Getting a Grip on the New GRIP & LRIP: the Corporate Side

By Don Nilson, CMA, FCMA

The linkage, or "integration", between corporate and personal taxation has long been vexing for taxing authorities. In Canada, thanks to the Rowell-Sirois and Ives Commissions in the Forties, individuals started receiving a 10% dividend tax credit in 1949, which was increased to 20% in 1953. The same 1949 Budget introduced the preferential lower tax rates for small business, which started us on the ride to the integration inequity between public and private company dividends, which landed with a resounding thump on former Finance Minister Ralph Goodale's desk in 2005.

The solution to this topic in the Carter Commission Report (1966) was to eliminate the preferential tax rate for small business. Overall, this report recommended a 100% gross-up and 50% dividend tax credit for all corporations, and the conversion of dividend tax credits to "refundable", instead of "non-refundable", treatment for individuals.

History of GRIP & LRIP

Five years of public debate followed the release of the Carter Report, culminating in the famous watershed Budget of December 1971. Small business tax preference was **retained** and **one** dividend system was enacted for **all** corporations: **introducing** a 33 1/3% gross-up accompanied by the tax credit of 20%. The dividend tax system remained on the radar screen for Finance Ministers through the Seventies, including Chretien's Budget of 1977 which increased the gross-up from 33 1/3% to 50% and the tax credit from 20% to 33 1/3%. This was specifically enacted to bolster sagging Canadian public equity markets. However, this algorithm proved grossly rich for small business – again, the problem of one rate for two worlds – and led to the short-lived small business Part Two distribution tax of 12 1/2% in 1981 to repair the damage. There were further tweaks to the dividend system in the Budgets of 1982, 1986 and 1987.

The world Ralph Goodale inherited in 2005 had been around since 1988 – a gross-up of one quarter and a federal tax credit of 13 1/13%, followed by provincial matching, to approximately 20% combined. The long-standing problem was that the system still applied to **both private and public companies.** Given that each of them bore significantly different corporate tax rates, "perfect" integration requires **different systems** for each. When one system is applied to both, it either favours one of them or hurts the other, depending on the system chosen. The system in place hurt public companies. As nature abhors a vacuum, the capital markets solved the injustice they were served with the "invention" and subsequent proliferation of trust units. Goodale faced the growing popularity of trust units in the Fall of 2005, which were threatening a major tour-de-force of the capital markets.

Move Towards GRIP & LRIP

Goodale's controversial solution brought us to the long overdue world of dual taxation of Canadian-source dividends. This dual approach differentiates between private companies (CCPCs) and public companies (non-CCPCs). The former continues to receive tax treatment as before – dividends are grossed up by one quarter, and the same federal and provincial dividend tax credits follow. Starting in 2006, the latter received the "new" treatment brought forward by Goodale in the Fall of 2005, and later ratified by the Conservative government. This includes a gross-up of 45% (not 25%) and higher federal and provincial dividend tax credits (federal at 11/18ths of the gross-up).

This would be fine and simple if it stopped here. However, the complexity of real life required further refinements to cover special situations, with the result that this change involved 19 pages of federal explanation!

We now see two new concepts added to our corporate tax landscape: "GRIP" and "LRIP". These are special accounts – the former involves CCPCs only and the latter involves non-CCPCs only. In both situations, it is possible that a subject corporation in fact may never have a balance in these new accounts.

The GRIP account for a CCPC tracks taxable income that has not benefited from the small business rate (i.e. active income above the small business deduction level – $400,000 as of the end of 2007) or other tax preference rates (including RDTOH and corporate dividend refund accounts).

The LRIP account for a non-CCPC likely has a narrower application. First, it includes income received from a shareholding in a CCPC which enjoyed the small business rate. Second, it includes any retained earnings earned at the small business rate that is brought from a CCPC which "goes public".

The norm is that a non-CCPC pays an "eligible" dividend, unless it has an LRIP balance, which requires it to either pay a new 20% Part iii.1 tax to make the dividend eligible or else reclassify the amount of the dividend as an "ordinary" (now called "ineligible") dividend (which gets the lower gross-up treatment). This requires shareholder consent!

There is no specified ordering for CCPCs between eligible and ineligible dividends and both can trigger a dividend refund from the RDTOH account.

There is a new ordering specified for non-CCPCs to pay ineligible dividends first if they have an LRIP balance, as measured **at the time of the dividend payment.** This is contrary to the GRIP account **which measures only at the fiscal year-end.**

Calculating GRIP

GRIP is a continuity account, which can be positive or negative, calculated as follows:

(i) Opening balance PLUS (ii) 68% of taxable income for the year NOT eligible for SBD or dividend refund MINUS (iii) 68% of amounts for the year NOT eligible for the SBD or dividend refund which have been carried back within the allowable carryback period (3 years!) PLUS (iv) eligible dividends received during the year from a sub PLUS (v) dividends received during the year from a foreign affiliate which are deductible under Sec 113 MINUS (vi) eligible dividends paid in the PRECEDING year (excluding any excessive eligible dividends).

