

# Tax Advantages of Fixed Income Investments

For income-oriented investors looking for limited to no portfolio volatility<sup>1</sup>, Guaranteed Investment Certificates (GICs) and High Interest Savings Accounts (HISAs) have become a top option. As interest rates have risen to levels not seen in over a decade, bond yields (yield to maturity) have also significantly increased. Investors can now purchase bonds that are deeply discounted<sup>2</sup> relative to their maturity value<sup>3</sup>. Most significantly on the short-end of the term where price volatility repayment risk tend to be the lowest. As a result, the fixed income ETF market may actually offer a more attractive investment opportunity than GICs and HISAs for taxable investors. The after tax difference can be significant for high-net worth investors creating an opportunity to add value. Fixed income mutual funds and ETFs are a good way to access this advantage as one can buy a basket of bonds targeted to a specific credit<sup>4</sup> and duration<sup>5</sup> exposure, similar to individual bonds. As always, professional advice should be obtained with respect to any circumstance.

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*The advantage of buying a basket of bonds trading at a discount is that a portion of the future return will come from price appreciation (difference between the discounted price and the maturity value) which is treated as a capital gain for tax purposes.*

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Using a capital gain's inclusion rate of 50%, means that half the capital gain is tax-free, while the other 50% is added to taxable income, with the coupon (interest) income. This compares to a GIC and HISA's where 100% of the return comes from periodic interest income which is taxed as regular income. Income is the least-efficiently taxed distribution, as it is taxed at the holder's marginal tax rate instead of the lower tax treatment of dividend income or capital gains.

## Tax Breakdown

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### BMO Ultra Short-Term Bond ETF (Ticker: ZST) BMO Ultra Short-Term Bond ETF Fund (the "Fund")

BMO Ultra Short-Term Bond ETF and the underlying BMO Ultra Short Term Bond ETF ZST holds a basket of investment grade holds a basket of investment grade corporate bonds with under 1 year to maturity. The objective is to hold these bonds to maturity with the added benefit of intraday liquidity.

- Current Yield to Maturity<sup>6</sup> (YTM) is 3.29%<sup>7</sup> and the coupon is 2.40%<sup>7</sup>
- The difference between the Yield to Maturity and the coupon is also reflected in the discount that the basket of bonds is trading at, currently the average bond price within the portfolio is \$98.75<sup>7</sup>.
- Using a one-year time horizon with an investment of \$100,000<sup>8</sup>, with no changes to interest rates or credit spreads, the pre-tax total return will equal 3.29% and for taxable investors will be a combination of income and capital gains.

### Hypothetical Example:

The comparison presented is intended to illustrate the After-Tax Returns of the products listed below. There are various differences that may exist between the products, that may affect the performance of each. This is a hypothetical calculation and not tax advice. Please consult a tax professional with respect to any circumstance.

	Coupon	YTM <sup>9</sup>	Before Tax Return		After Tax Return		After Tax Return (\$)	After Tax Return (%)
			Interest Income (\$)	Capital Gains (\$)	Interest Income (\$)	Capital Gains <sup>10</sup> (\$)		
<b>BMO Ultra Short Term Bond ETF (Fund/ETF Series)</b>	2.40%	3.29%	\$2,400	\$890	\$1,115	\$652	\$1,767	1.77%
<b>GIC<sup>11</sup></b>	2.75%	2.75%	\$2,750	\$0	\$1,278	\$0	\$1,278	1.28%
<b>HISA<sup>12</sup></b>	2.95%	2.95%	\$2,950	\$0	\$1,371	\$0	\$1,371	1.37%
<b>ZSDB - BMO Short Term Discount Bond ETF</b>	1.36%	2.88%	\$1,360	\$1,520	\$632	\$1,113	\$1,745	1.75%

#### Tax Calculation

### BMO Ultra Short-Term Bond ETF Fund

#### Interest Income

- 2.40% Coupon x \$100,000 Initial Investment = **\$2,400 Pre-Tax Interest Income**
- \$2,400 Income Before Tax x (1 - Marginal Tax Rate<sup>13</sup>) = **\$1,115 After Tax Interest Income**

