

DISTRIBUTIONS 101

WHAT IS A MUTUAL FUND DISTRIBUTION?

A mutual fund distribution occurs when the net investment income and realized capital gains of a mutual fund are distributed to those who have invested in the fund (unitholders). Distributions can be delivered in the form of cash or reinvested units. The amount of the distribution received by unitholders is determined based on the number of units of the mutual fund that they own on the record date prior to the payment date.

WHY DO MUTUAL FUNDS PAY A DISTRIBUTION?

All Canadian mutual funds are subject to taxation on their income and realized capital gains. The purpose of a mutual fund distribution is to optimize this tax payable on the fund's earnings by passing the responsibility to pay taxes onto the unit holders. This way, each unitholder pays their portion of the tax at their own marginal tax rate.

WHY DO UNITHOLDERS PAY THE TAX?

Ultimately, it is because most unitholders would be taxed at a lower rate than the mutual fund itself. Mutual funds are taxed at the equivalent of investors' highest marginal tax rate so if the fund did not distribute its earnings it would pay tax on its earnings at the highest tax rate. By distributing its investment income and realized capital gains to unitholders the tax rate is typically much lower (or none at all if it's held in a registered account) which results in a higher return on investment for unitholders.

WHY DOES THE NET ASSET VALUE DROP WHEN A DISTRIBUTION IS PAID?

The net asset value (NAV) of a mutual fund is the value of the underlying assets that make up the fund, so when a mutual fund pays out a distribution (which comes from its assets), the NAV decreases by this exact same amount. Regardless of the method of distribution (in cash or reinvested units), the value of your investment remains the same. Hard to picture? See a comparison of cash versus reinvestment on the next page.

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5% DISTRIBUTION FOR A FUND WITH A \$10 NAV/UNIT

If the distribution is paid in cash:

Pre-distribution value of investment	Distribution	Cash paid to investor	Post-distribution value of investment
1,000 units @ \$10 = \$10,000	1,000 units @ \$0.50 = \$500	\$500	1,000 units @ \$9.50 = \$9,500

If the distribution is reinvested:

Pre-distribution value of investment	Distribution	Reinvested distribution	Post-distribution value of investment
1,000 units @ \$10 = \$10,000	1,000 units @ \$0.50 = \$500	$\$500 / \9.50 = 52.63 units	1,052.63 units @ \$9.50 = \$10,000

HOW DO DISTRIBUTIONS AFFECT MY ADJUSTED COST BASE?

The adjusted cost base (ACB) of your investment will be relevant in determining your capital gain (or loss) when you sell or dispose of mutual fund units held in a non-registered account. The ACB per mutual fund unit changes with each additional purchase or reinvested distribution. Unitholders are not subject to double taxation because reinvested distributions are added to the ACB of your investment.

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