

MUTUAL FUND DISTRIBUTIONS

What is a Distribution?

Mutual funds invest in a variety of instruments, including stocks, bonds and other income generating securities. Both the income paid and the capital gains realized through the sale of securities are taxable as they would be if you held them outside of a fund. Since mutual funds pay tax at the highest rate, fund companies distribute this income to the unitholders, many of whom may be taxed at a lower rate.

A distribution may be in the form of interest income, dividends or capital gains, each treated differently for tax purposes. Canadian dividends and capital gains are taxed more favourably than is interest income. While interest income is fully taxable, Canadian dividends are eligible for the dividend tax credit and only 50% of capital gains is taxable.

The type of income that you receive also depends on how the mutual fund is structured.

While most are mutual fund trusts, funds can take the form of either a trust or a corporation. When a mutual fund trust makes a distribution, all of the various types of income (domestic and foreign) "flow through" the fund and reach the investor's hands in the same form as it was realized. Mutual fund corporations, however, can only flow through Canadian dividends and capital gains.

Why is a Distribution Accompanied by a Unit Value Decline?

When a fund makes a distribution, its unit value will decrease by the same amount

as the distribution. If your distribution is reinvested, it is used to purchase more units of the fund. When you multiply the new number of units by the lower unit value, the value of your investment remains unchanged. If you choose to receive the distribution in cash, the combination of the remaining investment value and the cash distribution should equal the value of your investment before the distribution. (See table 1)

Investment Value	1000 units @ \$10 per unit	\$10,000
Distribution	\$1 per unit @ 1000 units = \$1,000 distribution	
Unit Value Decline	\$10 original unit price - \$1 distribution = \$9 new unit price	
Distribution Reinvested	\$1,000 distribution reinvested @ \$9 new unit price = 111.11 units 1000 original units + 111.11 units from reinvested distribution = 1111.11 total units	
	1111.11 units @ \$9 new unit cost	\$10,000
Distribution Paid in Cash	1000 units @ \$9 new unit cost = \$9,000 post distribution value	
	\$9,000 post distribution value + \$1,000 distribution	\$10,000

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How do Distributions Affect the Investor?

If your mutual funds are held within a registered plan, such as an RRSP, RRIF or RESP, distributions paid into the plan are not taxable. They can, however, affect your foreign content, making a quick revisit early in the year a good idea. If your funds are held within a non-registered investment account, the distributions paid from the funds are taxable according to the type of income received.

Recall that distributions can usually be paid out in cash or reinvested to purchase additional units of the fund. If you choose to receive the distributions in cash, such amounts will be subject to

charges equivalent to any applicable deferred sales charges, unless the units were purchased with a front-end charge. However, with many funds, there is a 10% free redemption rule that will allow the investor to receive some or all of their distributions without charge, provided the 10% room has not yet been used.

Another way in which distributions affect the investor is on the timing of both purchases and redemptions. If you are invested in a mutual fund trust as of the distribution's "record date" (usually the date before the distribution is paid), you will receive the entire distribution, regardless of how long you have held that investment. For

example, if you invested in the fund a month before the record date, you will have a tax bill for distributions accrued throughout the calendar year, from which you may or may not have benefited. As such, investors do not typically buy funds where a distribution is expected just before the record date.

Some investors may choose to redeem their funds prior to the fund making its distribution in order to avoid receiving the tax bill. However, this strategy has other tax implications that need to be examined in advance.

We encourage you to consult with your Investment Executive and your tax advisor for more information.