

Financial Solutions



Segregated Fund Taxation:

There are clear tax advantages to investing in segregated funds versus mutual funds

Investors who buy units of mutual funds and segregated funds often have questions at tax time. Two common questions are:

I haven't sold any units, so why did I receive a T3 slip?

The income earned within a segregated fund must be allocated to each unitholder on an annual basis. This allocation is done periodically through the year. At the end of the year, the income allocated to each unitholder is reported to that unitholder on a T-3 slip.

The value of my fund has declined, so why is there income or a capital gain reported on my T3?

All income earned by a fund during the year, must be allocated out to the unitholders.

It is important to understand that income can be attributed in two ways. The first is through gains (losses) and income earned by the Fund itself as a result of the fund manager's trading profits, as well as through dividends and interest received on the investments. The second source is through gains incurred when the individual investor redeems fund units at a profit.

For tax purposes, most investment funds are set up as trusts. This means income earned by the fund itself is flowed through to unitholders. If the income remained in the fund,

the fund would pay the tax at the top marginal tax rate. By distributing the income to investors, the investors pay tax at a potentially lower tax rate.

These flow-through entities distribute income to unitholders in the form of interest from Canadian sources, dividends originating from Canadian common or preferred shares, capital gains and foreign income from either stocks or bonds. Unless the investments are held within an RRSP, income received on your clients' investment funds is reported on their T3 tax slip and must be declared on their tax return.

These various sources of income have different tax implications, so the type of income is itemized separately on the T3 slip for easier reporting. The following table shows the type of investment income a fund can earn.

Fund Investments	Type of Income Earned	
Canadian Treasury Bills, Bonds, Mortgages and Index Futures Contracts	Interest Income	Interest income is fully taxable as if it were regular income. Clients are taxed on interest income at their marginal tax rate (rate paid on the last dollar earned). This type of income is not eligible for any preferential tax treatment.
Shares of Canadian Corporations	Dividend Income	Dividend income receives a dividend tax credit. Eligible and ineligible dividends have different dividend tax credit rates.
Foreign Stocks or Bonds Interest	Foreign Income	Foreign interest and dividends are fully taxable in Canada, and are not eligible for dividend tax credits. Foreign taxes are deducted from income allocated to the client.
When the Fund sells investments	Capital Gains or Losses	Capital gains receive the preferential tax treatment. Only 50% of the total realized capital gains is included in your clients' income for tax purposes. The remaining 50% is tax-exempt.

Dividend tax credit

The federal dividend tax credit will be calculated using two different rates depending on the source of the dividends. Certain dividends received from qualified corporations will be considered eligible dividends. Such dividends will qualify for the dividend tax credit at a higher rate. Dividends that qualify for the lower rate are referred to as dividends other than eligible dividends.

The high-rate dividend tax credit will be applied to the grossed-up amount of dividends at a rate of 18.9655%. Dividends that do not qualify for this higher rate will still be entitled to a credit at the 13.3333% low-rate. We refer to these as high-rate dividends and low-rate dividends respectively. Box 23 shows the actual amount of low-rate dividends and Box 49 shows the actual amount of high-rate dividends on the T3.

Sample of T3 slip

Canada Revenue Agency / Agence du revenu du Canada		Year / Année	STATEMENT OF TRUST INCOME ALLOCATIONS AND DESIGNATIONS / ÉTAT DES REVENUS DE FIDUCIE (RÉPARTITIONS ET ATTRIBUTIONS)		T3
Actual amount of eligible dividends / Montant réel des dividendes déterminés	Taxable amount of eligible dividends / Montant imposable des dividendes déterminés	Dividend tax credit for eligible dividends / Crédit d'impôt pour dividendes déterminés	Capital gains / Gains en capital	Capital gains eligible for deduction / Gains en capital admissibles pour déduction	
49	50	51	21	30	
Actual amount of dividends other than eligible dividends / Montant réel des dividendes autres que des dividendes déterminés	Taxable amount of dividends other than eligible dividends / Montant imposable des dividendes autres que des dividendes déterminés	Dividend tax credit for dividends other than eligible dividends / Crédit d'impôt pour dividendes autres que des dividendes déterminés	Other income / Autres revenus	Trust year end / Fin d'année de la fiducie	Year / Année, Month / Mois
23	32	39	26		
Other information (see the back) / Autres renseignements (voir au verso)	Box / Case, Amount / Montant	Box / Case, Amount / Montant	Footnotes - Notes		
Recipient's name (last name first) and address - Nom, prénom et adresse du bénéficiaire			Trust's name and address - Nom et adresse de la fiducie		
→					

SAMPLE

How tax is allocated

Mutual fund income is distributed according to the unit holder's directions, either by cheque, or by automatic reinvestment. Many mutual funds distribute income either semi-annually or annually to all unitholders of record on a certain day, regardless of how long the unitholder actually held units in the fund.

Segregated fund income is not distributed but allocated. The income that is allocated is not paid out to the investor by way of a cheque or the purchase of additional units in the fund, but instead all income is reinvested and reflected through an increase in the unit price. Income earned within our Segregated Funds is allocated to unitholders on a monthly basis.

Simpler tax reporting

Tax reporting is much simpler with segregated funds too. The insurance company keeps track of the unitholder's adjusted cost basis for tax purposes. When the person redeems units, they are issued a T3 that shows the exact amount of taxable gains they must report on their income tax return. Mutual fund unitholders, on the other hand, are not provided with a T3 slip when they redeem their units. They must calculate the gain or loss themselves for tax reporting.

Capital losses within a segregated fund are allocated to its investors. These capital losses can be used to offset capital gains from any source in the previous three years or they can be carried forward indefinitely to offset future capital gains. Capital losses within a mutual fund are maintained within the fund and used to offset future capital gains within the fund.

Please note that residents of Quebec will receive a provincial tax form, Relevé 16 in addition to the T3. The Relevé 16 will contain information on the allocated segregated fund income that is relevant for Quebec filing purposes.

Ask your advisor for more details on the tax advantages of Empire Life Segregated Funds.



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We are rated A (Excellent) by A.M. Best Company¹ and *Financial Post Business* magazine has ranked us among the top 10 life insurance companies in Canada.²

Our success is based on our commitment to being approachable and responsive to the needs of our clients and business partners, on consistently solid investment performance, and on faith in our employees as future leaders.

¹As at June 2, 2008

²June 2008, based on revenue

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A description of the key features of the Empire Life Segregated Funds is contained in the information folder. **Subject to any applicable Death and Maturity Benefit Guarantee, any part of the deposit(s) or other amount that is allocated to a Segregated Fund is invested at the risk of the Owner and may increase or decrease in value.**



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