ETF Taxation FAQ

Having an understanding on how ETF investments are taxed is vital for investors. Having sound tax management is essential in an effective investment plan. Most ETFs are structured as trusts and provide income streams. Depending on whether the ETF is held in a registered or non-registered account will impact the tax treatment. Tax considerations can generally be placed into two buckets:

1. The treatment of distributions paid by the ETF; and

2. The treatment of realized gains and losses when an ETF is sold

What are ETF distributions and how does NBI treat them?

Investors may receive distributions through the calendar year. They will receive information on the different types of distributions from the ETF before the end of March of the following calendar year. If investors hold ETFs within a tax-sheltered account (RRSP, RRIF, RESP, or TFSA), distributions are not taxed and investors will not receive a tax form. If the ETF is held within a taxable account and has a taxable distribution, the investor can expect to receive a T3 tax form.

TYPES OF ETF DISTRIBUTIONS:

	Canadian dividends	Interest and other income	Capital gains	Foreign income (not from a company) and foreign tax paid	Return on Capital (ROC)
Tax treatment	Individual investors qualify for a dividend tax credit if the ETF invests in listed Canadian companiespaying eligible dividends.	When an ETF pays out distributions as interest and other income; distributions are treated as ordinary income.	Only 50% of capital gains are subject to tax and are included in the taxable income.	When the ETF pays distributions out of foreign income (not from a company), an investor paying Canadian tax may be able to claim a foreign tax credit for some of the foreign tax paid by the ETF.	An ETF may distribute return on capital, which is non taxable. Such a distribution will decrease the adjusted cost basis (ACB) of the held units. Selling the units will lower the ACB and will increase the capital gain (or decrease the capital loss) that would be realized on the sale.

How are ETF distributions paid?

NBI ETFs may pay distributions in cash on either a monthly, quarterly, or annual basis. If the ETF has any capital gains, they are typically distributed annually in December and investors receive them as reinvested distributions.

ETF Taxation FAQ

What triggers a capital gain?

An investor can incur a capital gain in a few different scenarios. First, performance could be a trigger. If the ETF experiences positive returns since the initial purchase and is sold thereafter, the holder could realize a capital gain if it is held in a non-registered account. Secondly, the trigger could be a corporate action. This is when a merger or acquisition occurs on one of the underlying holdings, the ETF may realize a capital gain. Lastly, the gain can come from portfolio rebalancing when underlying securities are sold within the ETF.

What is return on capital (ROC) and how does NBI treat it?

ROC is a tax term used to describe distributions in excess of an ETF's earnings (income, dividends and capital gains). For tax purposes, ROC represents a return to investors of a portion of their own invested capital. Therefore, any distribution paid out in excess of taxable factors is classified as ROC. This distribution is not taxable but results in a reduction in the ACB.

NBI ETFs generally distribute the taxable factor to avoid any ROC at the end of the year.

What are "phantom" distributions?

ETF capital gains are paid annually in reinvested distributions. Therefore, the ACB of the initial investment must be increased by the amount of the distribution reinvested in the ETF. This adjustment may be processed by the institution through which the ETF was subscribed. The increased ACB avoids unnecessary taxation by realizing a larger capital gain or a smaller capital loss on the sale of ETF units.

How NBI ETFs provide the simplest solution for foreign investing

NBI ETFs offer investors a simple and effective way to benefit from the diversification of their portfolio abroad. However, when investing outside Canada through ETFs, investors should consider the impact of foreign withholding tax on the earnings generated by their investment.

What are withholding taxes?

Many countries impose a tax on income paid to foreign investors – whether it's dividend or interest income. While the tax rate can vary from country to country, Canadian investors are generally subject to a 15% withholding tax for dividend payments from U.S. companies.

The way an ETF obtains its exposure to foreign equities affects withholding tax. In addition, the type of account in which an ETF is held is the second important factor in determining the amount of withholding tax a Canadian investor will pay. Different account types are subject to withholding tax in different ways.

1. NON-REGISTERED ACCOUNT

An investor can claim a foreign tax credit on their tax return to recover the tax paid in the foreign country.

ETF Taxation FAQ

2. RRSP/RIF

These accounts are not subject to U.S. withholding tax due to the Canada-U.S. Tax Treaty but are generally subject to withholding tax collected by other countries that is not recoverable.

3. TFSA/RESP

These accounts are generally subject to withholding tax, regardless of where the withdrawal was made. There is no exemption from U.S. withholding tax for these accounts and no foreign tax credit can be claimed.

How does NBI treat withholding tax within their ETF structure?

NBI ETFs are Canadian-listed that may hold foreign stocks directly. In this case:

- non-registered accounts do allow for the recovery of foreign withholding tax;
- RRSP/RIF accounts do not allow for the recovery of foreign withholding tax; and
- TFSA/RESP accounts do not allow for the recovery of foreign withholding tax.

Consult your qualified tax advisor to help better understand the impact of tax on your ETFs while making informed investment decisions. To find out more about NBI ETFs, please visit nbinvestments.ca/etf.

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