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Foreign Withholding Taxes

How to estimate the hidden tax drag on US and international equity ETFs

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June 2016

This report was written by Justin Bender, PWL Capital Inc. and Dan Bortolotti, PWL Capital Inc. The ideas, opinions, and recommendations contained in this document are those of the authors and do not necessarily represent the views of PWL Capital Inc.

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Justin Bender, *Portfolio Manager*, PWL Capital Inc. and Dan Bortolotti, *Associate Portfolio Manager*, PWL Capital Inc. "*Foreign Withholding Taxes: How to estimate the hidden tax drag on US and international equity ETFs*"

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Introduction

Canadian investors get an enormous benefit from diversifying their portfolios with US and international stocks. But this benefit carries a cost in the form of **foreign withholding taxes**.

Many countries impose a tax on dividends paid to foreign investors: for example, the US government levies a 15% tax on dividends paid to Canadians. Because these taxes are withheld before the dividends are paid in cash, they often go unnoticed. But their impact can be far greater than that of management fees, which get much more attention.

Our goal in this paper is to **quantify the costs** of foreign withholding tax in an effort to help investors make good decisions when choosing ETFs for their registered and taxable accounts.

The amount of foreign withholding tax payable depends on two important factors. The first is the **structure of the ETF** that holds the stocks. Canadian index investors can get exposure to US and international stocks in three ways:

- through a US-listed ETF
- through a Canadian-listed ETF that holds a US-listed ETF
- through a Canadian-listed ETF that holds the stocks directly

In all of these cases, investors are potentially subject to withholding taxes levied by the countries where the stocks are domiciled, whether that is the US or overseas (international developed or emerging markets). We refer to this as **Level I** withholding tax.

When international stocks are held indirectly via a Canadian-listed ETF that holds a US-listed ETF, investors may also be subject to what we've called **Level II** withholding tax. This is an additional 15% withheld by the US government before the US-listed ETF pays the dividends to Canadian investors.

You can think of **Level I** foreign withholding tax like a departure tax you pay when taking a flight to Canada from any foreign country (including the US). **Level II** tax is like a second departure tax you pay when an overseas flight to Canada has a layover in the US.

The second key factor is the **type of account** used to hold the ETF. Different account types—RRSPs, taxable (non-registered) accounts, TFSAs and RESPs—are vulnerable to foreign withholding taxes in different ways:

- When US-listed ETFs are held directly in an RRSP—or other registered retirement account, such as a RRIF or a locked-in RRSP—investors are exempt from withholding tax from the US (but not from overseas countries).
- This exemption does not apply to TFSAs or RESPs.
- If you hold foreign equities in a personal taxable account, you will receive an annual T3 or T5 slip indicating the amount of foreign tax paid. This amount can generally be recovered by claiming the [foreign tax credit](#) on Line 405 of your return.
- Since no tax slips are issued for dividends received in a registered account, any foreign withholding taxes incurred in an RRSP, TFSA or RESP are not recoverable.

How foreign withholding taxes affect your returns

In this paper we explain that some foreign withholding taxes do not apply in RRSPs, while in non-registered accounts they apply but are potentially recoverable by claiming the foreign tax credit.

When deciding on the right ETFs for your portfolio, you can treat these as equivalent. In other words, whether the taxes are avoided altogether or paid upfront but later recovered, the overall impact is the same. However, it is worth noting that these two situations affect your personal rate of return in different ways.

When ETF providers report performance, the figures are net of foreign withholding taxes: in other words, they do not presume that the taxes will be subsequently recovered. If a Canadian ETF holds US stocks that pay an annual dividend of 2%, the 15% foreign withholding tax amounts to a drag of 0.30% and these 30 basis points would be subtracted from the ETF's published return. So if you hold this fund in a taxable account and successfully recover the foreign withholding taxes, your return would effectively be 30 basis points higher than what was reported.

However, although recovered foreign withholding taxes result in a reduced income tax bill, they do not increase the value of your investment account. Those 2% dividends are still reduced to 1.7% before being paid to you. This means if you measure your personal rate of return, the recovered taxes would not be reflected in your calculation. The 0.30% levy would be reflected in a lower personal rate of return.

The situation is different when foreign withholding taxes are avoided altogether in an RRSP. If you hold a US-listed ETF that is exempt from withholding taxes, those savings result in higher dividends received, more money in the RRSP, and a higher personal rate of return.

