

Spotlight on Distributions

Taxes are an unavoidable reality when investing outside a registered plan. Unless you hold mutual funds in a tax-deferred account such as a Registered Savings Plan (RSP) or Tax Free Savings Account (TFSA), you will need to pay taxes to Canada Revenue Agency (CRA) on any mutual fund distributions received. The following guide is designed to help individual investors who hold mutual funds outside a registered plan understand what mutual fund distributions are, why they exist and how they are calculated. Investors seeking advice on their personal tax situation are strongly encouraged to contact a tax specialist.

Mutual Fund Distributions

Mutual funds are structured so that the fund's tax liability is passed onto individual investors (unitholders). Net income, including interest and other ordinary income, dividends, foreign source income and net realized capital gains, is paid to unitholders in the form of distributions, which may be paid out on a monthly, quarterly or annual basis to the unitholders of record at the time.

Individual investors are required to pay the tax due on any distributions at their personal marginal tax rate, regardless of whether those distributions are received in cash or reinvested.

ScotiaFunds sends all unitholders who receive distributions a T3 tax slip or, in the case of Quebec resident unitholders, a Relevé 16 (RL16) tax slip. The slips are mailed in early March.

Frequently Asked Questions

How are distributions paid?

For the most part, investors may choose to receive a distribution in cash or have it automatically reinvested in the form of additional units; in either instance the amount is taxable. Distributions on any ScotiaFunds mutual fund units are automatically reinvested in additional units of the same fund, unless you tell your mutual fund representative that you want to receive them in cash.

Some ScotiaFunds make distributions on a regular basis.

Historical distributions for select funds are available at **scotiafunds.com**

What are the Different Types of Investment Income?

Type of Distribution	Description	Tax Treatment	Tax Slip
Interest and other income	Interest is earned from debt securities such as bonds. Money market and bond funds typically make this type of distribution. Other income also includes income from certain derivatives.	Taxed at the unitholder's marginal tax rate.	Interest income and other income earned and distributed is identified in Box 26 of a T3 slip and Box G of a RL16 slip.
Foreign source income	Income from non-Canadian sources, such as dividends from foreign corporations.	Taxed at the unitholder's marginal tax rate. Investors may be entitled to foreign tax credits with respect to related foreign withholding taxes.	Foreign source income is reported in Box 25 of a T3 slip and Box F of a RL16. Foreign taxes are reported in Box 34 of a T3 and Box L of a RL16.
Dividends	Dividends represent a distribution of a company's earnings to shareholders. Income, dividend and Canadian equity funds will typically make this type of distribution.	The dividend income received or deemed received from a taxable Canadian corporation is grossed up by 25% or 45%, depending on its eligibility, to which a dividend tax credit is applied.	The amount investors have to report as dividend income from Canadian sources is shown in Box 32 and Box 50 of a T3 slip and Box I of a RL16. The federal dividend tax credit entitlement is the total of Box 39 and Box 51 of a T3 slip and Box J of a RL16.
Capital gains	A distribution of the profit that results when the proceeds from the sale of a fund's security exceeds the cost. A broad range of funds, including, fixed income, balanced and equity funds, will typically have this type of distribution.	Fifty percent of realized capital gains are included in income and taxed at the investor's marginal tax rate.	Distributions of capital gains made by the fund will appear on Box 21 of a T3 slip and Box A of a RL16; capital gains realized on the redemption of units must be calculated by the individual investor.
Return of capital	Return of capital (ROC) is not an actual distribution of investment income, but a payment from the capital of the fund. Funds that provide fixed monthly distributions are most likely to have this type of distribution.	Not taxable. ROC reduces the cost base of the unitholder's investment in the fund, increasing the capital gain or decreasing the capital loss on the unitholder's investment upon disposition.	Even though there are no immediate tax consequences for a ROC distribution, any amount paid still appears on Box 42 of a T3 slip or Box M of a RL16.

Source: Canada Revenue Agency.

When are distributions paid?

Mutual funds earn income and realize capital gains throughout the year. In general, a mutual fund will distribute enough of its net income and net realized capital gains each year to unitholders so it will not have to pay income tax. Interest income is usually distributed to unitholders on a monthly, quarterly or annual basis, depending on a fund's investment mandate. The frequency of dividend distributions tends to vary. Net realized capital gains are typically distributed to unitholders on an annual basis, most often at year-end.

How much do I receive?

Distributions are allocated to unitholders in direct proportion to the number of units owned by each investor of a fund on the day prior to the distribution, known as a fund's Record Date. For instance, if an investor owned 100 units on the record date of a fund that paid a 10 cent per unit distribution, he or she would receive a taxable distribution of \$10.

What if I've held the fund for only a short time?

