Using Corporate Class Funds to Boost Tax Efficiency

Corporate class funds are mutual funds that allow you to switch between investments without triggering a taxable event. This is a valuable option for investors with savings outside of registered plans and many Canadians use corporate class funds to build a more tax-efficient portfolio. This strategy may be worth a closer look for your own investments.

Back in 1987, a new kind of mutual fund with some unique tax benefits emerged in Canada. In many ways, these new "corporate class" funds were just like mutual funds, but allowed investors to switch from one fund to another without triggering a taxable gain.

Now, 25 years later, corporate class funds are still used by thousands of Canadians to build tax-efficient nest eggs. Today there are more than 750 corporate class funds in Canada with more than $75 billion in assets under management.

A New Breed of Tax-Efficient Fund

The favourable tax treatment of corporate class funds comes from their unique corporate structure, which involves a single fund corporation that has many different classes of shares. Each class of shares has its own investment strategy, such as Canadian, U.S., or global equities or fixed income. The end result is that each class of shares acts like a separate fund. But since each class of shares is part of the same corporate structure, you can convert from one class of shares to another (i.e. switch between funds) without generating a taxable event.

In other words, the corporate structure acts like an umbrella covering several funds where you can defer tax on capital gains whenever you switch to another fund under the same umbrella. Only when you finally redeem your investments and leave the corporate structure will you pay tax on the capital gains realized.

If you've already used up the contribution room in your Registered Retirement Savings Plan (RRSP) or Tax-Free Savings Account (TFSA), or looking to hold tax-efficient savings outside of your registered investment accounts, it may be time to learn more about corporate class funds.

Tax-Free Rebalancing

One of the best ways to use corporate class funds is for tax-free rebalancing in your portfolio. If you've ever built up a gain in an investment and decided to make a change, you usually had no choice but to sell the investment and pay tax on the gain.

But corporate class funds give you another option: you can switch to another investment without incurring a tax penalty, so you can make the right choices for your portfolio without worrying about the tax costs. If you are switching funds, you must choose a fund that is in the same corporate class structure as the original fund to get the tax-free switch. And it's important to remember that, while the switch is tax-free at the time you do it, you'll still pay tax on any gains you've built up when you finally sell your corporate class funds altogether.

Minimizing Taxable Distributions

Another way that corporate class funds might help with your tax-minimization goals is their potential to pay smaller taxable distributions. Funds earn income in the form of interest, dividends or capital gains and deduct their fees, expenses and losses to reduce the amount of taxable income they distribute to investors. In a corporate class fund, the excess deductions in one fund can be used to shield taxable income in other funds which may further reduce the overall taxable income distributed to investors.

Is Corporate Class Right for You?

Corporate class funds can be right for a number of situations:

- Tax-deferred rebalancing over time. Because you can switch and rebalance without triggering tax penalties, you can rebalance your portfolio to the right asset mix for you without the immediate worry about tax consequences.
- To reduce taxable income from your investments. You may be able to reduce taxable distributions by sharing deductions across funds in a corporation. Losses in one fund can be used to shield taxable income in another fund.
- When you have maxed out your RRSP and TFSA contributions for the year. Through a corporate class fund, investors can gain some of the tax-deferral advantage of registered plans, but without the contribution limits associated with these plans.

With the right guidance, corporate class funds may help you achieve your tax and investment objectives at the same time. By paying tax later, you keep more money working for you today, and may ultimately pay less tax. Waiting until you're in a lower tax bracket, or until you realize losses from other investments can reduce the taxes paid overall.

Corporate class funds are all connected

Canadian Equity Class	Canadian Bond Class	Emerging Market Class
U.S. Equity Class	International Equity Class	Global Bond Class
Global Equity Class	European Equity Class	Canadian Balanced Class
Global Balanced Class	High Yield Bond Class	Canadian Small Cap Class

Please contact us for more information about corporate class funds and other ways to build a tax-efficient investment portfolio.

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