

**CORPORATE-CLASS FUNDS
INDEX FUNDS**

It is not uncommon for index mutual fund investors to move index funds between different index asset classes, for example:

- Real estate
- Canadian equity
- US equity
- International equity
- Bonds
- Emerging markets
- Commodities

When such transfers are made, there may be significant tax costs on any capital gains. Assume a tax rate of 40% and a capital gain was 10% on an investment, an investor could lose up to 2% of the gain - or 20% (taxable gain of 5% times 40% tax rate). If this occurred on an annual basis, 10% gross being reduced to 8% net, over 25 years, this cost investors thousands of dollars.

30 yrs Investment	Growth @ 10%	Growth @ 8%
\$100,000	\$1.44 million	\$0.721 million

But...moves within a mutual fund “**corporate-class index fund structure**,” offer the distinct advantage of tax deferral into a lower tax year. Corporate mutual funds are structured with multiple classes of shares, where each class represents and tracks a different investment category. As a result, a complete family of index funds can be housed in a single corporation. On a sale from one index fund to another, there is an automatic tax-deferred rollover under Section 51 of the Income Tax Act—thus deferring taxes.

A Section 51 exchange is deemed not to be a disposition of the convertible property for tax purposes and therefore, no capital gain or loss is recognized. And the cost base of the new shares acquired is deemed to be equal to the cost of the converted shares.

Mutual fund corporations also have flow-through attributes, but only for Canadian dividends and capital gains. Interest income and foreign source income generally cannot be flowed through a mutual fund corporation tax efficiently. The flow-through of dividends and capital gains of a mutual fund corporation are facilitated through the operation of two separate systems: Part IV tax and Refundable Capital Gains tax.

Part IV Mechanism

Dividends received by Canadian corporations from other taxable Canadian corporations may be deducted in computing taxable income. However, for mutual fund corporations (other than investment corporations), these dividends are subject to a fully refundable Part IV tax. As a result, a mutual fund corporation will pay no tax on the taxable Canadian dividends it receives, as long as it pays this income to shareholders in the form of dividends.

Refundable Capital Gains Tax

Ordinarily, corporations cannot distribute capital gains to shareholders in the form of capital gains. However, a mutual fund corporation may distribute its realized net capital gains by electing to pay special capital gains dividends. Capital gains dividends are taxed as capital gains to the shareholder who receives them. To avoid double taxation (corporate tax on the capital gain and tax at the shareholder level on the capital gains dividend), the mutual fund corporation is entitled to a capital gains refund (effectively representing the tax on realized capital gains) if it pays these dividends. In addition, capital gains refunds are available (without paying capital gains dividends) to the extent that capital gains have been realized as a result of shareholder share redemptions. This avoids double taxation that could result when a shareholder realizes capital gains on the redemption of shares and at the same time, the corporation realizes gains on the disposition of underlying investments required to fund the redemption