



Tax Issues, U.S. Investing, and Your Clients

Investment advisors buying U.S. investments should be aware of issues impacting client tax liabilities – we can help.

With Canadian investors continuing to diversify their portfolios outside of Canada, investors need to understand the potential withholding tax and estate tax implications. Investors are often unaware that their assets may be subject to Foreign and U.S. taxes. As Canadian investors seek U.S. and foreign investments opportunities, they need to keep in mind the cost of doing so. This diversification comes at the cost of Foreign and U.S. Taxes.

By investing in Canadian mutual funds and Canadian listed ETFs, investors avoid getting hit with unexpected taxes. **BMO ETFs and BMO Mutual Funds** offer investors a comprehensive suite of solutions that provide tax effective foreign diversification. Through exposures to U.S. securities in both Canadian and U.S. Dollar options, we have solutions that allow investors to achieve their desired exposure without the added cost.

U.S. Estate Taxes

- High net worth Canadian residents with U.S. assets with a value that exceeds US\$60,000 or US\$11.58M¹ in worldwide assets, may be required to pay U.S. estate tax on the value of their U.S. assets.
- If the value of your worldwide estate is not greater than US\$11.58 million, you will not be subject to U.S. estate tax. However, if the value of your U.S. assets is greater than US\$60,000, you must file a U.S. estate tax return even though you will not have an estate tax liability.
- The tax rate starts from 18% and moves up to 40% for investors with U.S. assets exceeding US\$1 million.
- The Canada-U.S. Tax Treaty allows for the estate tax liability to be reduced by claiming a 'unified credit' and a 'marital credit'.

Note: Most U.S. equity, U.S. property, and some U.S. debt securities will be subject to estate tax.

Wealthy Canadians looking for a place to invest their greenbacks but who are also concerned about U.S. estate taxes, might be better suited to invest in a Canadian listed ETF or mutual fund. Canadian mutual funds and Canadian listed ETFs (even if they invest in U.S. equity or debt securities), are generally not considered to be U.S. assets for estate tax purposes.²

Enhanced Unified Credit

This credit is available for residents of Canada only, and is equal to the greater of:

- \$13,000
- US\$4,577,900* x the value of your U.S. assets ÷ value of your worldwide assets³

*This is the unified tax credit which essentially exempts US\$11.58MM of property from estate tax (not applicable to Canadian's on assignment).

Example: Zach, a Canadian resident has \$15 million in worldwide assets, of which US\$1.5 million is considered a U.S. asset.

Gross U.S. Estate Tax: \$545,800⁴
 Unified Credit: \$457,780⁵ (prorated)

Marital Credit

Net Estate Tax: \$88,020

If a Canadian's U.S. assets pass over to a spouse, upon death the Tax Treaty provides marital credit.

The marital credit equals the lesser of the unified credit or the amount of the estate tax. This is a deferral of tax, tax is paid at the time of spouse's death.

Example: If Zach were to leave his U.S. assets to his wife Susan (also a Canadian resident), the U.S. estate tax liability would be reduced to \$0.

Estate Tax: \$95,220 (before marital credit)
 Marital Credit: \$95,220

Net Estate Tax: \$0 (liability after both unified and marital credits are applied)

Example is for illustrative purposes only and should not be construed as legal or tax advice. Please consult your own legal and tax advisor about your own situation.

¹ \$11.4MM in 2019; indexed annually for inflation. ²As long as the Canadian funds are treated as corporations for U.S. tax purposes. ³ All \$ figures on this page are in US dollars. ⁴ The tax rate is tiered and starts at 18% and increases to 40% for US assets exceeding \$1 million. \$345,800 on first \$1M, \$200,000 over \$1M. ⁵ If your US stock portfolio accounts for 10% of the value of your worldwide assets, you will be entitled to a credit of \$457,780 (\$4,577,900 x 10%).

Form T1135 – Foreign Income Verification Statement

Form T1135 is a mandatory filing for any Canadian with certain foreign property with a total cost over \$100,000 (CAD).

Impacted individuals may include:

- Canadians that hold foreign assets
- Immigrants to Canada who have foreign assets*
- Canadians abroad that acquire foreign assets

Examples of assets that must be reported:

- Shares of non-resident corporations and bonds issued by non-residents, even if held by a Canadian broker
- Domestic securities (such as Canadian stocks) held outside of Canada
- Life insurance policies issued by foreign issuers

Examples of foreign assets that are exempt from reporting:

- Foreign assets used primarily for personal use & enjoyment
- Foreign assets held in a RRSP or TFSA

The \$100,000 threshold is triggered when the total cost amount of the assets (not the value) exceeds \$100,000.