For more about how to properly measure investment performance, see our white paper, [Understanding your portfolio's rate of return](#) and download our free [rate of return calculators](#).

To fully explain the impact of foreign withholding taxes, we'll start by discussing seven different ETF structures, which we have labeled Type A through Type G. For each structure and each account type, we estimate the cost of the foreign withholding taxes that apply. The results are first explained in detail and then summarized in a table in the Appendix to this paper.

Most foreign equity ETFs available to Canadians can be classified in one of the following seven categories:

A. US-listed ETF of US stocks.

When Canadians hold a US-listed ETF of US stocks, they face only Level I foreign withholding taxes. This is exempted in RRSPs and recoverable in taxable personal accounts, making Type A ETFs extremely tax-efficient:

- In an **RRSP**, Level I withholding taxes **do not apply**.
- In a **taxable account**, Level I withholding taxes apply, but are **recoverable**.
- In a **TFSA or RESP**, Level I withholding taxes apply and are **not recoverable**.

Level I withholding tax on Type A funds is 15% of dividends. We have used the [Vanguard Total Stock Market ETF \(VTI\)](#) as an example. This ETF currently has a dividend yield (D/P) of 2.07% and an expense ratio (ER) of 0.05%.

Estimated Foreign Withholding Taxes: [Vanguard Total Stock Market ETF \(VTI\)](#)

$$\begin{aligned}
 \text{RRSP} &= 0.00\% \\
 \text{Taxable} &= 0.00\% \\
 \text{TFSA or RESP} &= \text{FWT}_{\text{Level I}} \\
 &= 15\% \times (2.07\% - 0.05\%) \\
 &= 0.30\%
 \end{aligned}$$

Where:

ER = Most recently reported expense ratio of the ETF

D/P = Dividend yield of the underlying index as of April 30, 2016

FWT_{Level I} = 15% × (D/P – ER)

B. Canadian-listed ETF that holds a US-listed ETF of US stocks.

Canadian ETF providers such as Vanguard and iShares often take advantage of economies of scale by getting their exposure to US markets by holding a US-listed ETF rather than buying each of the stocks individually.

On the [iShares website](#) you can identify these funds by reviewing the “Top 10 Holdings” tab on the ETF’s web page. The US-listed ETF(s) will be named at the top of the list.

These funds can also be identified by looking at the Statement of Investments section in the fund’s annual report. For example, the annual report for the [Vanguard U.S. Total Market Index ETF \(VUN\)](#) reveals its primary holding is the US-listed [Vanguard Total Stock Market ETF \(VTI\)](#):

Schedule of Investment Portfolio

As at December 31, 2015

Number of Units	Description	Average Cost (\$)	Fair Value (\$)	% of Net Assets
	Exchange-Traded Funds			
4,382,180	*Vanguard Total Stock Market ETF	526,588,569	632,496,460	100.0
	Total investments	526,588,569	632,496,460	100.0
	Other assets and liabilities (net)		86,128	0.0
	Total net assets attributable to holders of redeemable units		632,582,588	100.0

* This fund (a U.S.-based Vanguard ETF) is managed by The Vanguard Group, Inc. Refer to Note 8(b).

Source: Vanguard Investments Canada Annual Financial Statements, 2015

Because the underlying stocks are domiciled in the US, only Level I withholding tax applies. Unlike with Type A funds, there is no exemption from this withholding tax when Type B funds are held in an RRSP:

- In an **RRSP, TFSA or RESP**, Level I withholding taxes apply and are **not recoverable**.
- In a **taxable account**, US withholding taxes apply, but are **recoverable**.

In our example below, we calculate the estimated foreign withholding tax of the [Vanguard U.S. Total Market Index ETF \(VUN\)](#), assuming a 15% Level I withholding tax. The dividend yield and the expense ratio of the underlying US-listed ETF are the same as in our Type A example.

Estimated Foreign Withholding Taxes: [Vanguard U.S. Total Market Index ETF \(VUN\)](#)

$$\begin{aligned} \text{RRSP} &= \text{FWT}_{\text{Level I}} \\ &= 15\% \times (2.07\% - 0.05\%) \\ &= \mathbf{0.30\%} \\ \text{Taxable} &= \mathbf{0.00\%} \\ \text{TFSA or RESP} &= \text{FWT}_{\text{Level I}} \\ &= 15\% \times (2.07\% - 0.05\%) \\ &= \mathbf{0.30\%} \end{aligned}$$

Where:

ER = Most recently reported expense ratio of the US-listed ETF

D/P = Dividend yield of the underlying index as of April 30, 2016

FWT_{Level I} = $15\% \times (D/P - ER)$

In an earlier version of this paper we created a separate category for Canadian-listed ETFs that hold US stocks directly. Examples include the **BMO S&P 500 Index ETF (ZSP)**, which differs from its iShares and Vanguard counterparts by holding the index's underlying 500 companies individually, as opposed to using an underlying US-listed ETF.

