MACKENZIE Investments | CONFIDENCE IN A CHANGING WORLD

# ETF TAX ASPECTS FOR INVESTORS

## Foreign Withholding Taxes

ETFs can be an easy way to gain low-cost exposure to international markets. However, investors purchasing foreign investments through ETFs should be aware of the withholding tax that can occur in some situations. Oftentimes, this tax goes unnoticed since distributions are usually paid after the withholding tax is applied to the ETF and may or may not be reflected on year-end tax slips. An investor investing in an ETF will receive a distribution net of the withholding taxes. Foreign withholding, the cost of foreign currency exchange as well as management and trading fees are all cost considerations investors should be mindful of. The following will explain how ETFs are taxed by outlining the common structures and account types generally affected by withholding tax. This will help investors make more informed decisions when investing in ETFs.

## Taking Advantage of Foreign Tax Credits

Canadian tax laws allow for individuals to take advantage of foreign tax credits available to investors of ETFs with exposure to international markets to decrease the amount of tax paid. Normally, an investor would be subject to tax in both Canada as well as the foreign country that the dividend originates from. The foreign tax credit allows for the investor to claim any international tax paid which ultimately lowers the Canadian taxes payable.

## ETF Structures

The amount of withholding tax incurred by the ETF investment is dependent on the structure of the ETF and how that structure exposes itself to international markets.

The three most common structures that Canadian investors have access to include:

### 1. US-listed ETF that invests in international stocks.

In this structure, the investor incurs exposure to international markets directly. The 15% withholding tax will be applied first by the country where the stock originates from. After the first 15%, the US applies an additional withholding tax on distributions made by the US ETF to the Canadian taxpayer. In non-registered accounts, this secondary withholding tax can amount up to an additional 15%.

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| $5.00<br>Dividend from Foreign Corp. | » | -$0.75<br>Foreign Withholding Tax (15%) | » | $4.25<br>Dividend Received by US ETF | » | -$0.65<br>US Withholding Tax (15%) | » | $3.60<br>Dividend Received by Investor |

### 2. Canadian-listed ETF that holds US-listed ETFs which invests internationally.

In this structure, the exposure to international markets is experienced indirectly by the investor. When the foreign investments pay out dividends to the US-listed ETF, the investor will be subject to foreign withholding tax which will be applied by the company that the dividend originates from. The investor will then be exposed to US withholding tax when the US-listed ETF pays the dividend to the Canadian ETF.

| | | | | |
|---|---|---|---|---|
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### 3. Canadian-listed ETF that invests directly in international stocks.

Through this structure, the investor gains direct exposure to international markets through the foreign companies in the ETF's portfolio. The global weighted average of withholding tax on international stocks is 12%* and only applies one time when the foreign investment pays dividends to the Canadian ETF.

| | | |
|---|---|---|
| $5.00<br>Dividend from Foreign Security | -$0.60<br>Foreign Withholding Tax | $4.40<br>Dividend Received by Investor |

## Withholding Tax by Type of Account

The type of account that holds the investment also plays a role in determining the amount of withholding tax that is experienced. The following chart provides information on the tax experienced based on the type of account that holds the ETF.

| ETF Structure | Account Type | | | | | |
|---|---|---|---|---|---|---|
| | RRSP, RRIF | | TFSA, RDSP, RESP | | Taxable Accounts | |
| | Level 1 Tax | Level 2 Tax | Level 1 Tax | Level 2 Tax | Level 1 Tax | Level 2 Tax |
| **U.S Markets** | | | | | | |
| U.S Listed ETF | X | X | ✓ | X | TC | X |
| Canadian Listed ETF (holding US Listed ETF) | ✓ | X | ✓ | X | TC | X |
| Canadian Listed ETF (investing internationally) | ✓ | N/A | ✓ | N/A | TC | N/A |
| **Foreign Markets** | | | | | | |
| U.S Listed ETF | ✓ | X | ✓ | ✓ | ✓ | TC |
| Canadian Listed ETF (holding US Listed ETF) | ✓ | ✓ | ✓ | ✓ | ✓ | TC |
| Canadian Listed ETF (investing internationally) | ✓ | N/A | ✓ | N/A | TC | N/A |

✓: Tax will apply    X: Tax will not apply    TC: Tax credit is available
Level 1 Tax: First level of withholding tax
Level 2 Tax: Second level of withholding tax



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