

## **Tax Tip**

**Week of June 20, 2011**

### **Mutual Fund Purchases**

Income and capital gains generated by mutual funds are normally distributed to unit holders at the end of the calendar year. The income type remains unchanged when it is distributed, i.e., capital gains of the mutual fund are capital gains to the unit holder and Canadian dividends distributed by the fund qualify for the dividend tax credit in the individual's return.

If individuals purchase units of a mutual fund late in the year, they will receive a distribution of the entire year's income and capital gains, despite owning the units for a short period of time. In other words, they are paying tax on income earned prior to their ownership. Tactics to eliminate this potential tax hit include:

- defer the purchase of mutual funds to the start of the next calendar year
- if the fund has experienced considerable growth and a significant distribution is expected, one could sell the funds in December, purchase units in a money market mutual fund and repurchase the original fund in January. One must be aware of any transfer fees before initiating such a strategy

If mutual funds are contained in a RRSP, RESP or TFSA, the timing of the purchase is not relevant, as distributions are tax sheltered.