What needs to be reported	What does not need to be reported
<ul style="list-style-type: none">• Stocks traded on U.S. exchanges such as:<ul style="list-style-type: none">- General Electric (GE)- Ford Motor Company (F)- Pfizer Inc. (PFE)• U.S. Listed ETFs such as:<ul style="list-style-type: none">- SPDR S&P 500 ETF (SPY)- Vanguard S&P 500 ETF (VOO)- iShares Core S&P 500 ETF (IVV)	<ul style="list-style-type: none">• Canadian listed ETFs and mutual funds

 Even if a Canadian mutual fund or a Canadian listed ETF holds foreign securities, the units of the Canadian fund are not foreign property, and are not subject to the T1135 reporting requirement.

The cost amount of an asset is generally the average cost base at the time you acquired it (so if your foreign property was initially purchased for a total of \$90,000, you do not need to report even if the property is now worth \$110,000).

Visit the [CRA 'Questions and Answers about Form T1135'](#) page or contact your tax advisor for more information.

* not applicable to first year residents

The Impact of Foreign Withholding Taxes

Dividends and interest (and potentially other sources of income) received from non-Canadian investments may be subject to withholding taxes, which are applied before the investor receives the distribution. Interest income from bonds is not withheld.

1. Type of Account

Foreign tax credits can be claimed only for investments held in taxable (non-registered) accounts. Investors will receive a T3 or T5 slip after year end which indicates the amount of foreign taxes paid. Credits for these taxes may be claimed by completing T2209 forms.

In your RRSP account there is no need to report anything for foreign taxes paid in your RRSP, and there is no immediate recovery of the tax either. Foreign taxes paid in an RRSP account will reduce the amount of money available for distribution at retirement. Therefore, you pay less tax on the accumulation when building your pension income.

2. Type of Investment

Investors are generally subject to withholding taxes imposed by foreign countries on sources of income in those foreign countries (for example, dividends paid to Canadian resident investors by U.S. resident corporations are generally subject to a withholding tax of 15%).

Additionally, whenever foreign securities (outside of North America) are held indirectly by a Canadian investment fund that holds a U.S. listed ETF, investors may be subject to a further 15% U.S. withholding tax. This additional 15% U.S. withholding tax applies if the U.S. listed ETF is treated as a corporation for U.S. tax purposes.



Withholding Tax Example

iShares MSCI EAFE ETF (EFA) [U.S. listed ETF]

When held by a Canadian resident in a non-registered account, two withholding taxes apply in this scenario:

1. The withholding tax imposed by the U.S. which are recoverable.
2. The withholding tax imposed by foreign countries apply and are not recoverable.

Assuming 12% withholding tax on foreign dividends, investors in EFA (distribution yield of 4.01% as at March 31, 2020) **would lose approximately 48bps**.

Solution:

Because BMO MSCI EAFE Index ETF (ZEA) & BMO MSCI EAFE Hedged to CAD Index ETF (ZDM) are Canadian listed ETFs and generally hold their underlying securities directly, foreign tax credits can be claimed to offset the foreign withholding taxes.



IMPORTANT: Because the majority of BMO ETFs hold their underlying securities directly, foreign tax credits can be claimed to recover any applicable withholding taxes in a non-registered account.

Breaking Down Withholding Taxes

Non-Registered Account	Scenario	Applicable Taxes
Non-Registered Account	1 Canadian Mutual Funds or Canadian-listed ETFs that hold U.S. Stocks	U.S. withholding taxes apply and are recoverable by claiming foreign tax credit.
	2 Canadian Mutual Funds or Canadian-listed ETFs that hold a U.S.-listed ETF that holds U.S. stocks	
	3 U.S.-listed ETFs that hold U.S. Stocks	
	4 Canadian Mutual Funds or Canadian-listed ETFs that hold Foreign Stocks ¹	Foreign withholding taxes apply and are recoverable by claiming foreign tax credits.
	5 Canadian Mutual Funds or Canadian-listed ETFs that hold a U.S.-listed ETF that holds Foreign Stocks ¹	Foreign withholding taxes apply and are not recoverable. U.S. withholding taxes may also apply and are recoverable by claiming foreign tax credit.
	6 U.S.-listed ETFs that hold Foreign Stocks ¹	

¹Foreign Stocks are defined as shares of corporations that are resident outside of North America.

Registered Account: Foreign withholding taxes may apply and are not recoverable. U.S. withholding taxes may also apply and are not recoverable.

Additional Tax Considerations

In addition to withholding tax considerations, Canadian's invested in U.S. Listed ETFs should be aware that distributed capital gains resulting from portfolio rebalances may be taxed as foreign income.



By investing in Canadian listed ETFs, investors avoid getting hit with unexpected taxes. BMO ETFs offers investors a comprehensive suite of solutions that provide tax effective foreign diversification.

