TAX-SMART INVESTMENT SOLUTIONS

CORPORATE CLASS EXPLAINED

What is corporate class and how can it work for you?

Fidelity INVESTMENTS

Many of Fidelity's most popular mutual fund trusts are also offered as corporate class investments.

What's the difference?

While corporate class funds may hold the same types of investments as the traditional mutual fund trust versions (directly or indirectly), class funds are held inside a mutual fund corporation, which provides additional tax benefits for investors. Although each corporate class fund within the corporation has its own investment objective and strategy, together they are treated as a single entity for tax purposes.

How does corporate class provide tax benefits?

A mutual fund corporation is a single legal entity. Instead of taxing each individual mutual fund within the corporation, the corporation as a whole is taxed.

The resulting tax benefits are often referred to as "tax efficient" or "tax smart." While they may not reduce the tax paid in every situation, they do allow investors to organize their investments to increase the potential for tax savings.

1. Tax-efficient rebalancing

When investors sell traditional mutual funds, they must pay tax immediately on any gains. But corporate class funds are all held within the same corporation, so investors can move their money from one class fund to another class fund without triggering any immediate tax consequences.

Benefit: With corporate class funds, investors can rebalance their portfolios or change their investments without immediate tax consequences. That leaves more money in an investor's account to grow. Each time the asset allocation is reset, rebalancing within the corporate structure will not trigger any capital gains. The adjusted cost base (ACB) of the investment remains at its original purchase price regardless of the rebalancing activity and the related capital gains are only realized when the corporate class shares are redeemed or sold.

By contrast, any rebalancing activity between traditional mutual fund trusts can result in an immediate taxable event. Any resulting capital gains will be taxed in the year in which they are realized. In this case, the investor's ACB increases and is reset to the new purchase price.

2. Tax-efficient growth

Pooling income and expenses: In a mutual fund corporation, the income and expenses of all of the different mutual fund classes are pooled, rather than being managed and reported separately.

As a result, corporate class mutual funds can share income, gains, losses, expenses and loss carry-forwards to reduce taxable distributions generated by the corporation as a whole.

Distributions: When distributions are made, they tend to be more tax-efficient than distributions from traditional mutual funds. Corporate class funds can only distribute Canadian dividends and capital gains dividends, both of which are taxed more favourably than regular income.

Corporate class funds cannot distribute interest or foreign income. Such income is retained within the corporation, where it is subject to taxation unless it can be offset by expenses. Accordingly, an important factor in managing corporate class is seeking to ensure that such income does not exceed expenses.

Benefit: Taxes are minimized or deferred, leaving more money in an investor's account to benefit from compound growth. From a tax point of view, this is clearly preferable to holding a conventional fixed-income mutual fund, which pays interest income that is taxable at an investor's marginal tax rate.

3. Tax-efficient cash flow

Corporate class investments can be combined with the Fidelity Tax-Smart Withdrawal Program™ (Fidelity T-SWP™ Class) for even greater tax efficiency. T-SWP Class provides cash flow by returning an investor's original investment principal in a return of capital. This amount is not taxable, because the investor already paid tax on it before the investment was made.

A return of capital will reduce the ACB of class fund shares held. Once all of an investor's capital has been returned, the subsequent cash flows will be treated as capital gains and taxed at a favourable rate.

Benefit: Investors can receive tax-efficient cash flow without having to sell investments, meanwhile deferring capital gains.

Who should invest in corporate class mutual funds?

Individual investors

Corporate class funds are an attractive option for investors with non-registered investments, including those who

- have used up their RRSP and TFSA contribution room
- seek a steady stream of cash flow in the future or in retirement (using T-SWP Class)
- wish to rebalance their portfolios on a tax-deferred basis

Owner-managed corporations

- Corporate class may provide a more tax-efficient option for after-tax profits held in a corporation than other commonly used vehicles.
- Corporate class can also help fund a corporation's capital dividend account (CDA), which may facilitate the payment of non-taxable dividends from the corporation to its shareholders. (For more information, see Fidelity's tax-smart solutions brochure entitled "Capital Dividend Account.")

Trust accounts

- Corporate class provides the same tax-efficient benefits for those who may want to create trust accounts for children or grandchildren.
- Generally, parents or grandparents are taxed on interest and dividends received before the child turns 18. However, corporate class has the potential to reduce distributions, thereby minimizing the potential tax burden before the beneficiary turns 18.

Seniors

- Corporate class combined with T-SWP provides seniors with tax-efficient cash flow.
- It may be especially helpful in reducing or eliminating Old Age Security (OAS) clawback. Since T-SWP Class payments – at least in the initial years – are return of capital, they are not considered income for tax purposes. (The corporate class funds may pay Canadian dividends and capital gains dividends from time to time.) By supplementing income with return of capital, pensioners can get added spending power while keeping taxable income down – thus maximizing OAS payments.

Fidelity offers over 100 investment options in its corporate class structure to assist your advisor in constructing a portfolio for you according to your investment objectives, suitability and time horizon. And all our products are backed by our leading investment process, with solutions to suit almost every risk profile.

For more information, talk to your financial advisor.

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This information is for general knowledge only and should not be interpreted as tax advice or recommendations. Every individual's situation is unique and should be reviewed by his or her own personal legal and tax consultants.

Read a fund's prospectus and consult your advisor before investing. Mutual funds are not guaranteed; their values change frequently and past performance may not be repeated. Investors will pay management fees and expenses, may pay commissions or trailing commissions and may experience a gain or a loss.

The Fidelity Corporate Class funds are issued by Fidelity Capital Structure Corp., and are available through authorized dealers.

The monthly cash-flow distributions on Fidelity T-SWP are not guaranteed and will be adjusted from time to time and may include income. We will aim to keep cash flow between 7.5% and 9% of the NAV each year on T-SWP balanced funds on F8, T8 and S8, as well as 4.5% and 5.5% of the NAV on F5, T5 and S5 balanced funds. For equity funds, we will aim to keep cash flow between 6% to 10% of the NAV each year on F8, T8 and S8, and between 4% to 6% of the NAV each year on F5, T5 and S5.

A return of capital reduces an investor's adjusted cost base. Capital gains taxes are deferred until units are sold or until the ACB goes below zero. Investors should not confuse this cash-flow distribution with a fund's rate of return or yield. While investors in Series F8/T8/S8 and/or F5/T5/S5 will be able to defer some personal capital gains, they must still pay tax on capital gains distributions that arise from the sale of individual holdings by fund managers, and on interest and dividend distributions. T-SWP will also pay a distribution that must be reinvested in December, consisting of income and capital gains.

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