



Unlocking Tax-Efficient Investing with Mulvihill

Understanding the benefits of return of capital distributions

What are return of capital (ROC) distributions?

ROC distributions are not immediately taxable. Instead, they reduce the adjusted cost base (ACB) of the investment. This defers the tax liability until the investment is eventually sold, or the ACB is reduced to zero, at which point any gains are taxed at the preferential capital gains rate.

What Pre-Tax Yield is Needed to Earn 7% After-Tax?

7.0% Yield (ROC distributions) equates to 15% pre-tax equivalent yield from investments paying interest income and 11.5% pre-tax equivalent yield from dividends

Type of income	Pre-tax yield	Tax rate*	After-tax yield
Interest	15.06%	53.53%	7.0%
Eligible Dividends	11.54%	39.34%	7.0%
Capital Gains	9.56%	26.76%	7.0%
Return of Capital (ROC)	7.0%	**	7.0%

ROC Distributions Explained: What You Need to Know

Income Today, Taxes Tomorrow

- Unlike interest and dividend income, ROC distributions are not immediately taxable in the year you receive them.
- Tax is deferred until disposition of units, or ACB is reduced to zero. Provides flexibility for selling when in a lower tax bracket, granting greater control over tax payments.
- Deferring tax liability today leaves more money to compound in the future
- ROC distributions decrease the adjusted cost base (ACB) of your investment.
- Upon selling your investment, you'll incur capital gains tax on the difference between the disposition value and the adjusted cost base (ACB). If the disposition value is lower than your ACB, you'll experience a capital loss.

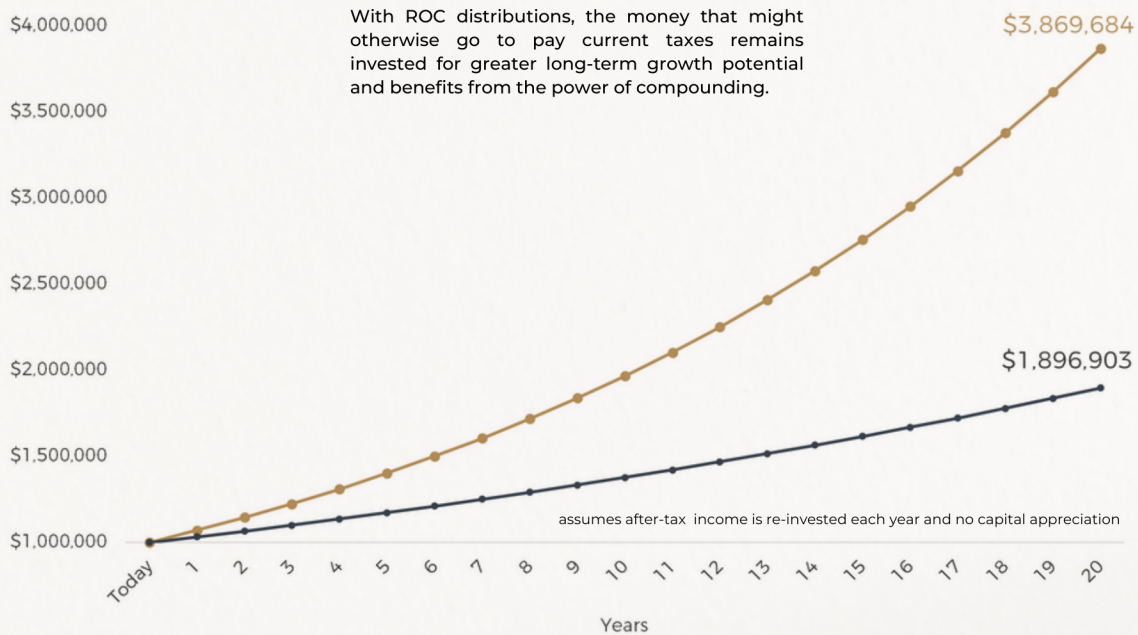
*Using highest marginal tax rates in Ontario

**ROC distribution require an ACB adjustment and unitholders pay capital gains tax when units sold or ACB reached zero

Benefits of Tax-Deferred Growth

Illustrative purposes only

Comparison of two investments of \$1 Million dollars over 20 years. Both distribute 7% per annum. Investment one distributes ROC and investment two pays interest income



The tax is deferred, not eliminated

ROC distributions decrease the ACB of the investment. Upon sale of the investment after 20 years, a capital gains tax is incurred on the difference between the disposition value and the adjusted cost base (ACB). The tax-deferred strategy provides two main benefits. First, flexibility to defer the tax payment until you're in a lower tax bracket, granting greater control over tax payments. Two, the money that might otherwise go to pay current taxes remains invested for greater long-term growth potential