BMO GAM's Foreign Investment Solutions

Fund Name	Hedged	Unhedged	US Dollar Unit	Accumulating Unit	Management Fee (%)
Equity					
BMO Low Volatility US Equity ETF (CAD)	ZLH	ZLU	ZLU.U		0.30
BMO MSCI USA High Quality ETF	ZUQ.F	ZUQ	ZUQ.U		0.30
BMO US Dividend ETF (CAD)	ZUD	ZDY	ZDY.U		0.30
BMO S&P 500 ETF (CAD)	ZUE	ZSP	ZSP.U		0.08
BMO MSCI USA Value ETF		ZVU			0.30
BMO NASDAQ 100 Equity Hedged to CAD ETF	ZQQ	ZNQ	ZNQ.U		0.35
BMO Dow Jones Ind Avg Hdgd to CAD ETF	ZDJ				0.23
BMO US High Dividend Covered Call	ZWS	ZWH	ZWH.U		0.65
BMO US Preferred Share Index ETF	ZHP	ZUP	ZUP.U		0.45
BMO US Put Write ETF	ZPH	ZPW	ZPW.U		0.65
BMO Low Volatil Intl Eq Hdgd to CAD ETF	ZLD	ZLI			0.40
BMO MSCI All Country World High Qual ETF		ZGQ			0.45
BMO MSCI Europe Hi Qual Hdgd to CAD ETF		ZEQ			0.40
BMO International Div Hdgd to CAD ETF	ZDH	ZDI			0.40
BMO Low Volatility Em Mkts Eq ETF		ZLE			0.45
BMO MSCI EAFE ETF	ZEА	ZDM			0.20
BMO MSCI Emerging Markets ETF		ZEM			0.25
BMO MSCI EAFE Value ETF		ZVI			0.40
BMO Premium Yield ETF	ZPAY.F	ZPAY	ZPAY.U		0.65
BMO S&P US Small Cap Index ETF	ZSML.F	ZSML	ZSML.U		0.20
BMO S&P US Mid Cap Index ETF	ZMID.F	ZMID	ZMID.U		0.15
BMO MSCI EAFE ESG Leaders Index ETF		ESGE			0.25
BMO Global High Dividend Covered Call ETF		ZWG			0.65
BMO MSCI Global ESG Leaders Index ETF		ESGG			0.25
Fixed Income					
BMO Ultra Short-Term US Bond ETF (USD)			ZUS.U	ZUS.V	0.18
BMO Mid-Term US Treasury Bond ETF		ZTM	ZTM.U		0.20
BMO Long-Term US Treasury Bond ETF	ZTL.F	ZTL	ZTL.U		0.20
BMO Short-Term US Treasury Bond ETF		ZTS	ZTS.U		0.20
BMO Mid-Term US IG Corp Bond ETF (CAD)	ZMU	ZIC	ZIC.U		0.25
BMO High Yield US Corporate Bond ETF	ZHY	ZJK	ZJK.U		0.55
BMO ST US IG Corp Bond Hedged to CAD ETF		ZSU			0.25
BMO ESG US High Yield Corporate Bond Index ETF	ESGH.F	ESGH			0.45
BMO Floating Rate High Yield		ZFH			0.40
BMO Short-Term US TIPS Index ETF	ZTIP.F	ZTIP	ZTIP.U		0.15

U.S. \$ Mutual Funds

Fund Name	NL	FE	LL	F	MER (%)	Series F MER (%)
BMO U.S. Dollar Balanced Fund	BMO70808	BMO99808	BMO98808	BMO95808	1.93	0.76
BMO U.S. Dollar Dividend Fund	BMO70807	BMO99807	BMO98807	BMO95807	1.93	0.82
BMO U.S. Dollar Money Market Fund	BMO70801	BMO99801	BMO98801	-	1.19	-
BMO U.S. Dollar Monthly Income Fund	BMO70804	BMO99804	BMO98804	BMO95804	2.27	0.78
BMO U.S. Dollar Equity Index Fund	BMO70803	-	-	-	0.98	-
BMO U.S. Equity Fund (US\$)	BMO70723	BMO99723	BMO98723	BMO40723	2.51	0.84
BMO US Equity Plus Fund (US\$)	BMO76744	BMO99744	BMO98744	BMO40744	2.20	0.82
BMO Global Dividend Fund (US\$)	BMO76725	BMO99725	BMO98725	BMO40725	2.45	1.00
BMO North American Dividend Fund (US\$)	BMO76721	BMO99721	BMO98721	BMO40721	2.56	0.89
BMO Concentrated Global Equity Fund (US\$)	-	BMO79213	BMO78213	BMO40213	2.09	0.96
BMO Concentrated Global Balanced Fund (US\$)	-	BMO79237	BMO78237	BMO40237	1.97	0.85
BMO Covered Call US High Dividend ETF Fund (US\$)	-	BMO79766	-	BMO40766	1.67	0.73

For more information on the topics in this booklet please reach out to your BMO GAM wholesaling team or please visit our website at www.bmo.com/gam/ca/advisor



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