FINANCIAL SOLUTIONS

Segregated Fund Taxation for non-registered policies

Investors who receive a T3/Relevé 16 slip from their segregated fund investments often have questions at tax time. A segregated fund may earn income from interest, dividends, foreign income, capital gains or losses on its investment holdings. By knowing how this income is allocated to unit holders, and reported, understanding your T3/Relevé 16 may be easier than you think—with help from Empire Life.

How income is reported to unit holders

A segregated fund earns income by investing in bonds, treasury bills, shares of Canadian and foreign corporations and other types of investments. These investments may pay interest or dividends throughout the year to the segregated fund. The fund will also earn capital gains income by the trading activity of the fund manager – the selling of bonds and shares for more than their cost. The segregated fund "flows through" or allocates all the income it earns to each unit holder.

A unit holder earns income in two different ways:

1. Allocated income from the segregated fund – interest, dividends, foreign income, capital gains or losses on sales of stocks owned by the segregated fund – earned within the fund is reported to each unit holder in proportion to units owned in the fund.
2. Realized capital gains or losses on units that were surrendered during the year. This is the difference between the surrender value and the ACB (adjusted cost basis) of the units redeemed in the year by a particular unit holder.

Segregated funds held as an investment in a non-registered policy will have income reported on a T3 slip for a Canadian resident, T3 and Relevé 16 for a Quebec resident, and NR4 for a non-resident.

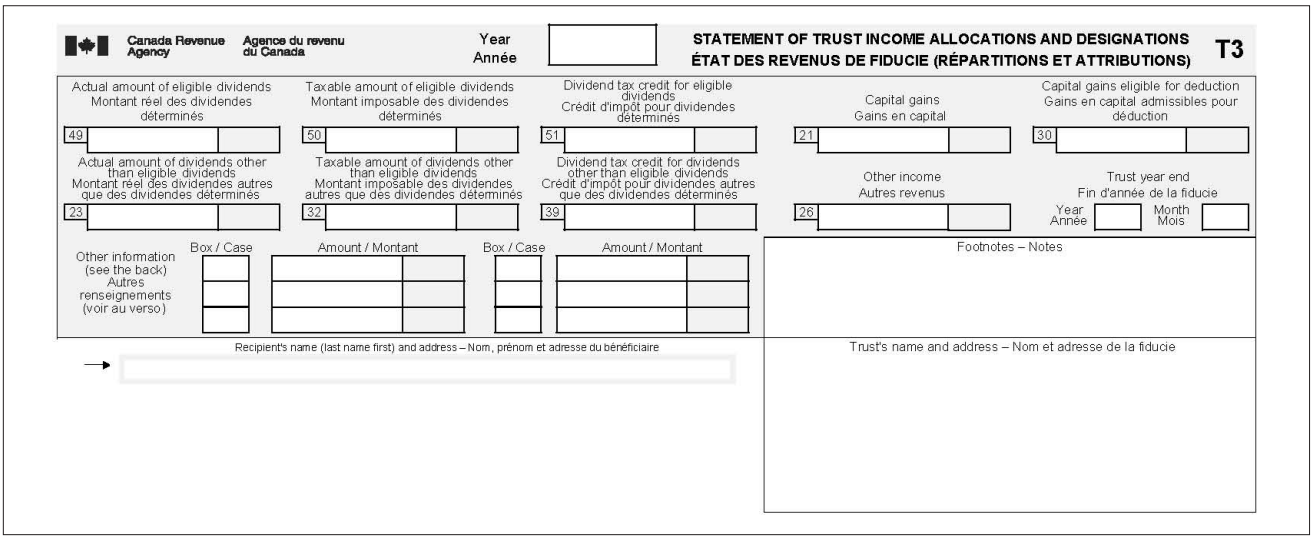
Empire Life®

How income is taxed

Various sources of income have different tax implications—that is why your T3 reports the type of income separately. The following table shows the type of investment income your segregated fund may earn.

Fund-level activity	Type of income earned	T3	Tax treatment
Canadian Treasury Bills, Bonds, Mortgages and Index Futures Contracts	Interest	Box 26	Interest is fully taxable and will be taxed at your marginal tax rate.
Shares of Canadian corporations	Dividends	Box 49 or Box 23	Dividend income receives a dividend tax credit. There are different dividend tax credit rates for eligible and non-eligible dividends that are reported in Box 51 and Box 39.
Foreign bonds and shares of foreign corporations	Foreign	Box 25	Interest and dividends received from foreign bonds are fully taxable in Canada. Often the foreign jurisdiction also taxes the income and these taxes are deducted from the income before it is allocated to you.
Sale of investments owned by the segregated fund	Capital gain or loss	Box 21: capital gains Box 37: losses	Capital gains qualify for preferential tax treatment and are taxed at 50% of your marginal tax rate.
Surrender of units in the segregated fund by the client		Box 21: capital gains Box 37: losses	Clients who surrender units of a segregated fund during the year will realize a capital gain if the market value when they surrender is greater than the adjusted cost basis (ACB) of the units. If the market value at date of surrender is below the ACB, the resulting loss is reported. The payment of a guarantee top-up on maturity of the policy or on the death of the annuitant of the policy will be reported as a capital gain.

