Manulife

Tax, Retirement & Estate Planning Services

Ideal candidates for mutual fund corporations

A Mutual Fund Corporation is a single taxable entity consisting of several classes of shares, with each class representing a different mutual fund. This allows Mutual Fund Corporations to offer tax benefits to those investors with non-registered funds.

1. As an investor, you can buy into the overall corporate structure by purchasing shares of one or more classes (funds). Since a corporation computes its net income and net capital gains as a single entity it can offset the income and capital gains of one fund with the expenses and capital losses of another thereby providing more flexibility in reducing potential taxable distributions.

2. Since a corporation cannot flow through ordinary income (i.e. interest or foreign income), any net income or capital gains generated within a corporate fund may be paid out as tax efficient distributions to investors either in the form of an ordinary Canadian dividend, or a capital gains dividend (which is taxed at 50 per cent as a taxable capital gain).

These tax advantages may be attractive to the following individuals:

Non-registered investors

An investment in a corporate class fund could be a great choice to consider for your non-registered investments. For registered funds, Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs) and Tax-Free Savings Accounts (TFSAs) already provide tax-deferred growth. When investing non-registered funds, this could provide greater potential to accelerate the rate of growth of your portfolio by earning tax-efficient distributions.

Seniors

Actively managing your taxable income in retirement can have a significant impact on both the tax you pay and whether or not you qualify for certain government income-tested benefits. If you are collecting Old Age Security (OAS) for example, this benefit can be clawed back if you have too much taxable income. Using a corporate class fund that usually distributes capital gains or return of capital in a non-registered portfolio can help reduce the amount of income reported on your tax return, and consequently potentially reduce any OAS clawback.

Trusts for Minors

Often, a parent or grandparent will set up a trust account to hold investments on behalf of their minor child or grandchild. One benefit of this is the potential to split income with the minor. The Income Tax Act (Canada) attribution rules cause any income (interest, ordinary Canadian dividends and foreign income) to be taxed in the hands of the parent or grandparent. However, capital gains are taxed to the minor, who is normally in a lower tax bracket resulting in little or no taxes being paid. In order to maximize the benefits of income splitting you should attempt to generate capital gains versus other income. Therefore, if you do not invest in a fund which distributes ordinary Canadian dividend income, all of the return would be capital gains or return of capital which will not be attributable to you.

Incorporated Business Owners

Many business owners have built up significant after-tax profits within their corporation and rather than withdrawing those funds and investing them personally they are being invested by the corporation. Since corporate tax rates on passive income are generally higher than the top marginal rates for individuals, reducing the amount of investment income the corporation reports is very beneficial. Using corporate class funds for corporate investments can help keep taxable distributions to a minimum, and since they can only be ordinary Canadian dividends, capital gains dividends or return of capital this can reduce the amount of investment income that is subject to the high passive income tax rates.

Investors Looking for Income

Many corporate funds also provide a Series T option which can provide the income-oriented investor with a regular stream of tax-efficient cash flow from monthly distributions.[1] All or a significant portion of the distribution is likely to be considered a tax-free return of capital (ROC). This essentially defers triggering capital gains from monthly withdrawals. However, there may still be taxable distributions of ordinary Canadian dividends or capital gains dividends as mentioned earlier.

Each time the corporate fund distributes ROC, the adjusted cost base of the investment decreases. When the adjusted cost base reaches zero, all further ROC distributions are taxable as capital gains, which is still tax-efficient since only 50 per cent of capital gains are taxable.

U.S. Estate Tax

If you are a Canadian resident but not a U.S. citizen, you may still be subject to U.S. estate tax on your "U.S. situs property" if the value of your worldwide estate at the time of your death is above a certain threshold. U.S. situs property includes, but is not limited to, U.S. real estate (e.g., a vacation home in Florida) as well as U.S. securities (e.g., shares of Apple Inc.). U.S. securities are considered U.S. situs property regardless if they are held in a Canadian brokerage account even if they are held in a registered account such as an RRSP or TFSA. However, an investment in shares of a Canadian mutual fund corporation (or an investment in units of a Canadian mutual fund trust) are not considered to be U.S. situs property, even where a fund invests in U.S. securities, thereby limiting your potential exposure to U.S. estate tax. To learn more about U.S. estate tax see our related piece ***U.S. Estate Tax Exposure for Canadian Residents (who are not U.S. citizens)*** (MK2851E).

Ideal Candidates

Non-registered investors who:

- Want the potential to accelerate the rate of growth of their portfolio by saving taxes
- Want to actively manage their taxable income in retirement or for their corporation or trust

Take Action

Speak to your advisor if you are considering a Mutual Fund Corporation structure to help reduce taxes and find corporate funds that appropriately fit investment objectives and risk tolerance.

[1] To learn about how the Series T option can be used to provide tax-efficient income now and a tax effective way to donate to charity in the future see Tax Managed Strategy #20: Using Series T for Income Now and Charitable Donations Later (MK2367E).

For more information contact your advisor or visit
manulife.ca/investments

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