UNDERSTANDING MUTUAL FUND TAXATION

Explaining Capital Gains

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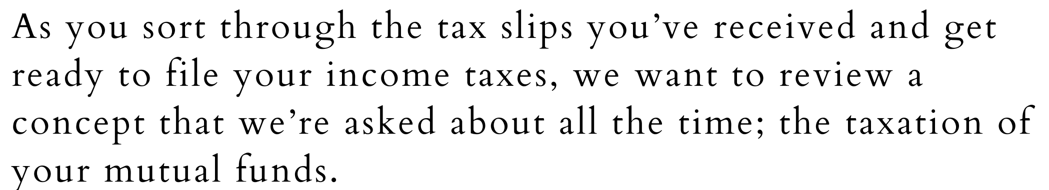
MANAGEMENT



As you sort through the tax slips you've received and get ready to file your income taxes, we want to review a concept that we're asked about all the time; the taxation of your mutual funds.

There are usually two scenarios that arise:

- You didn't sell any of your mutual funds, so why did you receive a tax receipt for capital gains?
- You received a tax receipt for capital gains but the fund had a negative return. Why?

Believe it or not, both of these questions actually have the same answer.

First, it's important to know that this only pertains to a non-registered account. TFSA's, RRSP's and other registered plans are either tax-free or tax-deferred.

Each year, mutual fund shareholders face the possibility of receiving capital gains distributions from their mutual funds, usually in the last couple of months of the year. These capital gains distributions are the result of the management selling shares of one or more of the fund's holdings during the taxable year.

If the fund manager decides to sell a stock due to the changing outlook, or even if the fund must simply raise cash for shareholder redemptions (when a shareholder sells shares of the fund), if the stock is trading higher than when the fund initially purchased it, the fund must distribute the gains to shareholders.

It is this distribution of gains to shareholders that is resulting in the tax receipts being received.

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