Sample of T3 Slip



Source: Canada Revenue Agency. The reverse side of the T3/Relevé 16 slip contains important information about how to report the income. For additional information, visit www.cra-arc.gc.ca (or www.revenu.gouv.qc.ca for Quebec).

Simpler tax reporting

With segregated funds, the insurance company keeps track of each unit holder's adjusted cost basis for tax purposes. When you redeem units, Empire Life will calculate the realized capital gain or loss and report this on your T3. You do not need to perform these calculations – simply include the amount reported in Box 21 or Box 37 on your personal income tax return!

Capital losses within a segregated fund are allocated to unit holders. These capital losses will be included in Box 37 on the T3 slip and can be used to offset capital gains from any source in the current year or any of your previous three tax years. If you don't use them, you may carry the capital losses forward indefinitely to offset future capital gains.

Death benefit guarantees are always reported as a capital gain on a non-registered segregated fund. This is because the purpose of the death benefit guarantee is to protect the beneficiaries of your policy from market declines. Effectively, the death benefit guarantee cancels out the realized capital loss that occurs at the date of death of the Annuitant. Note that income earned post-death will be reported to the beneficiaries.

All T3 slips are issued to the Owner of the policy – so making sure that you have planned for the tax impact of the death of the Annuitant is just as important as naming a beneficiary for the policy.

Non-resident tax treatment

Clients who own segregated fund policies and are non-residents will have different tax treatment than a Canadian resident. As well, income earned by a non-resident on non-registered segregated fund policies is usually reported on a NR4 slip instead of a T3.

Investment income from non-registered policies is subject to withholding tax based on the type of income and the country of residence. Generally, a 25% withholding tax rate applies to income earned by a non-resident.

Frequently Asked Questions

I haven't sold any units, so why did I receive a T3 slip/ Relevé 16?

A T3 slip is generated when you have earned income from within a non-registered segregated fund policy. At the end of the year, the income allocated to each unit holder is reported on a T3 slip (Relevé 16 for Quebec residents)*. If you haven't sold any units, you may still be earning income as a result of the allocation from each of your segregated funds.

*Unit holders who reside in Quebec will receive a provincial tax form, Relevé 16 in addition to the T3.

My annual statement shows positive market returns for my segregated fund, so why is there a segregated fund loss in Box 37 of my T3 slip?

Whenever the cost of the bonds and shares owned by the segregated fund is greater than the market value at the date the fund manager decides to sell the securities, a loss occurs. A segregated fund allocates these capital losses to unit holders on a T3 so that they will be able to claim the loss on their personal income tax return.

If you have not surrendered units during the prior year, the Box 37 is reporting your allocated share of the capital losses from activity within the fund.

The value of my fund has declined, so why is there income or a capital gain reported on my T3 slip/ Relevé 16?

Taxable income is not related to changes in market value. Your T3 slip is reporting your share of the allocated income of the segregated fund plus any realized capital gain or loss from surrender of units.

The change in value over the year in your fund represents an unrealized capital loss because your market value has declined. Your T3 does not include unrealized income.

Key Resources

For more information, please speak with a tax professional or contact

CRA TIPS hotline: 1 800 267-6999

CRA General Line: 1 800 959-8281

CRA website www.cra-arc.gc.ca

CRA website (Quebec) www.revenu.gouv.qc.ca

Ask your advisor for more details on the tax advantages of Empire Life Segregated Funds.

The Empire Life Insurance Company (Empire Life) offers competitive individual and group life and health insurance, investment and retirement products to help you build wealth and protect your financial security.

Empire Life is among the top 10 life insurance companies in Canada[1] and is rated A (Excellent) by A.M. Best Company[2]. Our vision is to be known for simplicity, being easy to do business with and having a personal touch.

[1] Source: *The Globe and Mail Report on Business Magazine*, July 2013, based on revenue
[2] As at May 21, 2014

The information in this article is for general information purposes only and is not to be construed as providing legal, tax, financial or professional advice. The Empire Life Insurance Company assumes no responsibility for any reliance made on or misuse or omissions of the information contained in this article. Please seek professional advice before making any decision.

A description of the key features of the individual variable insurance contract is contained in the Information Folder for the product being considered. Subject to any applicable Death and Maturity Benefit Guarantee, **any part of the premium/deposit or other amount that is allocated to a Segregated Fund is invested at the risk of the Plan/Contract Owner and may increase or decrease in value** according to the fluctuations in the market value of the assets of the Segregated Fund.

® Registered trademark of **The Empire Life Insurance Company**.
Policies are issued by The Empire Life Insurance Company.

Investments • Insurance • Group solutions
www.empire.ca investment@empire.ca

INP-0261-EN-05/15