

GIF Select[®]

Tax Treatment of IncomePlus

**An overview of the tax treatment of the
income stream received from IncomePlus**



AN OVERVIEW OF THE TAX TREATMENT OF THE INCOME STREAM RECEIVED FROM INCOMEPLUS

Depending on what funds the money is invested, there may be year end allocations reported. This commentary deals with the tax treatment of the income received from IncomePlus where the rate of return is a constant 5% per year, the same percentage as the guaranteed or lifetime withdrawal amount.

CONSIDER THE AFTER-TAX INCOME

Gross Income: \$10,000 Source of Income	Inclusion Rate	Income Reported (Line 234)*	After-tax Income (MTR 40%)
Dividends	145%	\$14,500	\$7,500
GIC/Bond/RRIF/Salary	100%	\$10,000	\$6,000
Capital Gains	50%	\$5,000	\$8,000
Income Fund w/ROC	≈ 45%	\$4,500	\$8,550
Prescribed Life Annuity	≈ 25%	\$2,500	\$9,000
Mutual / Segregated fund SWP (IncomePlus) ¹	≈ 2.5%	\$250	\$9,900

The above chart illustrates how \$10,000 of income, from different sources, is reported on a tax return and how much is remaining after-tax. Rate of return is for illustration purposes only.

* Line 275 in Quebec

¹Assumes \$200,000 invested, 5% annual rate of return (\$10,000) and a systematic withdrawal payment (SWP) of \$10,000. Represents results for Year 1 and does not take into account year end allocations.

DIVIDENDS (ASSUMES AN EFFECTIVE TAX RATE OF 25% – WILL VARY BY PROVINCE)

- From an income inclusion perspective, dividend income is the least income friendly since only the grossed-up amount is reflected on the tax return which is used to determine eligibility for many income tested benefits such as Old Age Security (OAS)

INCOME FUND WITH RETURN OF CAPITAL

- Assumes \$1,000 of dividends taxed at 25% and \$3,000 of interest taxed at 40%. The amount will vary by income fund and from year to year

MUTUAL / SEGREGATED FUND SYSTEMATIC WITHDRAWAL PLAN (SWP) AND THE TAX TREATMENT OF INCOMEPLUS

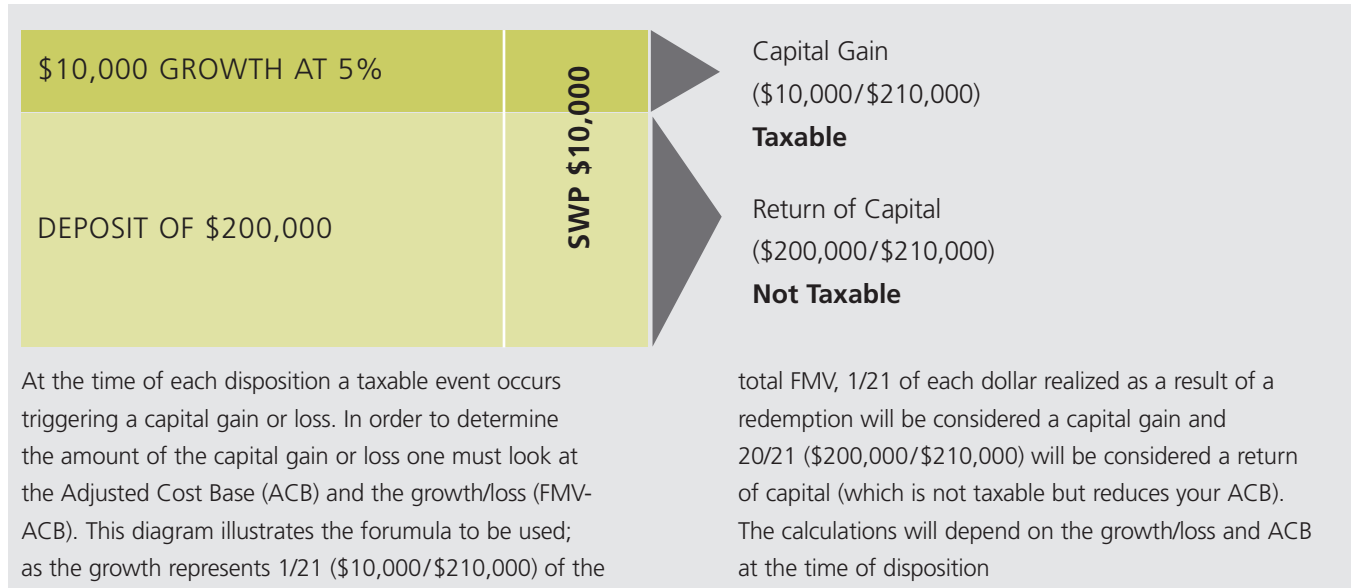
- From an income inclusion perspective, receiving income in this manner is very income friendly since only a small portion of the income stream is taxable