We have omitted this category from the current discussion because the distinction is trivial. Whether US stocks are held directly or via an underlying ETF the foreign withholding taxes are very similar in all account types.

C. **US-listed ETF that holds developed markets stocks directly.**

Dividends from ETFs of this type are subject to unrecoverable Level I withholding taxes levied by the countries where the stocks are domiciled (which include countries in western Europe, Japan and Australia).

Except when held in an RRSP, Type C funds are also subject to Level II withholding tax imposed by the US government before the ETFs pay the dividends to Canadian unitholders:

- In an **RRSP**, Level I withholding taxes apply and are **not recoverable**. Level II withholding taxes **do not apply**.
- In a **taxable account**, Level I withholding taxes apply and are **not recoverable**. Level II withholding taxes apply, but are **recoverable**.
- In a **TFSA or RESP**, Level I and Level II withholding taxes apply and are **not recoverable**.

Since the stocks are held by a US-listed ETF, Level I withholding taxes are payable at rates determined by tax treaties between these overseas countries and the US (not Canada). To estimate this tax rate for our example below, we've used the foreign dividend and withholding tax information from the 2015 Annual Report for the [Vanguard FTSE Developed Markets ETF \(VEA\)](#). For Level II withholding tax, we've assumed 15% on the remaining dividends.

Estimated Level I Foreign Withholding Tax of the [Vanguard FTSE Developed Markets ETF \(VEA\)](#)

Vanguard FTSE Developed Markets ETF	December 31, 2015
Net Dividends (A)	1,456,119,000
Foreign Withholding Tax (B)	76,357,000
Gross Dividends (A + B)	1,532,476,000
Foreign Withholding Tax Level 1 [B ÷ (A + B)]	4.98%

Source: The Vanguard Group Inc., 2015 Annual Report

VEA currently has a dividend yield (D/P) of 3.12% and an expense ratio (ER) of 0.09%. We now have all of the information we need to estimate the impact of foreign withholding tax for Canadians.

Estimated Foreign Withholding Taxes: [Vanguard FTSE Developed Markets ETF \(VEA\)](#)

$$\begin{aligned} \text{RRSP} &= \text{FWT}_{\text{Level I}} \\ &= 4.98\% \times 3.12\% \\ &= \mathbf{0.16\%} \end{aligned}$$

$$\begin{aligned} \text{Taxable} &= \text{FWT}_{\text{Level I}} \\ &= 4.98\% \times 3.12\% \\ &= \mathbf{0.16\%} \end{aligned}$$

$$\begin{aligned} \text{TFSA or RESP} &= \text{FWT}_{\text{Level I}} + \text{FWT}_{\text{Level II}} \\ &= (4.98\% \times 3.12\%) + [15\% \times (3.12\% - 0.16\% - 0.09\%)] \\ &= 0.16\% + 0.43\% \\ &= \mathbf{0.59\%} \end{aligned}$$

Where:

ER = Most recently reported expense ratio of the ETF

D/P = Gross dividend yield of the underlying index as of April 30, 2016

FWT_{Level I} = 2015 Level I foreign withholding tax of underlying US-listed ETF × D/P

FWT_{Level II} = 15% × (D/P – FWT_{Level I} – ER)

D. Canadian-listed ETF that holds a US-listed ETF of developed markets stocks.

International equity indexes can contain a large number of stocks denominated in several foreign currencies, making them costly to replicate. Rather than buying all of these stocks individually, Canadian ETF providers may get their exposure by holding a US-listed ETF tracking the same index.

