

systematic withdrawal plan



Many investors have systematic withdrawal plans that enable them to receive payments from their accounts on a regular basis. We are often asked questions about the tax treatment of these plans, so we are providing the following information for the benefit of investors with non-registered plans.

Realized capital gains and losses

Each systematic withdrawal is considered a redemption of units. A capital gain or loss is calculated as the difference between the total proceeds received (i.e., the systematic payment) and the average cost for the units redeemed. For mutual fund unitholders, an estimate of the capital gain (loss) is reported on their account statements on a semi-annual basis. The capital gain (loss) will be calculated for seg fund contract-holders and reported on a T3 supplementary slip.

Average cost

The average cost per unit at redemption is the total cost at which all units were purchased before the redemption, divided by the total number of units outstanding at that time. The average cost per unit will not change as a result of redemptions. However, the average cost will change when additional purchases are made, including those purchases that are made from reinvested distributions received from a mutual fund. Unlike mutual funds, seg funds do not pay distributions. The seg fund allocates income and capital gains (losses) to the contractholder. This results in an increase (decrease) to the adjusted cost base (ACB) of the seg fund units to ensure that these amounts are not taxed again on a withdrawal from the contract.

Distributions and allocations

Any income and capital gains distributed by a mutual fund or allocated by a seg fund have tax implications for the investor (seg funds can also allocate capital losses). These amounts must be included in the taxpayer's return in the year of distribution or allocation.

The income portion may comprise a combination of interest, Canadian dividends and foreign non-business income. Interest will be taxed as ordinary income at the full tax rate. Canadian dividends will be eligible for the dividend tax credit and the foreign non-business income may have a foreign tax credit attached to it. The distribution for mutual funds and/or allocation for seg funds may also have a capital gains component, which represents the gains realized by the fund through the sale of some of its holdings.

The taxpayer must include 66-2/3 per cent of the realized capital gain on a disposition and the capital gain (or loss for a seg fund) received by distribution or allocation in income.

Example

The example on the next page illustrates the effect that redemptions, reinvested distributions and additional unit purchases have on the average cost of the units.

In the example, the unitholder purchases 2,500 units at \$10 per unit at the beginning of year one and elects to withdraw \$500 per month from the account. Each redemption in the first year therefore has proceeds of \$500 and an average cost of \$10 per unit. The number of units redeemed each month will change as the market value changes. Similarly, the realized capital gain will change each month as the market value changes.

At the end of the first year, the unitholder receives a distribution of \$1 per unit on each unit then outstanding and reinvests the distribution in new units of the fund. The cost of each new unit is \$10.20 – the market value per unit immediately following the distribution. When the cost of the new units is combined with the cost of the old units, the new average cost of all units in the account becomes \$10.02.

Redemptions in the second year use the \$10.02 average cost to calculate realized capital gains until the unitholder makes a new purchase of units in the fifth month at the market price of \$10.70. This new purchase causes the average cost to rise to \$10.25 when the cost of all the units is averaged together. Subsequent redemptions during the remainder of the second year use this new average cost to calculate capital gains. At the end of the year, the distribution and reinvestment again results in a change in the average cost to \$10.26.

In summary, in each of the two years, the unitholder has withdrawn \$6,000, realized capital gains of \$360.27 and \$380.82 respectively, and received a return on original invested capital of \$5,639.73 in year one and \$5,619.18 in year two. The distributions of \$1,936.02 and \$2,506.86 comprise capital gains and income.

RRIFs

If the systematic withdrawal plan account is registered as a Registered Retirement Income Fund (RRIF) account, this model does not apply. Any withdrawals from a mutual fund or seg fund within an RRIF are fully taxed as ordinary income in the year received. Any distributions or allocations received by the RRIF are not taxed if left in the account as a reinvestment, but once withdrawn are fully taxed as ordinary income.

Unitholders are required to withdraw a minimum amount from their RRIF accounts each year (excluding the year the RRIF is established) based on a formula outlined in the Income Tax Act. All amounts withdrawn from an RRIF beyond the established minimum are subject to withholding tax deductions.

In all systemic withdrawal plans, if the payments are larger than the amount the fund is earning, your account will eventually run out of money. All specific cases should be dealt with on an individual basis and professional tax advice should be obtained.

