

AEGON Fund Management Tax Tips

A guide to tax-related issues that affect your clients.

January 2009

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Frequently asked questions about RRSPs

What is my 2008 contribution limit?

The 2008 RRSP contribution limit is the lesser of 18% of your previous year's earned income or \$20,000 (minus pension adjustments if you are a member of a pension plan or deferred profit sharing plan). The maximum is scheduled to increase to \$21,000 in 2009.

When can I contribute?

You can contribute to an RRSP on any day of the year and amounts contributed in the first 60 days of a calendar year can be deducted in the prior tax year.

How long can I contribute?

RRSP contributions may be made until Dec. 31st of the year in which the contributor reaches age 71.

Can I carry forward unused deductions?

Unused tax deductions from contributions, plus up to \$2,000 (lifetime) in over-contributions, may be carried forward indefinitely. Over-contributions in excess of \$2,000 may be charged a penalty of one per cent per month as long as the funds remain in the RRSP.

What are spousal contributions?

If you have earned income, you can contribute to an RRSP with your spouse (who must be 71 or younger) as the annuitant. Such contributions count against your RRSP limit. If your spouse dies, contributions can still be made to their plan up to 60 days after December 31st of the year of their death.

What is the definition of spouse?

With respect to RRSPs, the definition of spouse includes common-law and married couples.

What is income attribution?

Funds withdrawn from a spousal RRSP are attributed back to the contributor who then adds them to their taxable income if withdrawals were made at least two years after the contribution. All other withdrawals are taxed in the hands of the non-contributing spouse.

How do contribution receipts work?

Contribution receipts are produced for two periods each tax year: March to December of the tax year that just ended, and January to February of the current year.

The receipt for March-December is applied to the completed tax year, and the receipt for January-February can be claimed in either the completed tax year, or the current tax year. You can file your tax return without including contribution receipts (i.e. e-filing), but may have to provide copies to Canada Revenue Agency (CRA) at a later date.

What is withholding tax at source?

Registered plan withdrawals are subject to income tax. Registered Plan issuers are required to withhold taxes from all withdrawals according to the following schedule. The withdrawal amount rates are not cumulative on an annual basis, however are applied on an individual withdrawal basis. Withdrawals from a RIF/LIF that exceed the minimum are subject to withholding taxes.

Withdrawal Amount	All Provinces (Except Quebec)	Quebec Provincial Withholding Rates	Canadian Residents Only/ Quebec Federal Withholding Rates
Up to \$5,000	10%	16%	5%
\$5,001-\$15,000	20%	16%	10%
\$15,001 and over	30%	16%	15%



Understanding mutual fund distributions and segregated fund allocations

Throughout the year, mutual funds and segregated funds receive various forms of income from their investments. In the case of money market, bond and mortgage funds, income is generally in the form of interests. Equity funds may receive dividends from their holdings and all mutual funds may receive capital gains from their trading activities. As these payments are collected by the funds, they are reflected in the fund's unit value.

Mutual funds periodically distribute this income directly to unitholders. Most segregated funds do not distribute earnings, but “allocate” them for tax purposes. This difference stems from the fact that mutual funds are considered securities, and segregated funds are considered insurance policies.

Mutual fund distributions

Mutual funds are usually structured as trusts, and are subject to tax on their earnings unless they physically distribute them to unitholders. When earnings are distributed, the mutual fund receives a tax deduction, and the distribution becomes taxable income in the hands of the unitholders.

Why do mutual funds do this? A mutual fund trust would generally be taxed at a considerably higher rate than many individual unitholders since trusts are subject to the highest tax bracket rate. Shifting the tax liability from the fund itself to the unitholders reduces the average tax rate on the fund's income, thereby increasing the potential after-tax return of all investors.

Using automatic reinvestment programs, most unitholders simply re-invest their distributions in the fund and receive a T3 tax slip for their share of the fund's taxable income. To avoid double taxation (i.e., at the time of the distribution and again at the time units are sold), units purchased with the reinvested distribution have the effect of increasing the unitholder's adjusted cost base (ACB).

Case study #1: Investor receiving a mutual fund distribution

In April, an investor placed \$5,000 in a mutual fund with a unit value of \$10, purchasing 500 units. On the application form, he asked to have all distributions reinvested. By December, the unit value of the fund has risen to \$12, and the manager of the fund announced a \$1 per unit distribution of realized capital gains. Since the overall gain in the fund (\$2 per unit) was higher than the distribution per unit (\$1 per unit), the investor decided it would be more advantageous to accept the tax liability on the distribution than to sell the units.