As with Type B funds, you can identify Type D funds by checking the ETF's website or its annual report. For example, the annual report for the [Vanguard FTSE Developed All Cap ex U.S. Index ETF \(VDU\)](#) reveals its primary holding is the US-listed [Vanguard FTSE Developed Markets ETF \(VEA\)](#):

Schedule of Investment Portfolio

As at December 31, 2015

Number of Units	Description	Average Cost (\$)	Fair Value (\$)	% of Net Assets
	Exchange-Traded Funds			
7,788,069	*Vanguard FTSE Developed Markets ETF	349,595,521	397,251,892	100.0
	Total investments	349,595,521	397,251,892	100.0
	Foreign currency contracts (Schedule 1)		(22,381,698)	(5.6)
	Other assets and liabilities (net)		22,494,827	5.6
	Total net assets attributable to holders of redeemable units		397,365,021	100.0

* This fund (a U.S.-based Vanguard ETF) is managed by The Vanguard Group, Inc. Refer to Note 8(b).

Source: Vanguard Investments Canada Annual Financial Statements, 2015

With Type D funds, investors face both Level I and Level II withholding tax on dividends. Unlike with Type C funds, there is no exemption on the Level II tax if the fund is held in an RRSP:

- In an **RRSP**, **TFSA** or **RESP**, Level I and Level II withholding taxes apply and are **not recoverable**.
- In a **taxable account**, Level I withholding taxes apply and are **not recoverable**. Level II withholding taxes apply, but are **recoverable**.

For this example, we'll use the [Vanguard FTSE Developed All Cap ex U.S. Index ETF \(VDU\)](#). Since its underlying holding is the US-listed [Vanguard FTSE Developed Markets ETF \(VEA\)](#), discussed above, we can use the same estimate of 4.98% for the Level I withholding tax, as well as the same dividend yield (3.12%) and expense ratio (0.09%) for the underlying US-listed ETF.

Estimated Foreign Withholding Taxes: [Vanguard FTSE Developed All Cap ex U.S. Index ETF \(VDU\)](#)

$$\begin{aligned}
 \mathbf{RRSP} &= \mathbf{FWT}_{\text{Level I}} + \mathbf{FWT}_{\text{Level II}} \\
 &= (4.98\% \times 3.12\%) + [15\% \times (3.12\% - 0.16\% - 0.09\%)] \\
 &= 0.16\% + 0.43\% \\
 &= \mathbf{0.59\%}
 \end{aligned}$$

$$\begin{aligned}
 \mathbf{Taxable} &= \mathbf{FWT}_{\text{Level I}} \\
 &= 4.98\% \times 3.12\% \\
 &= \mathbf{0.16\%}
 \end{aligned}$$

$$\begin{aligned}
 \mathbf{TFSA \text{ or } RESP} &= \mathbf{FWT}_{\text{Level I}} + \mathbf{FWT}_{\text{Level II}} \\
 &= (4.98\% \times 3.12\%) + [15\% \times (3.12\% - 0.16\% - 0.09\%)] \\
 &= 0.16\% + 0.43\% \\
 &= \mathbf{0.59\%}
 \end{aligned}$$

Where:

ER = Most recently reported expense ratio of the US-listed ETF

D/P = Dividend yield of the underlying index as of April 30, 2016

FWT_{Level I} = 2015 Level I foreign withholding tax of underlying US-listed ETF × D/P

FWT_{Level II} = 15% × (D/P – FWT_{Level I} – ER)

E. Canadian-listed ETF that holds developed markets stocks directly.

Type E funds get their exposure to international markets by holding the underlying stocks directly, rather than via a US-listed ETF. Many ETF providers have been transitioning their Type D funds into Type E funds, due to the more favourable tax treatment.

With this type of fund, Level I withholding taxes are levied by the countries where the stocks are domiciled, and payable at Canadian rates. Since Canada has different tax treaties with the various countries, the foreign withholding tax rates may differ from those in Type D funds.

Level II withholding taxes do not apply to Type E funds. Therefore this structure can be extremely tax-efficient:

- In an **RRSP, TFSA or RESP**, Level I withholding taxes apply and are **not recoverable**.
- In a **taxable account**, Level I withholding taxes apply, but are **recoverable**.

To estimate the Level I foreign withholding taxes in Type E funds, we've used the most recent foreign withholding taxes paid by the [iShares Core MSCI EAFE IMI Index ETF \(XEF\)](#).

Estimated Level I Foreign Withholding Tax of a Type E Fund

iShares Core MSCI EAFE IMI Index ETF (XEF)	December 31, 2015
Net Dividends (A)	10,187,883
Foreign Withholding Tax (B)	890,763
Gross Dividends (A + B)	11,078,646
Foreign Withholding Tax Level 1 [B ÷ (A + B)]	8.04%

Source: BlackRock Canada 2015 Annual Report

This ETF currently has a dividend yield (D/P) of 3.27%. We now have the two variables we need to estimate the impact of foreign withholding tax for Canadians.

