Manulife

Tax, Retirement & Estate Planning Services

TAX MANAGED STRATEGY 20

Using Series T for income now and charitable donations later

Many Canadians may be looking for ways to increase the tax efficiency of their retirement investments. Additionally, they may want to give back while taking advantage of the tax benefits of donating investment funds to charity.

Did you know that there is an investment option that can allow you to combine both of these objectives? An investment in a Series T fund can provide tax-efficient income now and a tax effective way to donate in the future.

If the ability to receive more after-tax income today and eliminate capital gains tax on future donations seems appealing, this strategy could be for you.

What is a Series T Fund?

For non-registered investments, a Series T fund (also referred to as T-Class) can provide a regular stream of tax-efficient cash flow from monthly distributions. All or a significant portion of the distribution received is likely to be considered a taxfree return of capital (ROC). This essentially defers the triggering of capital gains from monthly withdrawals.

Each time the fund distributes ROC, the adjusted cost base (ACB) of the investment decreases. Since ROC is considered after-tax money, there is no tax payable on this cash flow. However, there may still be taxable distributions similar to those of a mutual fund.

Once the ACB reaches zero, additional ROC distributions are taxable as capital gains. Since capital gains are only subject to a 50 per cent inclusion rate, the cash flow would still be considered tax efficient.

The Opportunity

Through the power of ROC distributions, Series T funds can provide tax-efficient income. The ROC distributions from a Series T fund can also help lower the taxable income reported each year and reduce the clawback of income tested government benefits such as Old Age Security (OAS) and the Age Credit.

In addition, normally when transferring the ownership of publicly traded securities like stocks, bonds, mutual funds and segregated fund contracts to charity, the donor would have to pay tax on 50 per cent of the capital gains realized from the assets' appreciation in value

However, under a special government incentive program the donation of publicly traded securities benefits from a capital gains inclusion rate that is reduced to zero per cent. In other words, the tax on any capital gains arising from the disposition of publicly traded securities donated directly to a charity has been eliminated – a significant tax savings[1].

Using these charitable gifting rules in conjunction with a Series T fund can help you generate tax-efficient income and eliminate the capital gains tax on the donation. By transferring ownership of some or all of these mutual funds to charity, you will be able to take advantage of the zero per cent inclusion rate, eliminating the capital gains tax and receiving tax savings from the donation. This allows the tax that would have been paid to the Canadian Revenue Agency (CRA) to be redirected to a charity.

HERE'S HOW IT WORKS

Stephen, age 53, recently retired from his management position in a high tech manufacturing company. He wants to start drawing a sustainable and tax-efficient income from $200,000 of his savings. His goal is for the $200,000 to remain constant or even grow at a modest rate so that some day he still will have an amount left to donate to charity.

Stephen invests $200,000 in a Series T fund that generates six per cent in annual cash flow. This would provide him with an average after-tax income of $11,550 for 19 years.[1] The total he will receive after tax over that time period is $219,450. At that point, his ACB will reach zero.

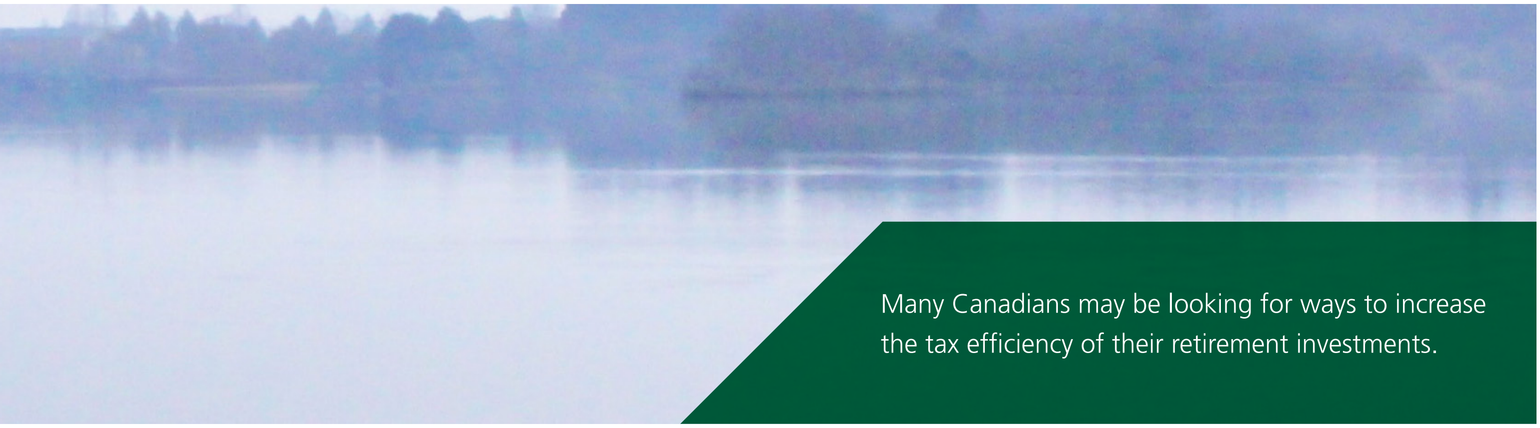
Assuming a six per cent annual rate of return, the market value of Stephen's account will still be $200,000. If he cashes out the investment, he will have to pay tax on the full $200,000 capital gain he has realized – generating additional tax of $40,150.

At this point Stephen has several options available to him. He can:

1. Maintain his investment and stop receiving ROC distributions altogether
2. Continue with future ROC distributions that will be less tax efficient
3. Donate the funds to charity

This is a fictional scenario. For illustration purposes only

[1] This applies to direct donations to a charity (or donations in kind) while alive. If a direct donation occurs at death a zero capital gains inclusion rate will only apply if the donation qualifies as a gift from a Graduated Rate Estate ("GRE"). See section 118.1 of the Income Tax Act or Charitable Giving - The Facts (MK1485) for more information on GREs and donations at death.



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Stephen chooses to make a charitable donation and transfer ownership of $59,000 of the portfolio to a registered charity. The capital gain realized on the transfer will not be taxed and he will receive a $59,000 charitable donation receipt, which provides a tax credit equal to about $27,140 (depending on the province).

Stephen can now remove the remaining $141,000 from the Series T fund and the tax of $26,785 on the capital gain will be offset by his donation receipt.

This strategy has allowed Stephen to receive tax-efficient income from annual withdrawals and enabled him to make a sizable donation to charity without triggering any tax on capital gains. Rather than paying this tax to the CRA, Stephen has redirected the funds to a charity of his choice.

1 Assumes six per cent annual rate of return, Stephen's marginal tax rate is 30 per cent and taxable distributions of $1,500 per year and ROC distributions of $10,500 per year.

For illustration purposes only

Ideal Candidates

- Individuals interested in tax-efficient cash flows from their investments
- Individuals planning to donate to charity and give back to their community
- Individuals looking for more flexibility in terms of how and when they donate

Take Action

- Use a tax-efficient structure such as Series T funds to reduce taxes today and generate tax savings by donating part of the investment directly to a charity

DID YOU KNOW?

Corporations that own Series T funds can also take advantage of the zero per cent inclusion rate. However, while individuals receive a tax credit for the donation, the corporation would deduct the amount instead. In addition, since none of the gain is being taxed, the full amount of the donated Series T funds is added to the capital dividend account and can be distributed to shareholders tax-free. See Corporate Class Mutual Fund: Corporate Donations (MK2843) for more information.

For more information, please speak with your advisor or visit manulife.ca/investments

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