Enbridge Inc.
Non-Eligible Dividend Tax Issue - June 1, 2012
Questions & Answers

Why is a portion of the Enbridge Inc. Q1 2012 share dividend not eligible for the enhanced dividend tax credit?

A portion of the June 1, 2012 common share dividend payment is not eligible for the enhanced dividend tax credit due to the fact that a portion of the funds being distributed are, effectively, sourced to non-eligible dividends that Enbridge itself received this quarter from Noverco Inc., a Canadian Controlled Private Company ("CCPC"). In March 2012, Noverco sold some shares of Enbridge Inc. and its resulting capital gain was not taxed at the full tax rate because Noverco is a CCPC. The tax rules require that public companies such as Enbridge must, effectively, distribute any such low-taxed funds received from CCPCs before paying further dividends that are eligible for the enhanced dividend tax credit.

What event triggered this change?

This situation arose as a result of Enbridge Inc. receiving a special dividend this quarter from the proceeds of a sale of Enbridge shares by a CCPC, Noverco Inc.

Has this happened in the past?

This has not occurred at Enbridge Inc. in the past as all previous dividends received from Noverco were eligible dividends. Noverco has not executed a share sale in the past and Noverco is the only CCPC from which Enbridge currently receives dividends. The specific Noverco share sale event that occurred in March 2012 will only impact the Enbridge common share dividend payment on June 1, 2012.

How are individuals taxed in Canada on dividends received from taxable Canadian corporations?

In Canada, dividends received by individuals from taxable Canadian corporations are taxed using a gross-up and tax credit mechanism. Individuals must include in their investment income an amount called the "Taxable Amount", which includes the actual amount of a dividend received grossed up by a specified percentage intended to restore the dividend to the amount the corporation would have paid the individual if it had not had to pay corporate income tax which reduced the amount it had available to pay dividends. This notional Taxable Amount is taxable at the individual's personal marginal tax rate but the individual then receives a dividend tax credit for the notional corporate tax already paid by the corporation on that income. The intended result is that the total tax paid should be the same as if the corporation had never paid tax but merely passed its pre-tax income on to the individual to pay tax on.

What is the enhanced dividend tax credit?

The dividend tax credit is intended to compensate the individual taxpayer for the amount of corporate tax already paid on the income from which the dividend was paid. The dividend tax credit is lower for dividends received, either directly or indirectly, from a CCPC that benefited from paying a low effective rate of corporate tax, while dividends received from Canadian public companies are eligible for an enhanced (higher) dividend tax credit to the extent that the income from which the dividends are sourced was subject to the full tax rate.

Because inter-corporate dividends received by a public company (e.g. Enbridge) from a CCPC (e.g. Noverco) are not subject to any incremental tax when received by the public company, they continue to not eligible for the enhanced dividend tax credit when paid out to public company shareholders because the related income was still never subject to full tax.

What is the financial impact to me as a taxable shareholder?

Shareholders should consult their own tax advisors to confirm the specific financial impact to them. Generally speaking, a portion [84%] of the June 1 $0.2825/share dividend will not be eligible for the enhanced (higher) dividend tax credit, a taxable investor's effective tax rate on the dividend will be slightly higher. This will vary depending on the province of residence.   For example, in 2012, an Alberta resident will generally pay an effective tax rate of 27.7% on the non-eligible component compared to 19.3% on the eligible component of the dividend, while an Ontario resident will generally only pay a 3% higher tax rate on the non-eligible portion of the dividend.

Using a simple example to illustrate the magnitude of the annual impact:

Assuming ownership of 1 ENB share with 4 quarterly dividends of $0.2825, the total after tax dividend proceeds to an Alberta resident for the year would normally be $0.91 whereas it will be $0.89 this year as a result of this unusual event.

Was there any benefit to me from this event?

Yes. As a result of Noverco selling a portion of its share position and dividending the proceeds to its owners, Enbridge Inc. has effectively raised additional equity capital to bolster its balance sheet and retain more internally generated funds to deploy on future growth projects

How do I report this on my taxes?

The total Taxable Amount of eligible dividends received as well as "other" (i.e. non-eligible) dividends received in 2012, along with the amount of dividend tax credit available for each, will be reported on the T5 slip that you will receive from your broker or financial institution next spring.   They will be outlined in separate boxes and input into your tax 2012 tax return in separate locations. Please consult your own tax advisor if you have any further questions on completing your personal tax return.

What are the tax implications for U.S. shareholders receiving this dividend?

The short answer is none. The whole amount of the June 1, 2012 dividends paid (i.e. both the eligible and other portions) will be "qualified dividends" for U.S, tax purposes. The Canadian rules around "eligible dividends" are completely unrelated to the US rules around "qualified dividends".