Estimated Foreign Withholding Taxes: [iShares Core MSCI EAFE IMI Index ETF \(XEF\)](#)

$$\mathbf{RRSP} = \mathbf{FWT}_{\text{Level I}}$$

$$= 8.04\% \times 3.27\%$$

$$= \mathbf{0.26\%}$$

$$\mathbf{Taxable} = \mathbf{0.00\%}$$

$$\mathbf{TFSA \text{ or } RESP} = \mathbf{FWT}_{\text{Level I}}$$

$$= 8.04\% \times 3.27\%$$

$$= \mathbf{0.26\%}$$

Where:

D/P = Dividend yield of the underlying index as of April 30, 2016

FWT_{Level I} = 2015 Level I foreign withholding tax of Canadian-listed ETF × D/P

F. US-listed ETF of emerging markets stocks.

This structure is very similar to Type C: the only difference is that the underlying stocks are domiciled in emerging markets rather than developed countries.

Except when held in an RRSP, Type F funds are also subject to Level II withholding tax, imposed by the US government before the ETFs pay the dividends to Canadian unitholders:

- In an **RRSP**, Level I withholding taxes apply and are **not recoverable**. Level II withholding taxes **do not apply**.
- In a **taxable account**, Level I withholding taxes apply and are **not recoverable**. Level II withholding taxes apply, but are **recoverable**.
- In a **TFSA or RESP**, Level I and Level II withholding taxes apply and are **not recoverable**.

As a group, emerging countries tend to have higher withholding tax rates on dividends paid within US funds. We've estimated the Level I foreign withholding tax at 9.63% for the [Vanguard FTSE Emerging Markets ETF \(VWO\)](#).

Estimated Level I Foreign Withholding Tax of a Type F Fund

Vanguard FTSE Emerging Markets ETF (VWO)	December 31, 2015
Net Dividends (A)	1,726,600,000
Foreign Withholding Tax (B)	183,953,000
Gross Dividends (A + B)	1,910,553,000
Foreign Withholding Tax Level 1 [B ÷ (A + B)]	9.63%

Source: The Vanguard Group Inc., 2015 Annual Report

We then applied this average withholding tax rate to the ETF's dividend yield of 3.06%.

Estimated Foreign Withholding Taxes: [Vanguard FTSE Emerging Markets ETF \(VWO\)](#)

$$\begin{aligned}
 \text{RRSP} &= \text{FWT}_{\text{Level I}} \\
 &= 9.63\% \times 3.06\% \\
 &= \mathbf{0.29\%}
 \end{aligned}$$

$$\begin{aligned}
 \text{Taxable} &= \text{FWT}_{\text{Level I}} \\
 &= 9.63\% \times 3.06\% \\
 &= \mathbf{0.29\%}
 \end{aligned}$$

$$\begin{aligned}
 \text{TFSA or RESP} &= \text{FWT}_{\text{Level I}} + \text{FWT}_{\text{Level II}} \\
 &= (9.63\% \times 3.06\%) + [15\% \times (3.06\% - 0.29\% - 0.15\%)] \\
 &= 0.29\% + 0.40\% \\
 &= \mathbf{0.69\%}
 \end{aligned}$$

Where:

ER = Most recently reported expense ratio of the ETF

D/P = Dividend yield of the underlying index as of December 31, 2013

FWT_{Level I} = 2015 Level I foreign withholding tax of US-listed ETF × D/P

FWT_{Level II} = 15% × (D/P – FWT_{Level I} – ER)

G. Canadian-listed ETF that holds a US-listed ETF of emerging markets stocks.

This structure is very similar to Type D: the only difference is that the underlying stocks are domiciled in emerging markets rather than developed countries. They can be identified in the same way as Type D funds: either by examining the holdings on the ETF's website, or by looking at the Statement of Investments section in the annual report.

For example, the annual report for the [Vanguard FTSE Emerging Markets All Cap Index ETF \(VEE\)](#) reveals its primary holding is the US-listed [Vanguard FTSE Emerging Markets ETF \(VWO\)](#):

Schedule of Investment Portfolio

As at December 31, 2015

Number of Units	Description	Average Cost (\$)	Fair Value (\$)	% of Net Assets
	Exchange-Traded Funds			
5,888,859	*Vanguard FTSE Emerging Markets ETF	263,660,306	266,534,629	100.0
	Total investments	263,660,306	266,534,629	100.0
	Other assets and liabilities (net)		83,371	0.0
	Total net assets attributable to holders of redeemable units		266,618,000	100.0

* This fund (a U.S.-based Vanguard ETF) is managed by The Vanguard Group, Inc. Refer to Note 8(b).