- In a down market, this type of income withdrawal will generally erode capital. GIF Select with IncomePlus can help reduce this risk if the withdrawals are less than or equal to the Guaranteed Withdrawal Amount (GWA) or Lifetime Withdrawal Amount (LWA)

Note: See "SWPs - How to calculate the tax?" for details on calculating the taxable portion of systematic withdrawal payments (SWPs).

SWPs – HOW TO CALCULATE THE TAX?

The following diagram illustrates the taxation of income in a SWP scenario and for IncomePlus.



TAXATION OF SWPs IN AN UP MARKET

Investment (ACB)	\$200,000	
5% growth	\$ 10,000	
Market Value after 1 year	\$ 210,000	
SWP	\$ 10,000	
Capital Gain		
(\$10,000/\$210,000)*\$10,000	\$ 476	4.76%
Return of Capital	\$ 9,524	95.24%

For illustration purposes only. Assumes no year-end allocations.

Of the \$10,000 withdrawal, 4.76% is a capital gain (of which only 50% is taxable) and 95.24% is a return of capital.

SWP	\$	10,000
Capital Gain	\$	476
Taxable Capital Gain 50%	\$	238
Tax Payable at 40% tax rate	\$	95
Effective tax rate (\$95/\$10,000)		0.95%

Since the capital gain is \$476 and only 50% of that amount is taxable, the effective tax rate in the first year is less than 1%. In this example you are left with \$9,905 after tax.

GIC EQUIVALENT

YEAR	EFFECTIVE TAX RATE	GIC EQUIVALENT
1	0.95%	8.25%
3	2.72%	8.11%
5	4.33%	7.97%
10	7.72%	7.69%
25	14.09%	7.16%
40	17.16%	6.90%

In a growth market, more of the withdrawal is considered a capital gain in subsequent years. However, even in year 40 the effective tax rate is still less than 20%. The GIC equivalent represents the interest rate needed on a GIC to get the same amount of after tax income.

For illustration purposes, we have assumed a \$200,000 deposit, 5% rate of return (therefore \$10,000 annual growth), and withdrawal of \$10,000 each year (i.e. withdrawal equals the growth). This way the client is still left with their original deposit of \$200,000 as with a GIC.

GIC EQUIVALENT WITH ALLOCATIONS

YEAR	EFFECTIVE TAX RATE	GIC EQUIVALENT
1	5.95%	7.84%
3	7.35%	7.72%
5	8.62%	7.61%
10	11.30%	7.39%
25	16.33%	6.97%
40	18.76%	6.77%

In addition to the assumptions above, the GIC equivalent with allocations assumes year end allocations equal to 20% of the fund return and a tax rate of 25% on the allocated amount.

SIMPLIFIED TAX REPORTING

SEGREGATED FUND TAX REPORTING

- All taxable amounts are reported on a T3
- Unlike mutual funds, gains and losses are reported for the SWP

ALL TAXABLE EVENTS REPORTED

The **KEY** benefit is that any capital gains/losses realized by unit-holders on the disposition of units (either a fund switch or redemption) are reported on a T3. Manulife tracks the ACB and reports the capital gain/loss on the T3 removing an enormous burden from the tax preparer who would have to prepare calculations for each disposition and keep a running ACB. This would include any fund switches, withdrawals or deposits and any previous years' allocations or distributions along with any fees (i.e. front end or back end loads); a very time consuming and complicated task. Just think of someone who does monthly SWPs, at least 12 taxable dispositions a year, in addition to the other events above.

GUARANTEED PAYMENT PHASE

This occurs when the FMV is \$0 while there is a positive GWB balance or the LWA is greater than \$0. The taxation of these payments is not certain at this time. Please consult your tax advisor for further information. We will report any payments during the guaranteed payment phase based on our understanding of tax legislation and CRA assessing practices at that time.

The Policyowner is responsible for any tax liabilities arising from any change in law interpretation, or CRA assessing practice.

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