FAQ FOR TAX SAVVY CLIENTS

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REFUNDABLE DIVIDEND TAX ON HAND

Tax Question:

Have you paid too much corporate tax and have a Refundable Dividend Tax on Hand balance?

Facts:

A Refundable Dividend Tax On Hand (RDTOH) is a balance your corporation has accumulated as a result of earning aggregate investment income in a prior year that was subject to an additional tax Part I tax. The corporation can get this tax refunded if it pays a dividend.

Aggregate investment income consists of:
Net taxable capital gains less net capital losses applied,
Rent,
Royalties and
Foreign dividends.

It does not include dividends between Canadian corporations.

Discussion:

When income is flowed through a corporation it will be subject to two levels of tax; corporation tax and personal tax. Aggregate investment income earned in a corporation is subject to the high corporate rate of tax as well as an additional Part 1 tax on investment income of 6-2/3%. If this income was earned directly by an individual, they would only be subject to tax at their marginal rate and no additional Part 1 tax. The Canadian income tax system is based on a concept of integration. This concept tries to ensure that there is no difference in the total tax bill between income earned directly by an individual or earned first by a corporation and then paid to the same individual. The high corporate tax rate on aggregate investment income contradicts the concept of integration.

The solution to compensate for the high corporate tax rate on aggregate investment income is to refund a portion of taxes to the corporation when this investment income is paid to the shareholder. To trigger the refund, a dividend must be declared.

Recommendation:

If your corporation has investment income and consequently you have paid too much corporate tax, please contact Gilmour Knotts Chartered Accountants to explore the possibility of using dividends to trigger a tax refund of your RDTOH.