

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 main tax considerations to understand, the treatment of distributions paid by the ETF and the treatment of the gain or loss realized on selling the ETF. Depending on what type of account, registered or non-registered, the ETF is held in will also impact 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 pay 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, distributions are treated as ordinary income.

Capital Gains: An ETF may incur capital gains if an underlying security in the ETFs portfolio is sold for more than its purchase price.

Tax Treatment: Only 50% of capital gains are subject to tax in Canada and must be included in the investor's taxable income.

Foreign Income and Foreign Tax Paid: When an ETF earns dividends or interest on foreign investments the ETF may have to pay foreign withholding tax.

Tax Treatment: When the ETF distributes this foreign income, a Canadian investor may be able to claim a foreign tax credit in respect of the foreign tax paid by the ETF.

Return of Capital: An ETF may distribute 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 T3s from their respective brokerages. The ETF provider posts the factors to CDS generally around mid-February. The dealer will then prepare the tax slips for clients and the cost adjustment thereafter.

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 underlying investment is sold, the ETF 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 income 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 investors 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.

T Series ETFs

T Series ETFs are designed to provide a higher, predictable and potentially more tax-efficient cash flow. Similar to a T Series Mutual Fund the T Series ETF will pay a fixed annual distribution rate monthly based on end of year NAV and will pay out Return of Capital (ROC) above the portfolio's yield less expenses.

Reinvested 'Phantom' Distributions

On a cash distribution of ROC, the ACB is reduced by the amount of ROC, since this is a return of the investor's money.

On a reinvested distribution, the ACB is increased, since the investor is paying tax on the distribution. Note that investors do not adjust their ACB from cash distributions of realized capital gains throughout the year since the NAV is decreased by those distributions. These two events can result in a net cost adjustment.

Accumulating Units

Accumulating units offer an effective solution to mitigate price declines by reinvesting coupons and consolidating the units.

Accumulating units will distribute a quarterly reinvested and consolidated distribution which will be added back to the NAV. Investors of Accumulating units will still receive a tax slip at year end, similar to distributing ETFs.

Inflation Protected Bonds ETFs - Special Income

In general the outstanding principal of the bond rises with inflation for inflation-linked bonds. The principal adjustment and the interest on these bonds are taxed in the year they are accrued. This income may be distributed via reinvestment and consolidation or as "phantom income".

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 treated 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 capital gains from currency is the movement in the exchange rate over the year, subject to fund growth. These capital 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 taxes 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.

T1135

Investors who own certain foreign property with a total cost over CDN\$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\$11.58M (2020, indexed to inflation) who have U.S. assets with a value that exceeds US\$60,000 may be required to pay U.S. estate tax upon death on the value of their U.S. assets. Canadian ETFs are generally not considered U.S. assets.

BMO ETFs Solutions:

ZEA & ZDM & ZEQ

Holds International Equities directly.

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

49 Actual amount of eligible dividends / Montant réel des dividendes déterminés	50 Taxable amount of eligible dividends / Montant imposable des dividendes déterminés	51 Dividend tax credit for eligible dividends / Crédit d'impôt pour dividendes déterminés	21 Capital gains / Gains en capital	30 Capital gains eligible for deduction / Gains en capital admissibles pour déduction
23 Actual amount of dividends other than eligible dividends / Montant réel des dividendes autres que des dividendes déterminés	32 Taxable amount of dividends other than eligible dividends / Montant imposable des dividendes autres que des dividendes déterminés	39 Dividend tax credit for dividends other than eligible dividends / Crédit d'impôt pour dividendes autres que des dividendes déterminés	26 Other income / Autres revenus	Trust year end / Fin d'année de la fiducie Year / Année: <input type="text"/> Month / Mois: <input type="text"/>
Other information (see the back) / Autres renseignements (lisez le verso)		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		

Protected B when completed / Protégé B une fois rempli

Recipient identification number / Numéro d'identification du bénéficiaire: **12**

Account number / Numéro de compte: **14**

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.

As ETF providers do not have insight to unit holders, investors will receive T3s from their respective brokerages. The ETF provider posts the factors to CDS generally around mid-February. The dealer will then prepare the tax slips for clients and tend to do the cost adjustment afterwards.

The foregoing is very general information. BMO Asset Management Inc. does not provide tax advice, and investors should consult their own tax advisors about their individual circumstances.

Commissions, management fees and expenses all may be associated with investments in exchange traded funds. Please read the ETF Facts or prospectus of the BMO ETFs before investing. Exchange traded funds are not guaranteed, their values change frequently and past performance may not be repeated.

For a summary of the risks of an investment in the BMO ETFs, please see the specific risks set out in the BMO ETF's prospectus. BMO ETFs trade like stocks, fluctuate in market value and may trade at a discount to their net asset value, which may increase the risk of loss. Distributions are not guaranteed and are subject to change and/or elimination.

BMO ETFs are managed by BMO Asset Management Inc., which is an investment fund manager and a portfolio manager, and a separate legal entity from Bank of Montreal.

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