold Canadian dividend paying companies in your portfolio. However, the tax benefits must always be weighed against your specific investment needs and risk tolerance.

Our professionals across the Scotiabank Group have the knowledge, resources, and team of experts to help you implement an investment plan that takes full advantage of the investment and tax opportunities that will complement your personal goals and circumstances.

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