



## Tax for the **Owner-Manager**

# CAN AN UNPAID DIVIDEND AVOID DEPARTURE TAX?

Departure tax applies under paragraph 128.1(4)(b) when a taxpayer becomes non-resident. If the taxpayer owns a private corporation, a capital gain, based on the shares' current fair market value (FMV), is triggered. Some planners believe that the departure tax can be avoided if the corporation *declares* a dividend in an amount equal to the FMV of the corporation's net assets but does not *pay* it until after the taxpayer becomes non-resident.

Consider the following simple example, in which the corporation, Xco, holds only cash. Shareholder S owns Xco. Xco declares a dividend of all of its cash but does not pay it, deferring payment until after S emigrates. The argument is that the value of Xco is now nominal because the dividend has been declared, so there is no departure tax. After the taxpayer leaves Canada, Xco pays the dividend, subject only to subsection 212(2) non-resident withholding tax (25 percent, but typically 15 percent if S has moved to a treaty country). But is that the only tax that applies?

In our view, this planning (quite apart from the obvious application of GAAR) does not work because the departure tax still applies. The unpaid dividend represents a *right* that S now owns (the right to be paid the dividend). Assuming that Xco is solvent, the FMV of the right should be the unpaid amount. On leaving Canada, S is deemed by paragraph 128.1(4)(b) to dispose of that right. The right is capital property, because S did not acquire it for resale. The tax on the capital gain (that is, on the right), plus the non-resident withholding tax, will be exactly the same amount of tax that is paid if S emigrates before the dividend is declared.

Administratively, the CRA has said (document no. 9640475, April 16, 1999) that paragraph 128.1(4)(b) applies to tax the dividend *as a dividend*: “[T]he dividend would be included in the income of the individual and would be subject to the normal gross-up and credit provisions in the year of emigration.” With respect, we think that this view is incorrect, because S is deemed to have disposed of the *right* to the dividend and has not actually *received* the dividend.

*David M. Sherman*  
Tax Lawyer and Author  
[ds@davidsherman.ca](mailto:ds@davidsherman.ca)

*Bal Katlai*  
Toronto  
[bk@emetcpa.ca](mailto:bk@emetcpa.ca)

*Kenneth Keung*  
Moody's Tax, Calgary  
[kkeung@moodystax.com](mailto:kkeung@moodystax.com)

*Tax for the Owner-Manager*  
Volume 24, Number 1, January 2024  
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