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Federal Budget Impacts Investment Taxation

The recent Federal Budget included measures to close a favorable tax rule for investors in investment accounts or through corporations, trusts and holding companies, who have proposed rules to curb the tax advantages of “corporate class” mutual fund shares.

Corporate class funds are organized as “switch funds” that offer different types of asset exposure such as Canadian equities, global equities, and various types of bond funds and other investment categories. Each fund is set up as a separate class of shares within the same mutual fund corporation, which allows investors to take profits in one type of fund or switch for other tactical reasons without triggering a disposition for tax purposes.

In effect, corporate class shares, pre-budget, allowed for tax deferral on the accumulated gains and distributions to more efficiently permit you to build up wealth while keeping the hands of the tax man away from your capital, just like an RRSP in the accumulation phase of your life. Note that the aforementioned tax deferral is not available to taxpayers investing in mutual fund trusts or investing directly in a portfolio of securities.

For example, imagine that you have a global dividend fund that you purchased for $10,000 in a corporate class structure in 2009 and that fund now has risen 50% from the purchase price. If you decide to change the investment today at $15,000 to a Canadian equity fund within the class structure, the tax gains would be rolled over to the new Canadian equity fund and any capital gains taxes will be deferred into the future to a time when you sell the Canadian equity fund and move the money outside of the corporate class structure.

The proposed changes in the March Budget are changing the rules in such a way that a switch within a mutual fund corporation from one class of shares to another class of shares will now become a taxable disposition, which may cause some investors to hesitate to take profits on their winner or to re-balance their portfolios (as part of a disciplined approach to proper investment management) in the future.

Using our example above, if you make the switch in the future, within the Corporate class you would trigger a capital gain of $5,000 and have to pay some tax on that gain (even if the money is still invested) when you file your 2016 Federal Income Tax Return.

At this time, there is still some debate as to the full impact of the proposed changes while the tax community awaits the fine print once the Budget is passed. However, we do know that the new rules will take effect October 1, 2016.

The good news is that several fund company commentators believe that the new rules will still allow investors to grow their money on a tax-deferred basis (just like within an RRSP or TFSA for example) after October 1st, which means there might still be a place within your financial strategy for non-registered money or for retained earnings within a corporation or holding company for Corporate Class fund investments.

Remember the goal of good investing is to make money so that you have to pay tax on your profitable investments. The goal of good tax planning is to push the tax payment as far into the future as possible to allow for the continued compounding of your family’s wealth.

Call us today [1] for a review of your specific situation and for our recommendations as to the best investments going forward in light of the new tax reality in Canada.

Do you have questions about your tax strategies?

Contact our office today ! [1]

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