

BMO ETF Taxation

BMO EXCHANGE TRADED FUNDS

► Tax considerations for the BMO ETF family

On all ETFs, we focus on a sustainable yield based on the earnings from the underlying portfolio. We also consider tax efficiency when rebalancing holdings and rolling derivative contracts to minimize the tax impact to the investor.

Unitholders who received distributions throughout a calendar year will receive information on the tax treatment of the distributions by the end of February of the following calendar year. The tax characteristics will generally reflect the dividends, income, and capital gains from the underlying portfolio.

Additionally, as a consideration that generally applies to the ETF industry as a function of fund growth, a portion of the cash distribution may represent a return of capital (ROC), which is not taxable. ETFs look to maintain a payout close to the index or market payout, net of fees. When an ETF receives a subscription, in addition to receiving the basket of securities that represent the portfolio, the ETF receives the cash component equal to the outstanding income on the fund. The ETF will then pay out the cash components received as part of its distribution to maintain the ETF's yield. This will result in a small amount of ROC.

► Equity ETFs

Generally for an equity only ETF, the cash distributions will include dividends and a small amount of ROC.

Net capital gains realized on the securities sold in the portfolio are reinvested and reported as capital gains distributions. These gains increase a unitholder's adjusted cost base (or adjusted purchase price) of the ETF, leading to lower capital gains when the ETF is sold. Net capital losses are carried forward within the ETF to apply against gains in future years.

► Fixed Income ETFs

Generally for a bond ETF, the cash distributions will include income and a small amount of ROC.

Net capital gains realized on the securities sold in the portfolio are reinvested and reported as capital gains distributions. These gains increase a unitholder's average cost base of the ETF,

leading to lower capital gains when the ETF is sold. Net capital losses are carried forward within the ETF to apply against gains in future years.

► Futures Based ETFs

Generally for a futures based ETF, the fund will not have cash distributions.

Reinvested income distributions based on the net gain positions on securities within the portfolio, are reported and reinvested. Net losses are carried forward within the ETF to apply against gains in future years.

► Covered Call ETFs

For an equity ETF with written call options, the cash distributions will include dividend income, capital gains (from the premiums received) and ROC. From a tax perspective, the gains from writing options are combined with gains and losses from trading the underlying portfolio. If the underlying portfolio trades have generated losses, these losses reduce or negate the tax gain from the written options and create ROC. Note that in the money options do not decrease the value of the ETF, as the increase in the value of the written option, which negatively impacts the ETF, is offset by the increase in the value of the underlying portfolio holding. Overall, this is a tax advantage for the ETF as capital gains are taxed favourably to dividends and income, and ROC is not taxable.

Reinvested capital gains distributions may be reported based on the net gain positions on sold securities within the portfolio, if those gains exceed the amount of capital gains paid out over the course of the year as cash distributions. Net losses are carried forward within the ETF to apply against gains in future years.

The Net Asset Value (NAV) will fluctuate with the returns on the underlying portfolio adjusted for call premiums received and capped by the strike level of the options. We pay a sustainable yield, equal to the dividend income plus the call premium received. There is no "depletion of the NAV" to fund the distributions, as the net return of the ETF above the strike price is flat. Any losses on the calls above the strike price are offset by gains in the underlying portfolio.

► Tax Management

For any fund, there is an element of tax management around year end distributions for capital gains. Income distributions may be paid periodically throughout the year, and therefore are less impactful to year end unitholders. However, portfolio capital gains are only calculated annually at year end.

If the ETF expects a large capital gain distribution as a result of selling portfolio securities in a net gain position, a unitholder may choose, dependant on their own adjusted cost base on the ETF, and the availability of a comparable investment, to sell the ETF prior to the capital gain distribution. If the unitholder's per unit gain position is similar or higher than the expected capital

gain distribution from the ETF (where the current market price exceeds the unitholder's adjusted cost base), there is no advantage to sell the ETF. If the unitholder's per unit gain position is lower than the distribution, they may look to sell the ETF and be subject to less capital gains. A major consideration in this case will then be if a comparable investment is available to maintain the unitholder's desired asset exposure.

If the unitholder receives the capital gain distribution, reinvested gain distributions add to the investor's adjusted cost base, resulting in a lower capital gain when the ETF is eventually sold as the adjusted cost base is then higher.

Visit bmo.com/etfs or contact Client Services at 1-800-361-1392.

For market views that lead to a variety of BMO ETF solutions, subscribe to the Monthly Strategy Report at bmo.com/etfs.

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BMO  **Financial Group**

Exchange Traded Funds