

Understanding Year-End Mutual Fund Distributions



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FINANCIAL VIEW
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Ah, mutual funds. Many of us own them within our investment portfolios. And why not? Mutual funds allow the average investor to invest in many stocks and bonds from Canada and around the world that they couldn't normally purchase on an individual basis. When you invest in mutual funds, your money is pooled with money from other investors and then invested on your behalf by the mutual fund manager.

During the course of the year, the mutual fund manager may sell individual stocks and bonds within the fund as better investments present themselves, thus potentially realizing a capital gain. Individual stocks and bonds held within the mutual fund may also pay distributions in the form of dividends or interest.

Mutual funds are also known as flow-through investments, meaning that taxable income earned inside the fund is taxable as if you held the investment directly rather than the fund itself. The income that is earned in the mutual fund is "flowed through" to you in exactly the same way it was paid into the fund. In other words, interest earned within the fund is taxable to you as interest, dividends distributed within the fund are taxable to you as dividend payments and capital gains are taxable to you as capital gains. These tax implications are avoided if the mutual fund is held in a tax sheltered account such as a Registered Retirement Savings Plan, a Tax Free Savings Account or a Registered Education Savings Plan. However, non-registered investment accounts are not tax sheltered and are a different story altogether.

As the year end approaches, it's important for individual investors who hold mutual funds within a non-registered account to be aware how certain buy and sell transactions can affect their taxable income for the year. If you sell mutual funds in a non-registered, non-tax sheltered account and there is a capital gain on the fund, you will pay the applicable taxes. If you were the owner of a mutual fund for most or all of the year, you will be sent a tax slip for any capital gains realized by the fund during the year through the buying and selling of stocks within that fund.

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But what if you purchase into the mutual fund towards the end of the year but before any distribution is made? If the mutual fund realizes any capital gains during the year, you will be subject to declaring the tax on the capital gain as well, even though you may not have held the mutual fund at the time that the gains were realized. Imagine purchasing a mutual fund near year end, having it in your portfolio for only a couple of short months but being responsible for all capital gains realized on the fund throughout the year! Not a pretty picture. This is one instance where delaying your purchase and "timing the market" may actually make sense.

To discuss this article or to arrange a free, no obligation review of your portfolio, please contact me at larry.gallant@queensbury.com or by calling 905-892-2100.

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