Segregated fund allocations

Although a segregated fund is established by an insurance contract, it is deemed to be a trust for tax purposes only. There is no expectation that the insurance contract will distribute earnings, so a notional (as opposed to actual) distribution to policyholders is deemed to be made annually. While the actual income is retained within the fund and there is no reduction in the fund's unit value, this deemed distribution transfers any tax liability from the segregated fund to the actual beneficiaries of that income — the policyholders. The notional distribution is allocated among all the policyholders according to provisions of the *Income Tax Act* and the terms of the insurance policy that governs the segregated fund.

To avoid double taxation (i.e., at the time of the deemed distribution and again at the time units are sold), the full amount of the deemed distribution is added to policyholder's adjusted cost base (ACB).

If a policyholder wishes to actually receive the income earned in a fund, they must redeem sufficient units. However, if the units have appreciated in value by an amount greater than the distribution value (which was added to ACB) an additional taxable capital gain may be “crystallized”.

NOTE: Deferred sales charges may apply where the income exceeds the annual “free withdrawal” privileges

In fact, any redemption from a segregated fund can be comprised of original invested capital, previously taxed distributions, and unrealized capital gains, depending on how much or little the unit value has appreciated. Therefore, redeeming units may accelerate the taxation of unrealized gains, and a buy-and-hold strategy is often more tax-efficient.

At the distribution date, the investor's \$500 distribution purchased an additional 45.45 units at a unit value of \$11. The unit value dropped by \$1 to reflect the distribution, but the total value of the investment did not change since 45.45 additional units were purchased. The fund's ACB increased from \$10 to \$10.08 ($[\$5,000 + \$500] \div 545.45$ units) to avoid double taxation.

Case study #1: Mutual Fund Distribution

Date	Transaction	Amount (\$)	Unit Value (\$)	Total Units	Market Value (\$)	ACB (\$ per unit)
April 1	Purchase	5,000	10	500	5,000	10.00
December 15	Record day	0	12	500	6,000	10.00
December 21	Distribution day	500	11	545.45	6,000	10.08

Case study #2 Investor receiving a segregated fund allocation

The same investor placed the same amount in a segregated fund and experienced the same performance. However, when a deemed distribution of \$1 per unit was announced, the number

of units and total value both remained the same, and the ACB of the fund increased from \$10/unit to \$11/unit (\$10 + \$1) to avoid double taxation.

Case study #2: Segregated Fund Distribution						
Date	Transaction	Amount (\$)	Unit Value (\$)	Total Units	Market Value (\$)	ACB (\$ per unit)
April 1	Purchase	5,000	10	500	5,000	10.00
December 30	Record day	0	12	500	6,000	10.00
December 30	Distribution day (notional)	500	12	500	6,000	11.00

When units are redeemed, the resulting capital gain is the difference between proceeds and the average unit cost. With this in mind, when units are purchased at different prices, the “first-in, first-out” rule DOES NOT apply.

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imaxx TOP Portfolio Name	Fund codes		
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What are you doing after work?



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imaxx Canadian Balanced Fund	AEGON Capital Management	AFM 203	AFM 103	AFM 503
imaxx Canadian Dividend Fund	AEGON Capital Management	AFM 242	AFM 142	AFM 542
imaxx Canadian Equity Growth Fund	AEGON Capital Management	AFM 240	AFM 140	AFM 540
imaxx Canadian Equity Value Fund	Foyston, Gordon & Payne Inc.	AFM 241	AFM 141	AFM 541
imaxx Canadian Small Cap Fund	AEGON Capital Management	AFM 243	AFM 143	AFM 543
imaxx U.S. Equity Growth Fund	Transamerica Investment Mgt., LLC	AFM 260	AFM 160	AFM 560
imaxx U.S. Equity Value Fund	Foyston, Gordon & Payne Inc.	AFM 261	AFM 161	AFM 561
imaxx Global Equity Value Fund	Foyston, Gordon & Payne Inc.	AFM 280	AFM 180	AFM 580
imaxx Global Equity Growth Fund	Walter Scott & Partners Ltd.	AFM 281	AFM 181	AFM 581

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AFM86 2/09