


# Understanding mutual fund distributions



Throughout the year, mutual funds receive various forms of income from their investments. In the case of money market, bond and mortgage funds, income is generally in the form of interest. Equity funds may receive dividends from their holdings, and all mutual funds may realize capital gains through their trading activities. As these taxable events occur within a fund, they are reflected in the fund's unit value. Mutual funds periodically distribute realized capital gains, dividends and interest income directly to unitholders.

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Mutual funds are usually structured as trusts, and are subject to tax on their earnings unless they physically distribute them to unitholders. When earnings are distributed, the mutual fund receives a tax deduction, and the distribution becomes taxable income in the hands of the unitholders. Why do mutual funds do this? A mutual fund trust would generally be taxed at a considerably higher rate than individual unitholders, since trusts are subject to the highest tax rate. Shifting the tax liability from the fund itself to the unitholders reduces the average

tax rate applied to the fund's taxable events (i.e. income received and capital gains realized), thereby increasing the potential after-tax return for all investors. Using automatic reinvestment programs, most unitholders simply reinvest their distributions in the fund and receive a T3 tax slip for their share of the fund's taxable income. To avoid double taxation (i.e., at the time of the distribution and again at the time units are sold), units purchased with the reinvested distribution have the effect of increasing the unitholder's adjusted cost base (ACB).

## An example of an investor receiving a mutual fund distribution

In April, an investor placed \$5,000 in a mutual fund with a unit value of \$10, purchasing 500 units. On the application form, he asked to have all distributions reinvested. By December, the unit value of the fund has risen to \$12, and the manager of the fund announced a \$1 per unit distribution of realized capital gains. Since the overall gain in the fund (\$2 per unit) was higher than the distribution per unit (\$1 per unit), the investor decided it would be more advantageous to accept the tax liability on the

distribution than to sell the units. At the distribution date, the investor's \$500 distribution purchased an additional 45.45 units at a unit value of \$11. The unit value dropped by \$1 to reflect the distribution, but the total value of the investment did not change, since 45.45 additional units were purchased. The fund's ACB increased from \$10 to \$10.08  $(\$5,000 + \$500) \div 545.45$  units) to avoid double taxation.

Example of mutual fund distributions

Date	Transaction	Amount (\$)	Unit value (\$)	Total units	Market value (\$)	ACB (\$ per unit)
April 1	Purchase	5,000	10	500	5,000	10.00
December 15	Record day	0	12	500	6,000	10.00
December 21	Distribution day	500	11	545.45	6,000	10.08

**Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the imaxxFund Simplified Prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.**