

## Tax efficiency for Product Allocation



The Product Allocation Tool is designed to provide a better understanding of how prepared your clients are for retirement. The Tool produces a portfolio that optimizes the sustainability of retirement income on a pre-tax basis. Once you have run a scenario of your client's situation in the Product Allocation Tool and have been provided a suggested optimal product mix, you may want to consider a couple of tax-related issues in fulfilling the Product Allocation strategy.

### **GENERAL RULES FOR REGISTERED AND NON-REGISTERED ASSETS**

Generally, you will want to assign registered and non-registered assets in the most tax-efficient manner. Since any income coming from registered assets is either fully taxed as income (RRSP, RRIF, RPP) or not taxed (TFSA), the general rule is to assign registered assets to the least tax-efficient investments, such as interest bearing or fixed income investments.

Generally, non-registered assets should include investments that are most tax-efficient. Annuities are a good example but any Guaranteed Minimum

Withdrawal Benefit (GMWB) product or any segregated fund contract or mutual fund investment with a regular Systematic Withdrawal Plan (SWP) can be a good choice for a non-registered portfolio.

In some instances, it may make sense to allocate assets to a GMWB product where the underlying investments are more conservative, and invest primarily in fixed income and balanced investments. In such cases, holding GMWBs in registered plans may be a good option.

For a retiree, one of the most important considerations is the income inclusion rate, or how income drawn from the investment portfolio will impact gross income, and

subsequently, government benefits. Consider the after-tax income of \$10,000 in various sources of income, based on the income inclusion rate.

SOURCE OF INCOME	INCLUSION RATE (%)	INCOME REPORT (LINE 234) <sup>1</sup> (\$)	AFTER-TAX INCOME (MTR 40%) (\$)
<b>Dividends<sup>2</sup></b>	141	14,100	7,500
<b>Interest/RRIF/Pensions/Salary</b>	100	10,000	6,000
<b>Capital Gains</b>	50	5,000	8,000
<b>Prescribed Life Annuity<sup>3</sup></b>	~25	2,500	9,000
<b>Mutual Fund/Seg Fund/SWP<sup>4</sup></b>	2.4	240	9,900
<b>TFSA (Tax Free Savings Account)</b>	0	0	10,000

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.

<sup>1</sup> Line 275 in Quebec. <sup>2</sup> Assumes an effective tax rate of 25% - varies by province. Dividends paid by public corporations qualify as "eligible dividends". Non-eligible dividends are included at 125%. Eligible dividends included @ 141% in 2011, 138% in 2012 and thereafter. <sup>3</sup> Taxable portion will vary depending on age. <sup>4</sup> Assumes \$200,000 invested, 5% annual rate of return (\$10,000) and a SWP of \$10,000. Represents results for year one and does not take into account year end distributions or allocations.

## INCOME BY INVESTMENT TYPE (NON-REGISTERED)

### ANNUITIES

Annuities provide a guaranteed income, typically for life, or for a specified term. For those 65 and older, the taxable portion of annuity payments qualifies for pension income splitting and the pension income tax credit which can offer additional tax relief.

#### Prescribed Annuities

- Many annuities purchased with non-registered funds may qualify for "Prescribed" taxation

- Offer tax advantages, including level taxation throughout the duration of the contract
- Recipient receives an element of tax deferral and may pay less tax over the life of the contract

#### Non-Prescribed Annuities

- Taxation is higher in the early years and decreases over time as capital is reduced



## SYSTEMATIC WITHDRAWAL PLANS (SWPS)

These include income that is linked to portfolios of mutual funds, segregated fund contracts, stocks, bonds, GICs, cash, etc.

### Dividends

- Dividends from Canadian corporations receive preferential tax treatment through the application of the dividend tax credit. However, dividend income can be the least “income-friendly” as the grossed-up amount is reflected on the tax return which is used to determine eligibility for many income-tested benefits such as OAS
- Dividends received from foreign corporations are fully taxable at your marginal tax rate

### Interest/Fixed Income

- The growth from a Bond, GIC<sup>5</sup>, or money market fund is considered interest income and is fully taxable at your marginal tax rate

### Mutual Fund/Segregated Fund Contract

- Taxation within these investment funds is based on the investments within (balanced, dividend, bond funds) and the rate of return, which determines the income inclusion rate
- Can produce tax-efficient income as a portion of each withdrawal includes a return of capital
- In a down market SWPs from an investment fund will generally erode capital

## GUARANTEED MINIMUM WITHDRAWAL BENEFITS (GMWBS)

GMWB products provide a guaranteed income stream that may be for life<sup>6</sup>. Income from GMWBs is treated the same way as a SWP from a segregated fund contract.

- Taxation is based on the investments within them (balanced, dividend, bond funds) and the rate of return, which determine the income inclusion rate
- Can produce tax-efficient income as a portion of each withdrawal includes a return of capital

## TAXATION BY INVESTMENT TYPE

### Overview of Tax considerations from Product Allocation

In this chart, the Registered and Non-registered product types with a [✓] provide the best tax efficiency.

PRODUCT TYPE	REGISTERED	NON-REGISTERED
Annuities		✓
GMWBs	✓	✓
SWP Investments GIC & Bond	✓	
Mutual Funds		✓
Segregated Fund Contracts		✓

FOR MORE INFORMATION PLEASE SEE THE TAX & RETIREMENT OVERVIEW SECTION ON [PRODUCTALLOCATION.CA](http://PRODUCTALLOCATION.CA)

<sup>5</sup> GIC includes a guaranteed interest contract issued by an insurance company and a guaranteed investment certificate issued by other financial institutions. For those age 65 and older, the interest from a GIC issued by an insurance company qualifies for pension income splitting and the pension income tax credit

<sup>6</sup> Age restrictions and other conditions may apply



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**TO LEARN MORE ABOUT PRODUCT ALLOCATION VISIT [PRODUCTALLOCATION.CA](http://PRODUCTALLOCATION.CA),  
OR FOR QUESTIONS ABOUT THE PRODUCT ALLOCATION TOOL, EMAIL [RSQ@MANULIFE.COM](mailto:RSQ@MANULIFE.COM)**

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