Segregated fund taxation
Non-Registered Funds

When you invest in non-registered segregated funds you may receive a T3 tax slip* that reports the income that was allocated to your policy in the previous tax year. Many investors find the income reported on their tax slip confusing.

*In Quebec the policyowner will also receive a Relevé 16. A non-resident will receive a NR4.

Keep reading to learn how segregated funds earn income, how this income is taxed, and what to expect on your tax slip.
To understand segregated fund taxation, it can be helpful to visualize how segregated fund investing works. It is important to note that segregated funds generally invest in an underlying mutual fund or funds.

Segregated fund investing:

When you invest in a segregated fund your money is pooled with the money of all the other people who have invested in that segregated fund.

The professional fund manager of the underlying fund will strategically buy and sell a variety of investments (such as stocks and bonds).

Taxable investment income:

Realized capital gains and losses occur when you surrender units of your segregated fund by making a withdraw or a switch.

Realized capital gains and losses occur when the fund manager sells investments in the underlying fund.

Dividends can be paid from stocks held in the underlying fund.

Interest can be paid from bonds and other investments that are held in the underlying fund.

“When you invest in a segregated fund your money is pooled with the money of all the other people who have invested in that segregated fund.”
Investment Income on Segregated Funds

There are three types of investment income that could be generated within a segregated fund. If any of the following types of income are generated, a tax slip is produced and sent to the investor:

1. **Dividends**
   Stocks held in the underlying fund may declare dividends, which are proportionally allocated to all of the segregated fund unit holders at the end of the year.

2. **Interest**
   Bonds and other investments held in the underlying fund generate interest, which is proportionally allocated to all of the segregated fund unit holders at the end of the year.

3. **Realized Capital Gains and Losses**
   Gains and losses are only taxable when they become realized, which occurs when:
   
   a) **You surrender units of your segregated fund**
      When you surrender units of your segregated fund by making a cash withdrawal or a switch, this will produce either a realized gain or loss depending on whether the units were surrendered for more or less than the purchase price.

   b) **The fund manager sells an investment in the underlying fund**
      When the fund manager sells one or more of the investments in the underlying fund, this will produce either a realized gain or loss, depending on whether the investments were sold for more or less than the purchase price.

What does this mean?

- You are likely to receive a tax slip every year even if you did not make a withdrawal, switch, or a new deposit. This is because the underlying fund will generate a combination of interest, dividends, as well as realized gains or losses.

- It is possible for the market value of your segregated fund to have decreased, but still have capital gains and income to declare. Your segregated fund value is not an indicator of whether or not investment income has been earned.

- The gains or losses that you see in your segregated fund value will not be the same as the realized gains and losses that are declared on your tax slip. This is because gains and losses only become realized (and therefore taxable) when units of the segregated fund are surrendered or when investments in the underlying fund are sold.

- Investment income that is allocated to you from the underlying fund is taxable. Equitable Life tracks the portion that you have already been taxed on so that you are never double-taxed on investment income when you surrender units of your segregated fund.

**Referred to as the Adjusted Cost Base, which is a calculation used to determine the cost of the investment for tax purposes.**
Let’s look at an example

In January, Sue made an initial deposit of $1,500 into a segregated fund. At that time, the underlying fund held the following investments:

- $400 of stocks from Sunshine Company
- $400 of stocks from Starlight Company
- $400 of bonds from Windstorm Company
- $300 of stocks from Moonbeam Company

The chart below shows the underlying fund investment activity, as well as any investment income that was generated throughout the year.

<table>
<thead>
<tr>
<th>Underlying Fund Investments</th>
<th>Purchased in January</th>
<th>Market Value (before investment income is declared)</th>
<th>Investment Income (portion allocated to Sue)</th>
<th>Market Value on December 31</th>
<th>Taxable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunshine Company (stocks)</td>
<td>$400</td>
<td>$275</td>
<td>$20 of dividends declared (deposited to cash)</td>
<td>$275</td>
<td>$20 dividends</td>
</tr>
<tr>
<td>Windstorm Company (bonds)</td>
<td>$400</td>
<td>$380</td>
<td>$10 of interest generated (deposited to cash)</td>
<td>$380</td>
<td>$10 interest</td>
</tr>
<tr>
<td>Starlight Company (stocks)</td>
<td>$400</td>
<td>$450</td>
<td>In December the fund manager sells all stocks resulting in a $50 gain</td>
<td>$0</td>
<td>$50 realized gains</td>
</tr>
<tr>
<td>Moonbeam Company (stocks)</td>
<td>$300</td>
<td>$340</td>
<td>No activity</td>
<td>$340</td>
<td>None</td>
</tr>
<tr>
<td>Cash</td>
<td>None</td>
<td>None</td>
<td>Deposits: $20 dividends $10 interest $450 from stocks sold</td>
<td>$480</td>
<td>None</td>
</tr>
</tbody>
</table>

Total segregated fund value $1,500 January $1,475 December

Even though Sue’s segregated fund value decreased by $25, her tax slip will report the following investment income:

- $20 of dividends
- $10 of interest
- $50 of realized gains

For more detailed information on segregated fund taxation or for tax advice, we encourage you to speak to a tax professional.

For illustration purposes only. The example does not include management fees and expenses which would be deducted from Sue’s investment. This information is provided for general use only and does not constitute legal, tax or other professional advice. Professional advice should be sought before an investor proceeds on any investment strategy. Investors do not purchase an interest in the underlying securities or funds, but rather, an individual variable insurance contract issued by Equitable Life of Canada. Investments in a segregated fund are at the risk of the contract holder any may increase or decrease in value. Segregated fund values change frequently and past performance does not guarantee future results.

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