FAQ – What to Expect During Tax Season

It is important to be prepared and plan for effective tax management. Each year ETF investors can expect to receive tax forms from their respective brokerages. As an investor, your primary focus should be on the total return of your portfolio and the tax efficiency of your return depending on your type of account, taxable or non-taxable.

How are ETFs Taxed?

As an ETF investor there are two tax considerations to understand, the treatment of distributions paid by the ETF and the treatment of the gain or loss realized on selling the investments in the ETF. Depending on what type of account, registered or non-registered, the ETF is held in will also impact how the tax treatment. Distributions flow through to the unitholder, based on the ETF's underlying portfolio.

More About BMO ETF Distributions

What are ETF Distributions?

Investors who received distributions throughout the calendar year will receive information on the tax treatment of the distributions by the end of February of the following calendar year. If investors hold ETFs within a tax sheltered account such as RRSP, RRIF, RDSP, and TFSA, they will not be taxed on distributions and therefore will not receive a T3 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.

What Are The Types Of ETF Distributions?

Canadian Dividends: Dividend distributions occur when an ETF invests in Canadian equity securities that pay dividends.
Tax Treatment: Canadian residents qualify for a dividend tax credit, if the ETF invests in Canadian securities that pays dividends.

Interest and Other Income: Fixed income ETFs earn interest on their investments in bonds and other debt obligations.
Tax Treatment: When an ETF pays out distributions as interest and other income are treated as ordinary income.

Capital Gains: An ETF may incur capital gains if the sale of investments in the ETFs portfolio is sold for more than its purchase price.
Tax Treatment: Only 50% of capital gains are subject to tax and has to be included in the investors taxable income.

Foreign Income and Foreign Tax Paid: An ETF may earn dividends or interest on foreign investments and have to pay foreign withholding tax.
Tax Treatment: When the ETF pays distributions out of this foreign income, an investor that pays Canadian tax may be able to claim a foreign tax credit for some of the foreign tax paid by the ETF.

Return of Capital: An ETF may have a distribution that returns a portion of your initial investment.
Tax Treatment: An ETF may distribute return of capital which is non taxable to investors. However, such a distribution will decrease the ACB of the investor's units. When the investor sells the ETF units, the lower ACB will increase the capital gain (or decrease the capital loss) that would otherwise be realized on the sale.

! As ETF providers do not have insight to unit holders, investors will receive T3's from their respective brokerages. The ETF provider posts the factors to CDS generally around mid-February. The dealer will then run the tax slips for clients and tend to do the cost adjustment afterwards.

How are ETF Distributions Paid?

BMO ETFs pay distributions in cash on either a monthly, quarterly, or annual basis. Generally, the greater the income generated in the fund, the higher the distribution frequency. If the ETF has any capital gains, they are typically distributed annually in December and investors receive them as reinvested distributions. BMO Covered Call ETFs also pay out capital gains on the option premiums on a monthly basis.

What triggers a Capital Gain?

An ETF could incur a capital gain if one of the following events occur:

Performance – If the ETF experiences positive returns since purchase and the ETF is sold, the holder could realize a capital gain

Corporate Action – When a merger or acquisition occurs on one of the underlying holdings, the ETF may realize a capital gain

Portfolio Rebalancing - When this occurs, the ETF will trade the underlying securities, which could result in a capital gain.

More About Return of Capital (ROC)

Any distribution that is paid out in excess of taxable factors is classified as ROC. For cash income distributions paid throughout the year, BMO ETFs generally distribute based on the underlying portfolio yield less expenses. This benefits investor's by providing greater certainty on the payout. As the ETF grows, the income earned is allocated across unitholders.

The important consideration for ROC, is whether it impacts the sustainability of the distribution. We define good ROC as sustainable, where the invested capital is not depleted over time. We define bad ROC as dipping into the invested capital to support the distribution, which leaves less investment for future years.

Reinvested 'Phantom' Distributions

ETFs capital gains are paid out annually as reinvested distributions. As a result, an investor's adjusted cost base is increased by the amount of the reinvestment distribution. Investors do not adjust their ACB if there are capital gain on the cash distributions through out the year. This adjustment may be handled by the brokerage where you purchased the ETF from. This reinvested distribution adds to the investors adjusted cost base, resulting in a lower capital gain once the ETF is sold and to avoid double taxation. On a cash distribution, reduce the cost (ACB) by the amount of ROC, since we are returning their money. On a reinvested distribution, increase the cost (ACB) by the taxable factors, since the client is paying tax now. These two events can result in a net cost adjustment.

Covered Call ETFs

BMO ETFs treat the premiums earned from writing call options on portfolio securities as capital gains. While the premiums earned are paid out as part of the monthly cash distributions, the premiums are combined with the gains and losses from selling underlying holdings which may result in higher ROC on the T3 tax form. Note that in the money options do not decrease the value of the ETF, as the increase in value of the sold option is offset by the increase in value of the underlying portfolio holding at the same time. This means that we consider this good ROC, as the invested capital is not depleted.

Currency Hedging

On our ETFs, currency hedging is taxed as capital gains. We use one month forward contracts, where the gains and losses are recognized as the contract expires in the year. A proxy for cap gains from currency is the movement in the exchange rate over the year, subject to fund growth. These cap gains co-mingle with the gains and losses from the underlying portfolio.

