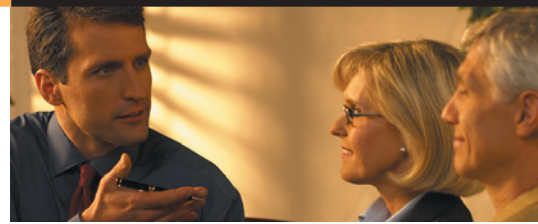


Tax-Efficient Investing



When it comes to choosing investments, it makes sense to pay attention to your investment objectives, time horizon and risk tolerance. It may also be important to compare the way different investments are taxed, because the amount of tax you pay can have an impact on your net profit from investments.

Investments grow tax-deferred within an RSP, which means income from your investments will not be taxed until it is withdrawn from the RSP. But outside an RSP, investment income becomes part of your income and is subject to taxation. Each type of investment income – interest, dividends and capital gains – has a different rate of taxation.

Over the long term, having a tax-efficient portfolio may save you thousands of dollars. When it comes to non-registered investments, investors pay the most tax on interest and the least on capital gains. Dividends fall somewhere in between.

Tax on Interest

Tax on interest is calculated at your full marginal tax rate, which varies depending on your income and province. In some cases, you can expect to pay up to 50 percent tax on interest income if you are in the highest tax bracket.

Tax on Capital Gains

Tax on capital gains is also calculated based on marginal tax rates. The difference is that you are only taxed on 50 percent of your gains. Capital gains only need to be reported when they are realized. For example, a \$10,000 investment in the ABC Equity mutual fund five years ago may be worth \$20,000 today, representing a \$10,000 unrealized capital gain on paper. The tax on these gains can be deferred as long as the investment is held. Once sold, a tax liability would be incurred on the difference between the price at purchase

and the price, or profit, at which units were sold. Please note, to ensure the preferential capital gains tax treatment for individuals, other than security traders or non-residents, the security has to be Canadian.

A second scenario when taxes are required to be paid occurs when the mutual fund itself generates any distributions from capital gains realized through trading activity by the fund manager. Whether or not a mutual fund pays any distributions is beyond the control of the unit holder – most funds pay an annual distribution (the amounts vary depending on the performance of the fund) and this income also needs to be reported on tax returns.

Of course, remember that capital gains are values that will fluctuate over time until they are realized. This can be a double-edged sword. Many unlucky investors will remember all-too-painfully the bursting of

How Investments are Taxed Where do investors get hit the hardest?

Personal Tax Position	Type of Income Generated	Tax Paid	After-Tax Return
45%	Interest	\$4,500	\$5,500
45%	Dividend	\$3,100	\$6,900
45%	Capital Gains	\$2,250	\$7,750

- Based on earnings of \$10,000
- Actual tax rates will vary according to income and province of residence
- 45% tax rate used for illustration purposes only
- Figures have been rounded and are approximates only



the dot-com bubble in early 2000, when stratospheric technology stock prices promising bountiful capital gains for scores of investors abruptly gave way to capital losses when the bubble suddenly burst. Of course, the silver lining in that situation is that capital losses may be used to reduce capital gains. For more guidance on capital gains and losses, you should speak with your Financial Advisor.

Tax on Dividends

A dividend is a distribution to shareholders of some portion of a corporation's earnings. Estimating the tax payable on dividends can seem complicated. Companies pay tax on profits before distributing them to shareholders. The amount received by individual investors in the form of dividends from a

Canadian company is "grossed up" by 25 percent to represent the full value of the income the company is presumed to have made before tax. Then a federal dividend tax credit is applied equal to 13.33 percent of the enhanced figure reported on the individual's tax return, plus an additional provincial dividend tax credit. The tax credits are designed to reduce the double taxation of business income earned through a corporation when distributed to shareholders.

What's the Best Investment?

For investors who have enough money to maximize their RSP contributions each year and invest in non-registered funds, the most tax-efficient strategy is to hold

their interest-and dividend-bearing investments within the RSP, and hold capital gains-producing investments in the non-registered account.

Of course, investing for tax efficiency is only one aspect of successful investing. Choosing an investment solely on the basis of its more favourable tax treatment is not the wisest course of action. This issue needs to be considered as part of your overall portfolio strategy based on your personal financial goals, risk tolerance, time horizon for investing, investment knowledge, net worth and income. Speak to your Financial Advisor if you want to find out more about tax-efficient investment options.

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