PAYING TAX ON **INVESTMENT INCOME?**

THINGS YOU SHOULD KNOW ABOUT TAXATION ON YOUR NON-REGISTERED INVESTMENTS

Since different types of income attract different tax rates, it's important to consider the amount of tax you will pay on income from investments.

Interest income is one of the most highly taxed types of income in Canada and can be earned from fixed-income investments, such as Guaranteed Interest Contracts (GICs) and Canada Savings Bonds.

Dividends are paid by corporations to their shareholders from after-tax earnings. You may also receive dividends from the segregated fund contracts or mutual funds that you own if the funds own shares of corporations that pay dividends. Canadian dividends generally attract a far lower level of taxation compared to interest income.

Capital gains happen when you sell a capital asset for more than its purchase price. The increase in value is a capital gain, and 50 per cent of the gain (called the taxable capital gain) is included in your taxable income.

Foreign income, such as dividends from foreign investments, is considered taxable income, whether owned directly or through a segregated fund contract or mutual fund. Foreign income receives no special tax break, making it as undesirable as interest income in terms of the higher rate of tax that it attracts.

Interest income is usually taxable each year as it is earned, whether or not it's actually received. Dividends are generally taxed when received. Capital gains, however, are taxable only when the capital property is sold. In tax terms, this is when capital gains are referred to as "realized."

Understanding the taxation of some common assets

Mutual funds

The increase between your purchase price and the market value of your mutual fund units is taxed as a capital gain when the units are deemed to

be sold. Distributions from a mutual fund, such as dividends or interest, are taxable whether you receive them in cash or reinvest them in additional units. If you reinvest distributions to purchase additional units of the same fund, the reinvested amount is added to your adjusted cost base (ACB).

Segregated fund contracts
From a tax perspective, when a segregated fund is redeemed, the contract's increase in value over its original purchase price is taxed as a capital gain. With a segregated fund, there is not a physical distribution. Instead, the segregated fund allocates taxable income and realized capital gains or losses to investors. The amount of the allocation is added to (or in the case of capital losses, deducted from) your ACB and tracked by the insurance company. Allocations cannot be paid in cash like mutual fund distributions.

Stocks
The increase between your purchase price and the market value of your stock holdings is taxed as a capital gain when the stock is sold. Any dividends received from the stock are taxed at rates applicable to Canadian or foreign dividends.

GICs and Canada Savings Bonds
The principal amount of a GIC or Canada Savings Bond is not taxable. Only the interest earned on this investment is taxable.

Incorporate investment tax planning into your overall strategy

It's a good idea to take every opportunity to minimize the tax you pay. After all, paying more tax than required means less money in your pocket. Investment taxation is an often overlooked but very important area of personal tax planning. Contact your advisor and discuss the best approach to taxes and your investments.

In Canada, one way that individuals pay tax is according to the amount of income on their tax return. As this taxable income increases, so does your tax rate, to a point. This is called a progressive tax system. Each increment of taxable income is taxed at a specific rate and is referred to as a marginal tax bracket. You should be aware that tax rates vary by province and different tax rates apply to different types of income.

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