

Dividends Paid by Journal Entry

In a recent technical interpretation (2007-0229311I7) dealing with the payment of dividends, the Canada Revenue Agency reiterated its position that an accounting journal entry alone is not sufficient evidence to consider that a dividend is paid.

The legal effect of journal entries was discussed by the Courts in *Hickman Motors Limited v. The Queen* [97 DTC 5363 (SCC)]. “The law is well established that accounting documents or accounting entries serve only to reflect transactions and that it is the reality of the facts that determines the true nature and substance of transactions.”

The case of *Banner Pharmacaps NRO Ltd. v. The Queen* [2003 DTC 5642 (FCA)] does confirm however that a transfer of cash is not required to evidence payment. “The legal effect of delivery of a promissory note depends upon all the relevant facts, the most important being the intention of the maker of the note. For example, in some circumstances a promissory note may be evidence of a debt to be paid at some future time. In other circumstances, delivery of a promissory note may itself be payment of a particular obligation.”

When a dividend is not going to be paid with cash, practitioners should make it a matter of habit to issue a promissory note in satisfaction of payment of the dividend and indicate such an intention in the resolution declaring the dividend. The Banner case referenced above includes an example of the wording of such a provision in a resolution.

There are two other related matters that are worthy of your attention.

It is useful to review the administrative position of the Canada Revenue Agency (see technical interpretation 2004-0060641E5) dealing with the payment of remuneration within 180 days after the end of the year (see 78(4) of the Income Tax Act) in light of the above position. “It is therefore our view that wages that remain unpaid after the 180 days specified in subsection 78(4) of the Act would be subject to the application of subsection 78(4) of the Act unless the payor has remitted the applicable payroll withholdings, the employer has issued a T4 information return to the employee and the employee has included the amount of the unpaid wages in income for income tax purposes.” It is interesting that the administrative position does not require actual cash payment of the remuneration.

Inter-corporate dividends are sometimes paid to a holding company in order to creditor-proof the retained earnings of an operating company. When the dividend is paid by the issuance of a promissory note or cash, which the holding company subsequently loans back to the operating company, it is usually advisable that the holding company secures those advances against the assets of the operating company. This will help retain the effectiveness of the creditor proofing structure even when the operating company has an immediate need for funds.