Source: Vanguard Investments Canada Annual Financial Statements, 2015

With Type G funds, investors face both Level I and Level II withholding tax on dividends:

- In an **RRSP, TFSA or RESP**, Level I and Level II withholding taxes apply and are **not recoverable**.
- In a **taxable account**, Level I withholding taxes apply and are **not recoverable**. Level II withholding taxes apply, but are **recoverable**.

For this example, we'll use the [Vanguard FTSE Emerging Markets All Cap Index ETF \(VEE\)](#). Since its underlying holding is the [Vanguard FTSE Emerging Markets ETF \(VWO\)](#), discussed above, we can use the same estimate of 9.63% for the Level I withholding tax, as well as the same dividend yield (3.06%) and expense ratio (0.15%) for the underlying US-listed ETF.

Estimated Foreign Withholding Taxes: [Vanguard FTSE Emerging Markets All Cap Index ETF \(VEE\)](#)

$$\begin{aligned}
 \text{RRSP} &= \text{FWT}_{\text{Level I}} + \text{FWT}_{\text{Level II}} \\
 &= (9.63\% \times 3.06\%) + [15\% \times (3.06\% - 0.30\% - 0.15\%)] \\
 &= 0.29\% + 0.40\% \\
 &= \mathbf{0.69\%}
 \end{aligned}$$

$$\begin{aligned}
 \text{Taxable} &= \text{FWT}_{\text{Level I}} \\
 &= 9.63\% \times 3.06\% \\
 &= \mathbf{0.29\%}
 \end{aligned}$$

$$\begin{aligned}
 \text{TFSA or RESP} &= \text{FWT}_{\text{Level I}} + \text{FWT}_{\text{Level II}} \\
 &= (9.63\% \times 3.06\%) + [15\% \times (3.06\% - 0.30\% - 0.15\%)] \\
 &= 0.29\% + 0.40\% \\
 &= \mathbf{0.69\%}
 \end{aligned}$$

Where:

ER = Most recently reported expense ratio of the US-listed ETF

D/P = Dividend yield of the underlying index as of December 31, 2013

FWT_{Level I} = 2015 Level I foreign withholding tax of the underlying US-listed ETF × D/P

FWT_{Level II} = 15% × (D/P - FWT_{Level I} - ER)

Summing it all up

If you're confused about the effects of foreign withholding taxes on ETFs in various accounts, we can boil it down to a few key takeaways:

In an RRSP or related retirement account:

- US-listed ETFs (Type A, C and F) often have a significant tax advantage. However, this must be weighed against other potential costs, particularly converting Canadian dollars to US dollars (see "The bigger picture," below). Many DIY investors will find it less costly overall to simply use Canadian-listed ETFs.

In a taxable account:

- Canadian-listed ETFs are generally a better choice. US-listed ETFs offer no tax advantage for US equities, and any benefits with international equities are small. Moreover, they are likely to be outweighed by other considerations, including currency conversion costs and additional recordkeeping (see "The bigger picture," below).

In a TFSA or RESP:

- Always use Canadian-listed ETFs for all foreign equities. US-listed ETFs offer no tax advantage whatsoever, and in some cases are significantly less tax-efficient.

In all account types:

- If you use Canadian-listed ETFs for international equities, an ETF that holds the stocks directly (Type E) will be more tax-efficient than one whose exposure comes via an underlying US-listed ETF (Type D).

The bigger picture

Foreign withholding taxes are just one of many costs of investing. Before choosing the right funds and account locations, consider the following factors as well:

The cost of currency conversion. In an RRSP, it may be significantly more tax-efficient to hold US-listed ETFs for foreign equities. However, this is only true if you can avoid the potentially high cost of converting currency before purchasing these ETFs. Unless you are able to convert your Canadian dollars to US dollars at a very low rate (for example, by using [Norbert's gambit](#)), the tax advantage offered by US-listed ETFs will be reduced.