#### Capital Gain

- (3.29% YTM - 2.40% Coupon) x \$100,000 Initial Investment = **\$890 Pre-Tax Capital Gains** realized at maturity
- Capital Gains before Tax x (1 - Capital Gains Inclusion Rate) + [ Capital Gains Before Tax x (1 - Capital Gains Inclusion Rate) x (1 - Marginal Tax Rate) ] = **\$652 After Tax Capital Gains**

#### Total Return

- \$2,400 Interest Income + \$890 Capital Gains = **\$3,290 Pre-Tax Return**
- \$1,115 Interest Income + \$652 Capital Gains = **\$1,767 After Tax Return**

### GIC

#### Interest Income

- 2.75% Coupon x \$100,000 Initial Investment = **\$2,750 Pre-Tax Interest Income Earned**
- \$2,750 Coupon x (1 - Marginal Tax Rate) = **\$1,278 After Tax Return**

### HISA

#### Interest Income

- 2.95% Coupon x \$100,000 Initial Investment = **\$2,950 Pre-Tax Interest Income Earned**
- \$2,950 Coupon x (1 - Marginal Tax Rate) = **\$1,371 After Tax Return**

*Given current market dynamics, an investor can generate a higher after-tax expected return (approx **+38%**) by investing in BMO Ultra Short-Term Bond ETF Fund versus a GIC, and approx **+29%** versus an HISA.*

While our comparison uses GICs and HISAs, they still remain an attractive option for tax-exempt investors, as well as for individuals seeking the \$100,000 CDIC coverage that they provide.

## Fund Code and Fees

Series	Fund Code/Ticker	MER
ETF Series	ZST	0.17%
Series F	BM095338	0.17%

Management Expense Ratio (MER) as of March 31, 2024.



<sup>1</sup> Volatility: Measures how much the price of a security, derivative, or index fluctuates. The most commonly used measure of volatility when it comes to investment funds is standard deviation.

<sup>2</sup> Discount Bond: a bond that is issued for less than its face value

<sup>3</sup> Yields and Bond Prices are inversely related. So, a rise in a bond price will decrease the yield and a fall in the price will increase the yield.

<sup>4</sup> Credit: An assessment of the creditworthiness of a borrower in general terms or with respect to a particular debt or financial obligation

<sup>5</sup> Duration: A measure of the sensitivity of the price of a fixed income investment to a change in interest rates. Duration is expressed as number of years. The price of a bond with a longer duration would be expected to rise (fall) more than the price of a bond with lower duration when interest rates fall (rise).

<sup>6</sup> Yield to Maturity: The total expected return from a bond when it is held until maturity – including all interest, coupon payments, and premium or discount adjustments

<sup>7</sup> As of December 31, 2024

<sup>8</sup> Initial investment of \$100,000 – holding period 1 year (assumes that the investor sells at 1 year)

<sup>9</sup> YTM is calculated gross of fees.

<sup>10</sup> Capital gains scenario assumes amount under \$250,000, amounts over \$250,000 after tax returns can vary

<sup>11</sup> BMO Guaranteed Investment Certificate 1-year non-redeemable rate as of December 31, 2024, compounded annually.

<sup>12</sup> BMO High Interest Savings Account (BMT104) rate as of December 31, 2024. <sup>9</sup> YTM is calculated gross of fees.

<sup>13</sup> Assuming the tax rate is 53.53%. Top marginal tax bracket will differ depending on province of residence.

Tax rate assumptions: marginal tax rate of 53.53% and capital gains inclusion rate of 50%. Assumes investors realizing capital gains < \$250,000. Calculations differ for corporate investors and/or individuals realizing > \$250,000 capital gains annually and most trusts. For more on tax rates: [Wealth Planning Facts & Figures](#).

We are not tax specialists and each individual circumstance and tax situation may be different. Investors should consult their tax specialist before acting on the information provided above.

The payment of distributions is not guaranteed and may fluctuate. The payment of distributions should not be confused with a fund's performance, rate of return or yield. If distributions paid by the fund are greater than the performance of the fund, your original investment will shrink. Distributions paid as a result of capital gains realized by a fund, and income and dividends earned by a fund are taxable in your hands in the year they are paid. Your adjusted cost base will be reduced by the amount of any returns of capital. If your adjusted cost base goes below zero, you will have to pay capital gains tax on the amount below zero. Please refer to the funds distribution policy in the prospectus.

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