Sun Life Global Investments

SUN GIF SOLUTIONS INCOME SERIES | SUN LIFETIME ADVANTAGE GIF

Taxation of non-registered income

Sun GIF Solutions Income Series and **Sun Lifetime Advantage GIF** offer lifetime guaranteed income.

Similar to mutual fund systematic withdrawal plans (SWPs), income from Sun GIF Solutions Income Series and Sun Lifetime Advantage GIF is:

- funded by the sale of units, and
- paid to Clients on a regular schedule.

Receiving income this way means that:

- just a portion of the income stream is taxable as a capital gain,
- the balance is non-taxable return of capital, and
- the amount that's a return of capital isn't included in calculating line 23400, net income before adjustments on the Client's income tax return, so it could reduce or eliminate the clawback of government income tested benefits like OAS or the age credit.

Taxation for non-registered contracts must consider both:

- regularly scheduled payments,
- year-end allocations, and
- unscheduled withdrawals and fund switches, if applicable.

How it works

To understand how a Client may be taxed, consider an example where:

- the Client invests $250,000,
- the rate of return is a constant 4% per year, and
- the Client's lifetime guarantee income amount is $10,000 and they withdraw that amount every year.

Keep in mind that each income payment requires the sale of units to fund the withdrawal, resulting in a capital gain or loss. To determine the amount of gain or loss, you need to consider:

- the adjusted cost basis (ACB), and
- the growth/loss (i.e., market value – ACB).

This example shows how it's calculated based on a $250,000 investment.

The Client's initial investment is $250,000 (from after-tax money), so their initial ACB is $250,000.

At the end of year 1, the Client's market value has grown to $260,000.

Part A—Taxation of year-end allocations

Segregated funds are required to allocate interest, dividends, foreign income, and realized capital gains or losses to Clients in proportion to the units held by each Client during the calendar year. These are reported to Clients on a Form T3 (R16 in Quebec). Unrealized capital gains and losses are not allocated.

Income allocated to each Client is also added to their contract's ACB. Realized capital losses, on the other hand, are subtracted from the ACB.

In this example, at the end of the first year, $6,000 is allocated to the Client as interest, dividends, and realized capital gains. The Client is required to include the allocations in their income for the year and pay tax according to the type of income. The table below outlines the tax for this example.

To prevent double taxation on withdrawals the Client takes, the allocations increase the ACB, in this case to $256,000 ($250,000 + $6,000).

Type of income	Year-end allocations	Tax on year-end allocations
Interest (marginal tax bracket = 45%)	**$1,000**	**$450** ($1,000 x 45%)
Dividends (tax rate = 35%)	**$2,000**	**$700** ($2,000 x 35%)
Realized capital gains (marginal tax bracket = 45%)	**$3,000**	**$675** ($3,000 x 50% inclusion rate x 45%)
Total	**$6,000**	**$1,825**

Part B—Taxation of the income stream

At the end of the first year, the Client withdraws their annual guaranteed income of $10,000.

For tax purposes, a withdrawal is treated as coming proportionately from the ACB and unrealized gains, if any. In this case, the market value is $260,000 and the ACB is $256,000. The formula to determine how much of the withdrawal will be treated as ACB is:

$$\frac{\text{ACB}}{\text{market value}} \times \text{withdrawal amount}$$

In this example:

$$\frac{\$256{,}000}{\$260{,}000} \times \$10{,}000 = \$9{,}846$$

This means that $9,846 of the $10,000 withdrawal will be treated as non-taxable ACB, or return of capital, and $154 ($10,000 - $9,846) will be treated as a realized capital gain. Since only 50% of realized capital gains are included in income, only $77 ($154 x 50%) is taxable.

If the Client is in the 45% marginal tax bracket, they pay only $35 ($77 x 45%) in tax on the withdrawal. This amount is in addition to any tax they pay on year-end allocations reported on their T3 (R16 in Quebec).

The withdrawal reduces the market value and the ACB. Immediately after the withdrawal, the market value is $250,000 ($260,000 - $10,000) and the ACB is $246,154 ($256,000 - $9,846).

Taxation in future years

In future years, even if the rate of return is a constant 4% each year with $6,000 in year-end allocations from the same types of income as in year 1, the tax on the $10,000 withdrawal would be slightly different due to the ACB.

For example, in year 2, if the Client's market value increases from $250,000 to $260,000 and the year-end allocations are $6,000 in the same proportions of interest, dividends, and realized capital gains as year 1, the ACB would be different since the allocations are added to a lower ACB.

- The pre-withdrawal ACB would be $252,154 ($246,154 + $6,000).
- The portion of the withdrawal representing ACB, or return of capital, would be $9,698 ($252,154 / $260,000 x $10,000).
- The Client would have a $302 ($10,000 - $9,698) realized capital gain and include 50% of the gain in income for the year.
- This would result in $68 ($302 x 50% x 45%) in tax (versus $35 in year 1).
- Again, the tax paid on the withdrawal would be in addition to the tax paid on the allocations.

DID YOU KNOW?

Canadians can claim a tax credit on "pension" income each year. Spouses and common-law partners can also split some of their pension income by transferring up to 50% of income eligible for the pension income tax credit to their spouse or common-law partner.

Income from Sun GIF Solutions Income Series and Sun Lifetime Advantage GIF qualifies for the pension income credit and pension income splitting if:

- the Client is age 65 or older, and
- the income comes from a registered retirement income fund (RRIF) – not a registered retirement saving plan (RRSP).

Tax reporting made easier

Unlike mutual funds, all capital gains or losses due to the sale of units from a segregated fund contract are reported on a T3. Sun Life tracks the ACB and reports the realized capital gain or loss on the T3, removing the onus from the Client.

This includes any:

- fund switches,
- withdrawals,
- deposits, and
- previous years' allocations (along with fees such as front and back-end sales charges).

Taxation during the guaranteed payment phase

The guaranteed payment phase occurs when the market value of the contract reaches $0 and there's still a lifetime guaranteed income. Currently, taxation of these payments isn't certain. When we make payments during this phase, we'll report them based on our understanding of tax legislation and Canada Revenue Agency (CRA) practices in effect, at that time. Clients are responsible for any tax liabilities that occur due to any change in the law, interpretation or the CRA's assessing practices (encourage them to contact a tax professional for advice, as required).

Learn more

See Taxation for non-registered segregated funds (810-4535).

For more information, speak to your advisor or:

Visit **sunlifeglobalinvestments.com** | Call **1-844-753-4437 (1-844-SLF-GIFS)**
Email **gifs@sunlife.com**

Any amount that is allocated to a segregated fund is invested at the risk of the contract owner and may increase or decrease in value.

Sun Life Global Investments is a trade name of SLGI Asset Management Inc., Sun Life Assurance Company of Canada and Sun Life Financial Trust Inc. Sun Life Assurance Company of Canada is the issuer of guaranteed insurance contracts, including Accumulation Annuities (Insurance GICs), Payout Annuities, and Individual Variable Insurance Contracts (Sun Life GIFs).

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