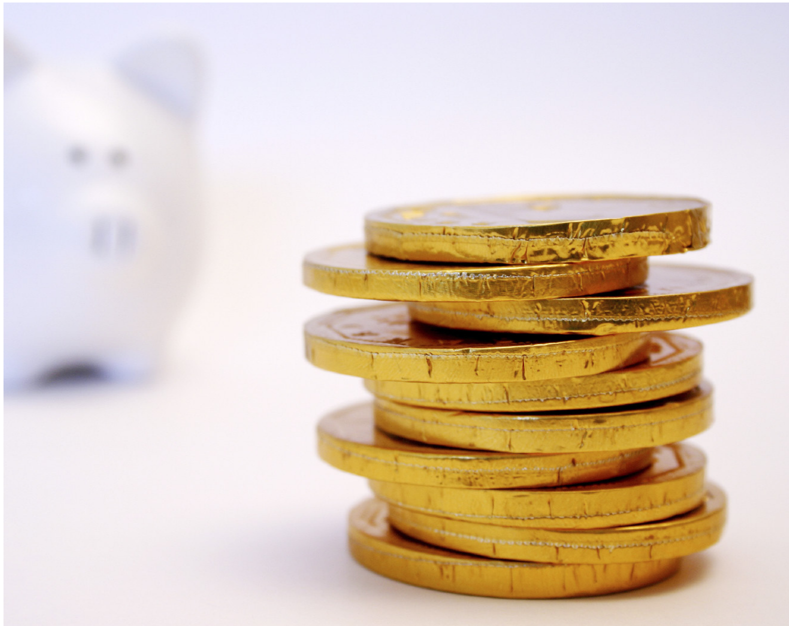
Tax Issues, U.S. Investing, and Your Clients



Investment advisors buying U.S. investments should be aware of issues affecting their client's tax liabilities - we can help

As Canadians, we have focussed and benefitted on finding investment opportunities in the U.S. and other foreign markets. However, investing outside of Canada can have its costs.

Withholding Taxes, and U.S. Estate Taxes can both have a potentially negative impact to your portfolios and be the difference between reaching your or your client's investment goals. Also, the T1135 Foreign Income Verification Statement is an additional compliance burden when filing your return.

Tax can be a defining item to help strengthen your investment returns and BMO Global Asset Management has the right solutions to help. This document was prepared to give you a better understanding of the potential tax implications associated with foreign investing, and remove some of the misunderstanding with a potentially complex topic.

BMO Global Asset Management

Understanding Foreign Withholding Taxes

Canadian's should consider the impact of withholding taxes

Dividend and interest (and potentially other sources of income) received from non-Canadian investments may be subject to withholding taxes, which are applied before the investor receives the distribution.

The amount depends on:

A. Type of Account

Foreign tax credits can be claimed only for investments held in taxable (non-registered) accounts. Investors will receive a T3 or T5 slip after year-end which indicates the amount of foreign taxes paid, and credits for these taxes may be claimed by completing T2209 forms.

Mutual Fund and ETF investors in registered accounts (such RRSPs and TFSAs) are generally not eligible to claim a credit for foreign taxes paid.

B. Type of Investment

Investors are generally subject to withholding taxes imposed by foreign countries on sources of income in those foreign countries (for example, dividends paid to Canadian resident investors by U.S. resident corporations are generally subject to a withholding tax of 15%).

Additionally, whenever foreign securities (outside of North America) are held indirectly by a Canadian investment fund that holds a U.S.-listed ETF, investors may be subject to a further 15% U.S. withholding tax. This additional 15% U.S. withholding tax applies if the U.S.-listed ETF is treated as a corporation for U.S. tax purposes.

Withholding Tax Example:

iShares MSCI EAFE ETF (EFA) [U.S.-listed ETF]

When held by a Canadian resident in a non-registered account, two withholding taxes apply in this scenario:

1) The withholding tax imposed by the U.S.
   U.S. withholding taxes apply, but are recoverable.
2) The withholding tax imposed by foreign countries
   Foreign withholding taxes apply, however, **are not** recoverable.

Assuming 12% withholding tax on foreign dividends, investors in EFA (yielding 2.5% as at May/31/2014) **would lose approximately 30bps**.