After-tax proceeds if sold after 20 years

	Starting Value	Ending Value After -tax	Return
ROC distributions	\$ 1 Million	\$ 3.1 Million (<u>highest</u> tax bracket)	210%
		\$ 3.6 Million (<u>lowest</u> tax bracket)	258%
Interest Income	\$ 1 Million	\$ 1.9 Million	89%

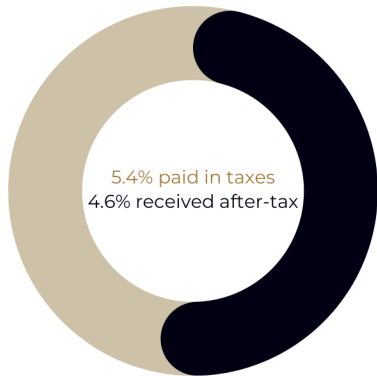
For illustrative purposes only. Assumptions: Based on tax rates for an Ontario resident in the highest marginal tax bracket in 2024. Return of capital distributions received after the adjusted cost base of an investment has been reduced to zero are taxable as capital gains. Ontario highest marginal tax rates: interest and foreign income, 53.53%; eligible dividends, 39.34%; capital gains, 26.76%. Sources: CRA and Mulvihill Capital Management Inc. Assumes ACB of investment after 20 years is greater than zero. This content is for informational purposes only and is not intended to provide specific financial, investment, tax, legal, accounting or other advice to you, and should not be acted or relied upon in that regard without seeking the advice of a professional.

Unlocking Tax Efficiency: The ROC Difference

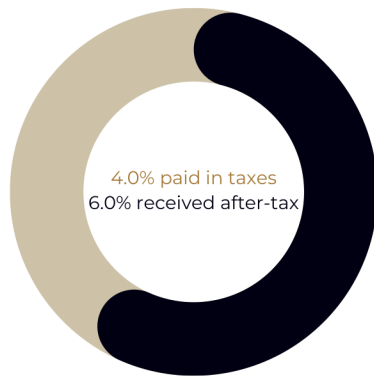
Understanding how various types of income are taxed is crucial when making investment decisions beyond registered plans like RRSPs, RESPs, and TFSAs.

After-Tax Yield Comparison: Evaluating 10% Yields Across Different Income Sources

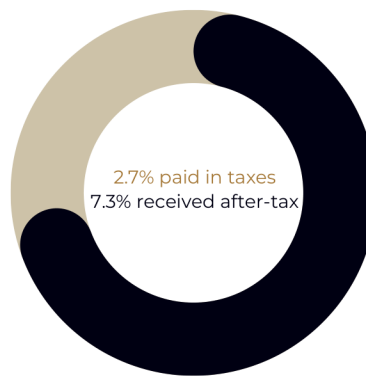
Interest and foreign income



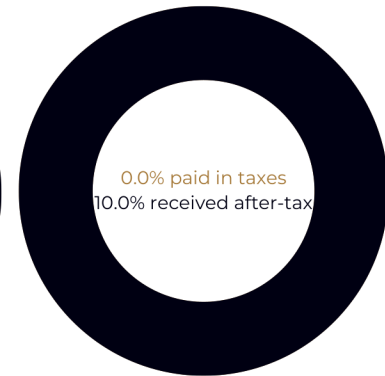
Eligible dividends



Capital gains



Return of Capital (ROC)



If an investor receives a 10% return that's taxed as interest income, they end up paying 5.3% in taxes and retain 4.6% of the total. On the other hand, if that same 10% is considered a return of capital distribution, the investor keeps the entire 10%, with taxes deferred until the units are sold, or ACB reduced to zero.



Who benefits from ROC distributions?

Taxable Investors

Investors in non-registered accounts capitalize on the tax deferral of ROC distributions, enjoying heightened income, deferred tax liabilities, and more capital for future growth.

Investors Shifting from High to Low Tax Bracket

Investors anticipating a transition from a higher to a lower tax bracket over the life of the investment can capitalize on the tax deferral on distributions while in the higher bracket, ultimately benefiting from lower taxes upon the disposition of units in the lower bracket.

Corporations

When a corporation receives ROC distributions they do not count towards the \$50,000 passive income threshold that starts eroding the \$500,000 SBD limit. Therefore they provide a benefit for preserving the Small Business Deduction (SBD) limit for Canadian Controlled Private Corporations (CCPCs). This allows for deferring more active business income inside the corporation at the lower SBD tax rate.

Seniors

ROC distributions benefit seniors as they provide tax-efficient cash flow that does not immediately increase taxable income or impact their eligibility for income-tested government benefits like Old Age Security (OAS).

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