

FREQUENTLY ASKED QUESTIONS

Explaining Year-End Distributions
to your Clients

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Contact us



If you have any questions or would like to discuss the impact of year-end distributions on your client portfolios in more detail, please contact your **Regional Sales Team.**



1. What is a year-end mutual fund (MF) distribution?

A

A year-end distribution is triggered when a fund manager sells underlying assets within a mutual fund at a profit or generates income (dividend or interest), without any accompanying losses to offset this gain within the calendar year.

The resulting net investment income is then passed on to investors and is taxable to them when received outside of a registered account.





2.

Why do MFs pay year-end distributions?

A

In most cases, it is actually beneficial for investors, rather than the mutual fund, to pay the distribution tax. This is because unlike investors, mutual funds are taxed at the highest marginal rate.

On the other hand, investors are typically taxed at a lower rate, or not at all if their fund is held in a registered account. As such, distributing net investment income directly to investors reduces the fund's tax liability which in turn improves the return on investment of its holders.





3. What are the different types of year-end distributions and how are they taxed?

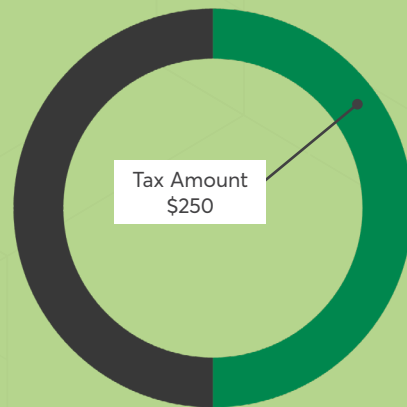


INCOME

Occurs when the fund earns income either on debt securities or in the form of dividends.

Income*

Fully taxable at the investor's marginal tax rate



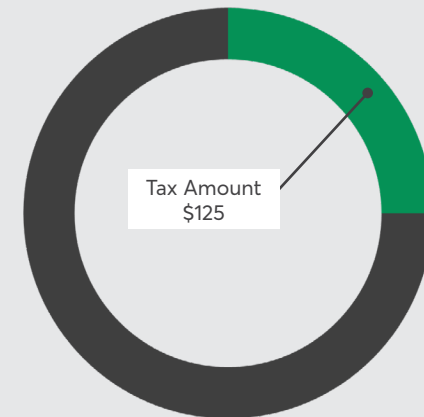
Example: \$500 income distribution

CAPITAL GAINS

Occurs as a result of trading activities within a fund culminating in a net gain for the year.

Capital Gains*

50% taxable at the investor's marginal tax rate



Example: \$500 capital gains distribution

*For illustrative purpose only.
 Income:
 For income other than dividend. Eligible dividend maximum marginal tax rate would be 39.34% (Ontario).
 Capital Gains:
 Tax rate assumptions of marginal tax rate of 49.53% (Ontario).



4.

When can my clients expect to receive year-end MF distributions?

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Year-end mutual fund distribution payouts are usually made by the end of December.

However, estimates are announced around mid-November.

To avoid receiving the distribution, you have until the Date of Record to sell the mutual fund.





5.

What is the impact of purchasing a MF close to year end?

A

→ If an investor buys a mutual fund before the year-end distribution is paid out, the investor will receive and will be taxed in full on the distribution for the current calendar year. Assuming the fund is not held in a registered account.

→ The Net Asset Value (NAV) is the market value of a MF. The NAV increases during the year as the aforementioned net investment income accumulates within the fund.

→ The NAV is reduced when a year-end distribution is made.

PRE-DISTRIBUTION DATE*

- \$10,000 purchase
- NAV = \$10
- # of units = 1,000 units

ON THE DISTRIBUTION DATE*

- Capital gains distribution of 5%
\$500 reinvested distribution
- NAV = \$9.50
- # of units = $(\$500 / \$9.50 = 52.63)$
so, 1,052.63 units
- Capital gain = \$500
- Unrealized capital gain = -\$500**

Illustration of what happens to the NAV on the distribution date *

*For illustrative purposes only.

** The reinvested distributions or dividends are added to the ACB, thereby reducing the amount of any capital gain that arises when the fund is ultimately sold.



6.

Should I wait until after the year-end distribution to invest in a MF for my client(s)?

Best practice for a non-registered account is to wait until after the distribution date to invest. However, if it is not possible to wait, keep in mind that in the example above ([Q. 5](#)), the unrealized capital gains means that you won't pay taxes on your next \$500 gain, there is no double taxation. That is because the reinvested distributions or dividends are added to the ACB, thereby reducing the amount of any capital gain that arises when the fund is ultimately sold.

This means that the taxes you pay now are taxes you won't be paying later. Another alternative would be to use any capital losses from previous years to offset taxable income.

A



7.

How are distributions calculated?

Distributions are calculated based on accumulated interest income/capital gains and total number of unitholders, and allocated to investors proportionally to the number of units they hold on the Date of Record.

A



8. How are distributions passed on to investors?

A

Distributions that are received in a non-registered account, even if reinvested, will be reported on the investor's T3 or T5 tax slips. This is true even if the return of the fund for the year is negative.



9. What can the turnover ratio of a MF tell us about the probability of year-end distributions?

A

The turnover ratio of a mutual fund could be a good indication of whether or not a fund will incur year-end distributions often. A high turnover ratio could indicate that a fund buys and sells assets often, which may result in frequent capital gains.

On the other hand, a lower turnover ratio generally means less frequent capital gain distributions due to fewer transactions.



CONTACT US



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