



# Tax treatment of segregated funds

For advisor use only



## Taxation of income generated within funds

Segregated funds contain different asset classes, such as stocks, Treasury bills, bonds and other financial securities. These asset classes generate different types of income, such as interest, dividends and capital gains and losses.

In addition, in the exercise of their duties, fund managers regularly carry out transactions to buy and sell assets within funds. When an asset is sold, the accumulated gain or loss on that asset is “realized” and is therefore subject to taxation as a capital gain or loss.

## Taxation when the client makes a withdrawal

Assets held in a fund are subject to market price fluctuations, which change the value of the fund over time and, therefore, the value of the units (unit value). This is what we call “market value”. Similarly, the income generated in a fund (as previously described) also changes the value of the fund and thus, the unit value.

As such, when the client makes a withdrawal, the profit or the loss on redeemed units is “realized” and subject to taxation.

Although this income remains in the funds, it is allocated to unitholders based on the number of units held. Investors are therefore taxed each year on the income earned by the funds in which they hold units, **regardless of whether the market value of their investments is a gain or a loss** (relative to the price paid).

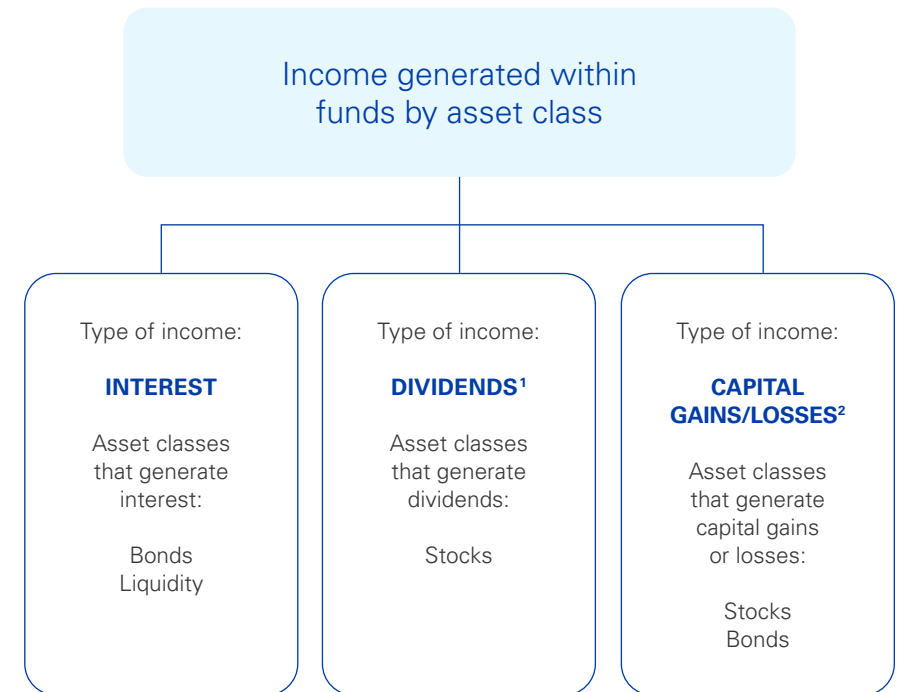
In short, every year, and for every fund, the income realized (interest, dividends and capital gains) by the fund is taxable for unitholders.

To determine the realized gain or loss, the following calculation is used:

$$\begin{array}{r} \text{Market value} \\ - \\ \text{Adjusted cost base (ACB)} \\ = \\ \text{Capital gain/loss} \end{array}$$

To find out the adjusted cost base (ACB), look under *My clients – Financial information – Investments* in the Advisor Centre.

## Income generated within the funds (assuming the client does not make a withdrawal)



Income generated within the fund is **allocated** (but not paid) to unitholders in proportion to the number of units held and is **taxed annually** depending on the type of income (interest/dividend/capital gain). For segregated funds investing directly in financial securities, and not in one or more underlying mutual funds, income generated within the fund is allocated on a **monthly basis**.

<sup>1</sup> Some of the assets held in the funds are foreign securities. For this reason, the client's tax slip sometimes states “Foreign non-business income”. In this case, it is always foreign dividend income.

<sup>2</sup> Capital gains and losses are recorded on tax slips (T3 [federal] and R16 [Quebec]) only when the fund manager sells securities.

## Conclusion

### ACCUMULATION

The client does not make any withdrawals.

INTEREST

DIVIDENDS

CAPITAL  
GAINS/LOSSES

Taxed annually

### DISBURSEMENT

The client makes withdrawals.

CAPITAL GAIN

CAPITAL LOSS

Taxation in the year of sale based on the difference  
between the market value and the ACB

### Notes

- Fifty percent of capital gains are taxable and 50% of capital losses are deductible (only against capital gains).
- Capital gains resulting from transactions made by fund managers AND capital gains resulting from withdrawals made by the client appear on the same tax slip (T3 [federal] and R16 [Quebec]).
- The market value and ACB are available in the Advisor Centre. This information is also available in your clients' non-registered contracts summary.
- If a client asks us for his/her ACB in order to calculate his/her gains and losses, he/she may be taxed twice. In segregated funds, all income generated by the funds as well as capital gains and losses resulting from redemptions by the client are included on the client's tax slip. The client or his/her accountant has no calculations to make.
- In mutual funds, however, the client must calculate his/her own gains and losses from redemptions and tax himself/herself by entering it on his/her tax return.





## EXAMPLE

The client makes a withdrawal from Fund A and Fund B

### FUND A

#### Information

Withdrawal:	\$7,000
Market value of the investment:	\$198,000
Adjusted cost base (ACB):	\$100,000

#### Calculation

Withdrawal:	\$7,000
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**Minus** ACB (\$7,000/\$198,000)

**X** \$100,000

**=** \$3,535

Capital gain on the withdrawal = **\$3,465**

### FUND B

#### Information

Withdrawal:	\$3,000
Market value of the investment:	\$76,000
Adjusted cost base (ACB):	\$50,000

#### Calculation

Withdrawal:	\$3,000
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**Minus** ACB (\$3,000/\$76,000)

**X** \$50,000

**=** \$1,974

Capital gain on the withdrawal = **\$1,026**

**For the year of the withdrawal, the client will pay tax on:**

- Fifty percent of the capital gain resulting from the withdrawal: **(\$3,465 + \$1,026) x 50% = \$2,246**
- Investment income generated during the year within the fund and allocated to the client:
  - Interest
  - Dividends
  - Capital gains and losses





F13-1023A (25-02) ACC

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