Solution:

Because **BMO MSCI EAFE Index ETF (ZEA)** & **BMO MSCI EAFE Hedged to CAD Index ETF (ZDM)** are Canadian listed ETFs and generally hold their underlying securities directly, foreign tax credits can be claimed to offset of the foreign withholding taxes.

DID YOU KNOW?

Because BMO Mutual Funds and the majority of BMO ETFs generally hold their underlying securities directly, foreign tax credits **can be** claimed to recover any applicable withholding taxes in a non-registered account.

Breaking Down Dividend Withholding Taxes

Generally, Canadian investors trying to diversify their investment portfolios outside of Canada by investing into U.S. and foreign equities will fall into one of the **six scenarios** displayed below.

Non-Registered Account

1. **CDN Mutual Funds or CDN-listed ETFs that hold U.S. Stocks**
2. **CDN Mutual Funds or CDN-listed ETFs that hold a U.S.-listed ETF that holds U.S. stocks**
3. **U.S.-listed ETFs that hold U.S. Stocks**
4. **CDN Mutual Funds or CDN-listed ETFs that hold Foreign Stocks[1]**
5. **CDN Mutual Funds or CDN-listed ETFs that hold a U.S.-listed ETF that holds Foreign Stocks[1]**
6. **U.S.-listed ETFs that hold Foreign Stocks[1]**

Scenarios 1, 2 and 3: U.S. withholding taxes apply and are recoverable by claiming foreign tax credit

Scenario 4: Foreign withholding taxes apply and are recoverable by claiming foreign tax credits

Scenarios 5 and 6: Foreign withholding taxes apply and **are not** recoverable.

U.S. withholding taxes may also apply and are recoverable by claiming foreign tax credit.

Registered Account

Foreign withholding taxes may apply and **are not** recoverable.

U.S. withholding taxes may also apply and **are not** recoverable.

[1] Foreign Stocks are defined as shares of corporations that are resident outside of North America.

DID YOU KNOW?

When you invest in a U.S.-listed ETF holding foreign stocks, foreign withholding taxes are not recoverable. One solution is to invest in a Canadian-listed ETF, such as BMO MSCI EAFE Index ETF, where the foreign withholding taxes **can be** recovered.

Understanding Form T1135

Form T1135 – Foreign Income Verification Statement

Form T1135 is a mandatory filing for any Canadian with certain foreign property with a **total cost over $100,000**.

Potential ways to get exposed:

- Canadians that hold foreign assets
- Immigrants to Canada who have foreign assets
- Canadians abroad that acquire foreign assets

Examples of assets that must be reported:

- Shares of non-resident corporations and bonds issued by non-residents, even if held by a Canadian broker
- Domestic securities (such as Canadian stocks) held outside of Canada
- Life insurance policies issued by foreign issuers

Examples of foreign assets that are exempted from reporting:

- Foreign assets used primarily for personal use & enjoyment
- Foreign assets held in a RRSP or TFSA

The $100,000 threshold is triggered when the **total cost amount** of the assets (not their value) exceeds $100,000. The cost amount of an asset is generally the property's fair market value at the time you acquired it (so if your foreign property was initially purchased for a total of $90,000, you do not need to report even if the property is now worth $110,000).

Visit the CRA **'Questions and Answers about Form T1135'** page or contact your Tax Advisor for more information.

Examples of what must be reported:

Popular stocks traded on the U.S. stock exchange that a Canadian resident might hold such as:

- General Electric (GE)
- Ford Motor Company (F)
- Pfizer Inc. (PFE)

Must all be reported on the Form T1135

Similarly, even U.S.-listed ETFs, such as:

- SPDR S&P 500 ETF (SPY)
- Vanguard S&P 500 ETF (VOO)
- iShares Core S&P 500 ETF (IVV)

Must also be reported on the Form T1135

Canadian-listed ETFs, such as **BMO S&P 500 Index ETF (ZSP)** and Canadian mutual funds such as **BMO U.S. Equity Fund**, are exempt from the T1135 reporting requirement.

DID YOU KNOW?

Even if a Canadian mutual fund or a Canadian-listed ETF holds foreign securities, the units of the Canadian fund are not foreign property, and are exempt from the T1135 reporting requirement.

U.S. Estate Taxes: Taxed after Death

U.S. estate taxes aren't just for Americans

High net worth Canadian residents with U.S. assets with a value that exceeds US$60,000 may be required to pay U.S. estate tax on the value of their U.S. assets.