BMO ETFs – Efficient Solutions for Foreign Investing

By investing in Canadian listed ETFs, investors can mitigate the amount of foreign taxes paid. BMO ETFs offers investors a comprehensive suite of solutions that provide tax effective foreign diversification.

Withholding Taxes

Dividend income received from non-Canadian investments may be subject to withholding taxes. Foreign tax credits can be claimed for investments held in taxable, non-registered accounts. If international securities are held indirectly through a U.S. ETF, withholding tax are not recoverable. If a Canadian resident holds a US listed ETF that holds international securities, in a non-registered account, investors could be subject to paying two levels of withholding tax. BMO ETFs avoid this unrecoverable tax by holding their underlying securities directly, allowing for foreign taxes to be claimed.

BMO ETFs Solutions:
ZEA & ZDM & ZEQ
Holds International Equities directly.

T1135

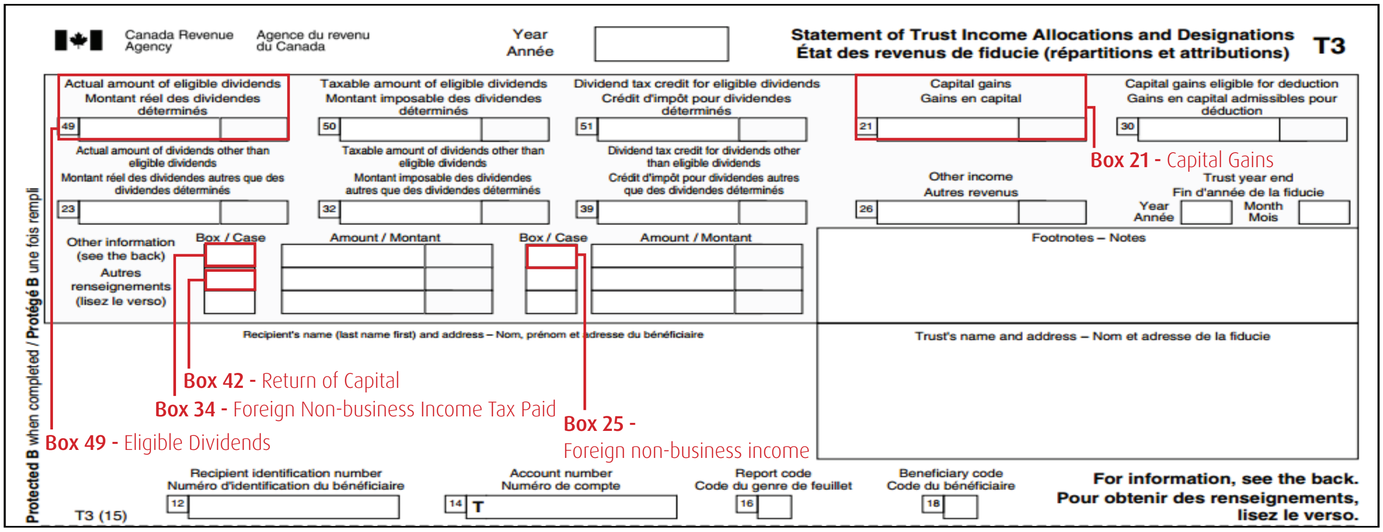
Investors who own certain foreign property with a total cost over $100,000 are required to file form T1135. Canadian ETFs are exempt from this reporting requirement, even if they hold foreign securities.

U.S. Estate Taxes

High net worth Canadians with worldwide assets exceeding US$11.4M (2019, indexed to inflation) or have 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. Canadian ETFs are generally are not considered U.S. assets.

BMO ETFs Solutions:
ZBK & ZUE & ZSP
Canadian ETFs are not subject to the T1135 reporting requirement and ordinarily are not subject to U.S. estate tax.

Example of a T3 tax slip


Canada Revenue Agency / Agence du revenu du Canada

Year / Année

Statement of Trust Income Allocations and Designations / État des revenus de fiducie (répartitions et attributions) **T3**

Actual amount of eligible dividends / Montant réel des dividendes déterminés (49)	Taxable amount of eligible dividends / Montant imposable des dividendes déterminés (50)	Dividend tax credit for eligible dividends / Crédit d'impôt pour dividendes déterminés (51)	Capital gains / Gains en capital (21)	Capital gains eligible for deduction / Gains en capital admissibles pour déduction (30)
Actual amount of dividends other than eligible dividends / Montant réel des dividendes autres que des dividendes déterminés (23)	Taxable amount of dividends other than eligible dividends / Montant imposable des dividendes autres que des dividendes déterminés (32)	Dividend tax credit for dividends other than eligible dividends / Crédit d'impôt pour dividendes autres que des dividendes déterminés (39)	Other income / Autres revenus (26)	Trust year end / Fin d'année de la fiducie: Year / Année; Month / Mois

Other information (see the back) / Autres renseignements (lisez le verso) — Box / Case; Amount / Montant; Box / Case; Amount / Montant

Footnotes – Notes

Recipient's name (last name first) and address – Nom, prénom et adresse du bénéficiaire

Trust's name and address – Nom et adresse de la fiducie

Recipient identification number / Numéro d'identification du bénéficiaire (12)

Account number / Numéro de compte (14) T

Report code / Code du genre de feuillet (16)

Beneficiary code / Code du bénéficiaire (18)

For information, see the back. / Pour obtenir des renseignements, lisez le verso.

T3 (15)

Protected B when completed / Protégé B une fois rempli

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