The system at point (iii) reduces the GRIP account prospectively, not retrospectively. Thus, dividends that were "eligible" in that earlier fiscal period do not become excessive thanks to a carryback. This also explains why **GRIP can have a negative balance.**

The GRIP can have a starting balance on January 1, 2006 which looks back as far as 2001, as follows: 63% of the afore-mentioned full-rate taxable income for all fiscal years that ended after 2000 and before 2006 LESS all taxable dividends paid in that same period.

There are other adjustments for amalgamations and wind-ups.

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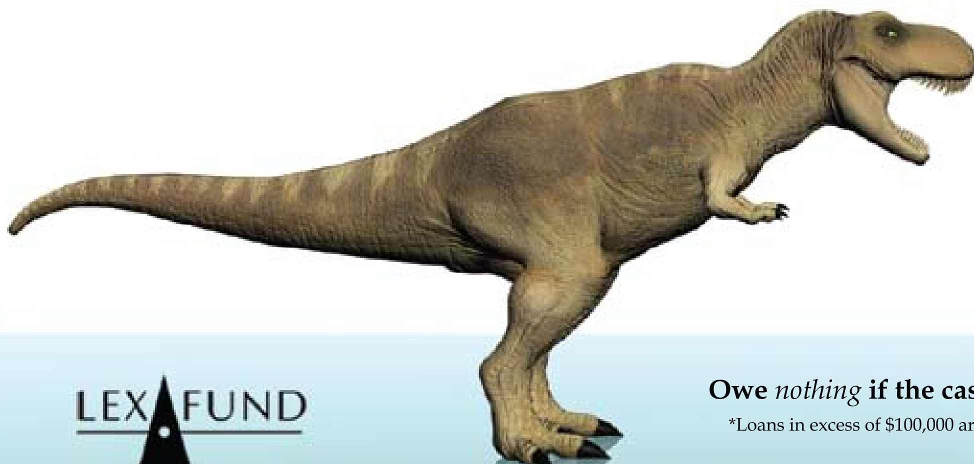

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Understanding GRIP & LRIP

GRIP – The GRIP account for a CCPC tracks taxable income that has not benefited from the small business rate or other tax preference rates (including RDTOH and corporate dividend refund accounts).

LRIP – The LRIP account for a non-CCPC includes amounts which enjoyed the small business rate prior to going public, or which the company received as dividends from a CCPC subsidiary.

Calculating LRIP

THE LRIP also is a continuity account which **only can have a positive balance** and is calculated as follows:

(i) Opening balance PLUS (ii) ineligible dividends received during the year which are deductible from Part 1 tax MINUS (iii) ineligible dividends paid in the year MINUS (iv) excessive eligible dividends paid in the year.

There are other additions to LRIP for "investment corporations" and CCPCs who elect NOT to be CCPCs.

There are also other adjustments for amalgamations and wind-ups.

There is no historical starting balance on January 1, 2006 for LRIP.

There is an anti-avoidance section where either a GRIP or LRIP has been artificially maintained or increased/decreased. This causes the entire eligible dividend to be reclassified as "excessive" and the Part iii.1 tax then is increased from 20% to 30%, with no provision to reclassify as "ineligible".

Non arms-length shareholders are enjoined with their corporation in any Part iii.1 tax liability assessed. The tax is due along with the regular tax obligation.

An election to reclassify an excessive dividend can be made within 90 days of the related Notice of Assessment, with no provision for extension.

This election requires the written concurrence of all shareholders whose addresses are known to the corporation. If this election is made after 30 months after the dividend was paid, then the corporation must seek the concurrence of all shareholders.

Carryover Management

Private corporations now face a more complex world of loss carryover management. For instance, a loss carryback might recover previous taxes at the "general" rate, whose income had been distributed that year as an eligible dividend, which after-the-fact would not be eligible. The corporation has three alternatives. The first choice is to pay a Part iii.1 tax of 20%, which is not punitive but legitimizes the enhanced tax treatment previously passed along to the shareholder. The second choice is to unwind the eligible dividend into ineligible. The third choice is to decline the carryback strategy and instead carry the loss forward. This decision is indeed strategic, as one must weigh the time value of money and the uncertainty of future profitability.

The new prescribed forms 53-4-5 must be included now along with the regular return, for every Canadian corporation that pays a taxable dividend.

For 2007 and onwards, corporations must communicate the payment of eligible dividends to their shareholders. Public companies can do so via their website, annual report or Press Release. Private companies can do so by direct communication or notation on the cheque foil. Eligible and ineligible dividend payments ought not to be blended in one cheque.

Lastly, now that the sleeping giant of corporate integration has awoken, the Finance Ministry is more acutely attuned to the symbiotic relationship between corporate tax rates and the gross-up system. The October 2007 Mini-Budget foreshadowed changes, which indeed were enacted in the 2008 Federal Budget and which come into effect beginning in 2010.

Don Nilson, CMA, FCMA *is the Principal at Nilson & Company. He is also a member of the Update Editorial Task Force.*

Watch for part two of Don's series on GRIP in the fall issue of Update magazine – Understanding GRIP: the personal side.