The length of time an investor owns units of a mutual fund has no bearing on the size of the distribution received. In other words, an investor who purchases a mutual fund trust in their non-registered account late in the year could receive a taxable distribution for any net realized capital gains they saw little or no benefit from. Although you should never invest solely on the basis of tax considerations, you may wish to consider the tax implication of investing in a mutual fund in your non-registered portfolio late in the calendar year.

Why does the fund unit price drop when a distribution is paid?

When a mutual fund makes distributions, its unit price, or net asset value per unit (NAV), drops by the same amount of the distribution per unit.

For example: if a fund has a NAV of \$10 and makes a 10 cent distribution, the new NAV would be \$9.90 (excluding market activity). For the investor, the impact could be:

Paid in Cash:

Pre-distribution value	100 units @ \$10	= \$1,000
Distribution	100 units @ \$0.10	= \$10
Cash paid to investor	\$10	
<hr/>		
Post-distribution value of investment	100 units @ \$0.90	= \$90

Reinvested:

Pre-distribution value	100 units @ \$10	= \$1,000
Distribution	100 units @ \$0.10	= \$10
Reinvested distribution	\$10 / \$9.90	= 1.0101
<hr/>		
Post-distribution value of investment	101.0101 units @ \$9.90	= \$1,000

When distributions are reinvested, the value of the portfolio remains the same as the pre-distribution level at \$1,000.00 (101.0101 @ \$9.90). Under both scenarios, the investor maintains \$1,000.00 of assets, \$10 of which is subject to taxation.

Am I taxed twice on the same gain if I sell my fund?

No, the adjusted cost base (ACB) of a mutual fund changes with each additional purchase, sale, or reinvested distribution made. A taxable distribution that is reinvested is added to the ACB of an investor's units to reduce the capital gains or increase the capital loss when those units are later redeemed.

Are there any tax implications for return of capital?

Some mutual funds aim to distribute a consistent amount of investment income monthly to investors. If the amount distributed exceeds the mutual fund's net income and net realized capital gains, such excess will constitute a return of capital (ROC). When mutual funds distribute ROC, they are simply returning a portion of the fund's capital. ROC distributions are not taxable; they do, however, reduce an investor's adjusted cost base by the amount of the distribution. Therefore, when an investor eventually sells his or her fund units, they will realize a greater capital gain or lesser capital loss.

How do distributions differ from capital gains or losses generated by selling my fund?

Mutual fund distributions are distinct from any gains or losses you may have when you sell a mutual fund.

Distributions are calculated and made at the fund level for securities bought or sold within the fund. Investors may realize gains or losses when they sell a fund for more or less than originally paid. Only net capital gains received from distributions made by the fund will appear on Box 21 of a T3 tax receipt and Box A of a RL16; capital gains realized through redeeming units must be calculated by the individual investor. You should keep detailed records of the purchase cost, sales charges, and distributions related to your units in order to calculate your ACB.

Quick Facts

- Mutual funds are structured as flow-through entities. They distribute net investment income to investors to keep from paying tax at the highest rate.
- Mutual fund distributions can be taken in cash or automatically reinvested in the form of additional units; in either instance the amount is taxable.
- There are different tax treatments for different types of investment income. Capital gains and dividends are taxed more favourably than interest income.
- Only net capital gains received from distributions appear on a T3 or Relevé 16 tax slip. Capital gains realized through selling a fund must be calculated separately by investors.

**Contact your
advisor today**

Or, to find out more
about ScotiaFunds,
visit us at
scotiafunds.com



® Registered trademark of The Bank of Nova Scotia, used under license.

This document has been prepared by Scotia Asset Management L.P. and is not for redistribution. This document is provided solely for information purposes. The information provided may not be relied upon or considered to be the rendering of tax, legal, accounting or professional advice. Readers should consult with their own accountants, lawyers and/or other professionals for advice of their specific circumstances before taking any action. The information provided is not intended to be investment advice. Investors should consult their own professional advisor for specific investment advice tailored to their needs when planning to implement an investment strategy to ensure that individual circumstances are considered properly and action is taken based on the latest available information.

This document is based on information from third party sources that are believed to be accurate and reliable, but Scotia Asset Management L.P. does not guarantee their accuracy or reliability. The information contained in this document, including information relating to interest rates, market conditions, tax rules and tax rates, and other investment factors are subject to change without notice. Nothing in this document is or should be relied upon as a promise or representation as to the future.

Unless otherwise indicated, securities purchased through Scotia Asset Management L.P. are not insured by a government deposit insurer or guaranteed by The Bank of Nova Scotia, and they may fluctuate in value.

ScotiaFunds are managed by Scotia Asset Management L.P., a limited partnership wholly-owned directly and indirectly by The Bank of Nova Scotia. Commissions, trailing commissions, management fees and expenses may be associated with mutual fund investments. Please read the simplified prospectus before investing. Mutual funds are not guaranteed or insured, their values change frequently and past performance may not be repeated.