The tax rate starts from 18% and moves up to 40% for investors with U.S. assets exceeding $1 million.

The good news is that the Canada-U.S. Tax Treaty ('Tax Treaty') allows for the estate tax liability to be reduced by claiming a 'Unified Credit' and a 'Marital Credit'.

Note: Most U.S. equity, U.S. property, and some U.S. debt securities will be subject to estate tax.

Protect your assets!

Wealthy Canadians looking for a place to invest their greenbacks but who are also concerned about U.S. Estate Taxes, might be better suited to invest in a BMO ETF.

BMO U.S. Dollar ETFs - Exempt from U.S. Estate Taxes:

- BMO S&P 500 Index ETF (ZSP.U)
- BMO US Dividend ETF (ZDY.U)
- BMO Low Volatility US Equity ETF (ZLU.U)
- BMO Mid-Term US IG Corp. Bond Index ETF (ZIC.U)

Unified Credit

This credit is the equal to the greater of:

- $13,000
- ($2,081,800* x the value of your U.S. assets) / (value of your worldwide assets)[1]

*$2,081,800 is the non-refundable unified credit for 2014. It represents the effective exemption amount of $5.34mm for 2014 and is adjusted annually.

Example: Zach, a Canadian resident has $15 million in worldwide assets, of which US$2.5 million is considered a U.S. asset.

Estate Tax:	$945,800	(before unified credit)
Unified Credit:	$346,967	(prorated unified credit)
Net Estate Tax:	**$598,333**	(liability after credit)

Marital Credit

If a Canadian's U.S. assets pass over to a spouse (also a Canadian resident and not a U.S. citizen) upon death the Tax Treaty provides marital credit.

The marital credit equals the lesser of the Unified Credit or the amount of the Estate Tax.

Example: If Zach were to leave his U.S. assets to his wife Susan (also a Canadian resident), the U.S. estate tax liability would be reduced to $252,133

Estate Tax:	$598,333	(before marital credit)
Marital Credit:	$346,967	
Net Estate Tax:	**$251,867**	(liability after both unified and marital credits are applied)

DID YOU KNOW?

Ordinarily, Canadian mutual funds and Canadian-listed ETFs (even if they invest in U.S. equity or debt securities), are not considered to be U.S. assets for estate tax purposes[1].

[1] As long as the Canadian Funds are treated as corporations for U.S. tax purposes.

BMO Global Asset Management

Efficient Solutions for Foreign Investing

By investing in Canadian Mutual Funds & Canadian-listed ETFs, investors avoid getting hit with unexpected taxes. **BMO ETFs & BMO Mutual Funds** offer investors a comprehensive suite of solutions that provide tax effective foreign diversification in their portfolios.

The BMO Advantage

1. BMO ETFs and Mutual Funds allow investors to claim foreign tax credits, offsetting any withholding taxes that may apply (U.S. and foreign)
2. BMO ETFs and Mutual Funds are exempt from T1135 Foreign Income Verification Statement reporting
3. BMO ETFs provide the same exposure as ETFs offered in the U.S. but ordinarily are not subject to U.S. estate taxes

BMO U.S. & Foreign Equity ETF Broad Market Offerings	Hedged	Unhedged	USD
BMO S&P 500 Index ETF	ZUE	ZSP	ZSP.U
BMO US Dividend ETF	ZUD	ZDY	ZDY.U
BMO Low Volatility US Equity ETF	-	ZLU	ZLU.U
BMO Dow Jones Industrial Average Hedged to CAD Index ETF	ZDJ	-	-
BMO MSCI EAFE Index ETF	ZDM	ZEA	-
BMO MSCI Europe High Quality Hedged to CAD Index ETF	ZEQ	-	-
BMO MSCI Emerging Markets Index ETF	-	ZEM	-

BMO U.S. & Foreign Mutual Fund Broad Market Offerings	$CDN	$USD
BMO U.S. Equity Fund	GGF99723	GGF79602[1]
BMO U.S. Dollar Dividend Fund	GGF49807	GGF99807
BMO U.S. Dollar Balanced Fund	GGF49808	GGF99808
BMO U.S. Dollar Monthly Income Fund	GGF49804	GGF99804
BMO Global Dividend Fund	GGF99725	GGF79211[1]
BMO International Value Fund	GGF99732	-

[1] Represents the Corporate Class fund code.

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