Your income tax situation. Some investors make decisions designed to save foreign withholding taxes and end up paying even more in income tax. For example, holding foreign equities in a taxable account allows you to recover at least some of the foreign withholding tax that would be lost in a TFSA. But in a non-registered account the dividends would be taxed at your full marginal rate, and you'd face additional taxes on capital gains. For an investor in a high tax bracket, it is better to pay a 15% withholding tax on dividends in a TFSA if the alternative is paying 50% income tax on dividends and 25% on capital gains in a taxable account.

Recordkeeping. In taxable accounts, US-listed ETFs generally have similar or better tax-efficiency and lower annual expense ratios compared with their Canadian-listed counterparts. They may therefore seem appealing to investors who have US dollars available. However, tracking the [adjusted cost base of US-listed ETFs](#) is significantly more difficult because you will need to look up the exchange rate on the settlement date of every transaction. This adds an additional cost, especially if you pay a tax preparer to do it for you.

Additional reporting to CRA. US-listed ETFs are considered foreign property by the Canada Revenue Agency, and non-registered holdings with a book value of \$100,000 CAD or more must be reported annually to CRA using the [T1135 form](#). Additional reporting is required when the total cost of your US-listed ETFs is over \$250,000 CAD.

US estate taxes. Wealthy Canadians may be subject to US estate taxes if they have significant holdings in US-listed ETFs, even if these are held in an RRSP. These investors may be better off holding Canadian-domiciled funds to avoid this risk, even if it means incurring foreign withholding taxes.

Expense ratios and bid-ask spreads. In general, expense ratios (annual fees) and bid-ask spreads are lower with US-listed ETFs, making them potentially a better choice even when Canadian-listed equivalents are equally tax-efficient. Again, however, this may be outweighed by the cost of currency conversion, additional tax reporting and portfolio complexity.

Sampling error. In general, Canadian ETFs that get their exposure to foreign equities by holding the underlying stocks directly (rather than through a US-listed ETF) are more tax-efficient. However, these ETFs may not include all of the stocks in their benchmark index, especially if they are relatively new and have not yet attracted many assets. ETFs that hold only a “representative sample” may deliver returns that are significantly lower (or higher) than comparable funds that fully replicate their indexes. In general, use ETFs that have been trading for at least a year, and verify that they hold virtually all of the stocks in their benchmark indexes.

APPENDIX: Foreign Withholding Tax of Equity ETFs

In the table below, we've estimated the foreign withholding tax drag of various broad-market equity ETFs when held in an RRSP, taxable, TFSA or RESP account.

US Equity ETF	Ticker	Type	Market	RRSP	Taxable	TFSA or RESP
Vanguard Total Stock Market ETF	VTI	A	US	0.00%	0.00%	0.30%
Vanguard U.S. Total Market Index ETF	VUN	B	CDN	0.30%	0.00%	0.30%
iShares Core S&P Total U.S. Stock Market ETF	ITOT	A	US	0.00%	0.00%	0.31%
iShares Core S&P U.S. Total Market Index ETF	XUU	B	CDN	0.31%	0.00%	0.31%

Source: BlackRock, BlackRock Canada, Vanguard Canada, The Vanguard Group Inc.

Developed Markets Equity ETF	Ticker	Type	Market	RRSP	Taxable	TFSA or RESP
Vanguard FTSE Developed Markets ETF	VEA	C	US	0.16%	0.16%	0.59%
Vanguard FTSE Developed All Cap ex U.S. Index ETF	VDU	D	CDN	0.59%	0.16%	0.59%
iShares Core MSCI EAFE ETF	IEFA	C	US	0.25%	0.25%	0.69%
iShares Core MSCI EAFE IMI Index ETF	XEF	E	CDN	0.26%	0.00%	0.26%

Source: BlackRock, BlackRock Canada, Vanguard Canada, The Vanguard Group Inc.

Emerging Markets Equity ETF	Ticker	Type	Market	RRSP	Taxable	TFSA or RESP
Vanguard FTSE Emerging Markets ETF	VWO	F	US	0.29%	0.29%	0.69%
Vanguard FTSE Emerging Markets Index ETF	VEE	G	CDN	0.69%	0.29%	0.69%
iShares Core MSCI Emerging Markets ETF	IEMG	F	US	0.28%	0.28%	0.63%
iShares Core MSCI Emerging Markets IMI Index ETF	XEC	G	CDN	0.63%	0.28%	0.63%

Source: BlackRock, BlackRock Canada, Vanguard Canada, The Vanguard Group Inc.



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