This Taxation Bulletin has been prepared with the assistance of the Chartered Accounting firm of

 ERNST & YOUNG

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Assumptions:

Original purchase \$25,000.00
 Fund price increase per year 12.00 %
 Capital gains distribution per year per unit \$0.85
 Income distribution per year per unit \$0.15
 Monthly withdrawal \$500.00

Month	Average Unit Cost	# of Units O/S	Investment at Cost	Investment at Market	Per Unit Market Value	Units Withdrawn	Value Withdrawn	Average Cost	Capital Gains Realized	Taxable Income	
										Capital Gain	Distribution Income
YR 1 0	\$10.00	2,500.000	\$25,000.00	\$25,000.00	\$10.00						
1	10.00	2,450.495	24,504.95	24,750.00	10.10	49.505	\$ 500.00	\$ 495.05	\$ 4.95		
2	10.00	2,401.475	24,014.75	24,495.05	10.20	49.020	500.00	490.20	9.80		
3	10.00	2,352.932	23,529.32	24,235.20	10.30	48.543	500.00	485.43	14.57		
4	10.00	2,304.855	23,048.55	23,970.49	10.40	48.077	500.00	480.77	19.23		
5	10.00	2,257.236	22,572.36	23,700.98	10.50	47.619	500.00	476.19	23.81		
6	10.00	2,210.066	22,100.66	23,426.70	10.60	47.170	500.00	471.70	28.30		
7	10.00	2,163.337	21,633.37	23,147.71	10.70	46.729	500.00	467.29	32.71		
8	10.00	2,117.041	21,170.41	22,864.04	10.80	46.296	500.00	462.96	37.04		
9	10.00	2,071.169	20,711.69	22,575.74	10.90	45.872	500.00	458.72	41.28		
10	10.00	2,025.715	20,257.15	22,282.86	11.00	45.454	500.00	454.54	45.46		
11	10.00	1,980.670	19,806.70	21,985.43	11.10	45.045	500.00	450.45	49.55		
12	10.00	1,936.027	19,360.27	21,683.50	11.20	44.643	500.00	446.43	53.57		
Distribution	10.20	189.807	1,936.02	1,936.02	10.20	563.973	6,000.00	5,639.73	360.27	1,645.62	290.40
YR 1 ending	10.02	2,125.834	21,296.29	21,683.50	10.20	563.973	6,000.00	5,639.73	360.27	1,645.62	290.40
YR 2 1	10.02	2,077.290	20,814.44	21,396.08	10.30	48.544	500.00	486.41	13.59		
2	10.02	2,029.213	20,332.71	21,103.81	10.40	48.077	500.00	481.73	18.27		
3	10.02	1,981.594	19,855.57	20,806.73	10.50	47.619	500.00	477.14	22.86		
4	10.02	1,934.424	19,382.93	20,504.89	10.60	47.170	500.00	472.64	27.36		
5	10.02	1,887.695	18,914.70	20,198.33	10.70	46.729	500.00	468.23	31.77		
New Purchase	10.70	934.579	10,000.00	10,000.00	10.70						
6	10.25	2,822.274	28,914.70	30,198.33							
7	10.25	2,775.978	28,453.77	29,980.56	10.80	46.296	500.00	474.54	25.46		
8	10.25	2,730.106	27,983.59	29,758.16	10.90	45.872	500.00	470.18	29.82		
9	10.25	2,684.652	27,517.68	29,531.17	11.00	45.454	500.00	465.91	34.09		
10	10.25	2,639.607	27,055.97	29,299.64	11.10	45.045	500.00	461.71	38.29		
11	10.25	2,594.964	26,598.38	29,063.60	11.20	44.643	500.00	457.59	42.41		
12	10.25	2,550.716	26,144.84	28,823.09	11.30	44.248	500.00	453.54	46.46		
Distribution	10.40	2,506.856	25,695.28	28,578.16	11.40	43.860	500.00	449.56	50.44		
YR 2 ending	\$10.26	2,747.900	\$28,202.14	\$28,578.16	\$10.40	553.556	\$6,000.00	\$5,619.18	\$380.82	\$2,130.83	\$376.03

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