# Tax Treatment of Mutual Funds for Individuals

This information sheet contains general information on the tax treatment of income received from Canadian mutual funds. It will help you understand what a mutual fund is, how to report income, and how to report the sale of mutual fund units or shares. An example is included on page 3 to show how to report these activities.

**Note**
This information sheet does not apply to certain investments in mutual fund trusts that are acquired through a securities option agreement, mutual fund investments held in a tax-free savings account (TFSA), or mutual fund investments that are held in tax-deferred plans. For more information, see guides RC4466, Tax-Free Savings Account (TFSA), Guide for Individuals, T4040, RRSPs and Other Registered Plans for Retirement, and RC4092, Registered Education Savings Plans (RESP).

## What is a mutual fund?

A mutual fund is an arrangement under which shares or units are sold to raise capital. Investors buy units if the mutual fund is a trust, or shares if the fund is a corporation. When you invest in a mutual fund, your money is pooled with the money of other investors and invested on your behalf by the fund manager.

## How is income from mutual funds taxed?

In most situations, income from mutual funds is taxed in two ways:

- While you **own** the shares or units, you are taxed on the distributions of income that are flowed out to you. If you own units of a mutual fund trust, the trust will give you a T3 slip, Statement of Trust Income Allocations and Designations. If you own shares of a mutual fund corporation, the corporation will give you a T5 slip, Statement of Investment Income. The distributions can be capital gains, capital gains dividends, dividends, foreign income, interest, other income, return of capital, or a combination of these amounts. A return of capital will reduce the **adjusted cost base (ACB)** of your units or shares.
- When you sell or **redeem** (or **cash in**) the units or shares, you are taxed on the gain, if any. This is usually a capital gain because your mutual fund investment is usually considered capital property for tax purposes. You will receive a T5008 slip, Statement of Securities Transactions, or an account statement from the mutual fund.

## How do you report income from information slips?

The back of the information slip explains where to report the income shown in each box and refers you to the appropriate section of Federal income tax and benefit information at **canada.ca/fed-tax-information** when necessary. For instructions on how to report the most common types of income, see page 5.

If you choose to reinvest any distributions by buying more units or shares, you may not actually receive the income shown on your information slips. However, you must still report on your income tax and benefit return the amounts shown on your slips. This is because the Canada Revenue Agency (CRA) considers you to have received these amounts before reinvesting them.

## How do you calculate and report capital gains when you sell or redeem units or shares?

When you sell or redeem your mutual fund units or shares, you may have a capital gain or a capital loss. Generally, half of your capital gain or capital loss becomes the taxable capital gain or allowable capital loss.

**Note**
If you hold more than one class or series of a single fund, you must calculate the ACB for each class or series separately for each mutual fund that you own.

Use lines 13199 and 13200 of Schedule 3, Capital Gains (or Losses) to calculate and report all your capital gains and capital losses from your mutual fund units and shares. List the information for each mutual fund separately. Multiple redemptions from the same fund in the same year should be grouped together.

To calculate your capital gain or your capital loss, you need to know the following three amounts:

- the **proceeds of disposition**, which is the amount you received or will receive for your units or shares
- the **ACB**, which is the cost of your units or shares, plus any expenses you incurred to acquire them, such as commissions and legal fees and minus any returns of capital on your units or shares

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- the **outlays** and **expenses** you incurred when selling your units or shares, such as redemption fees and commissions

**Note**
When calculating the capital gain or loss on the sale of capital property that was made in a foreign currency:

- convert the proceeds of disposition to Canadian dollars using the exchange rate in effect at the time of the sale
- convert the ACB to Canadian dollars using the exchange rate in effect at the time the property was acquired and returns of capital were received
- convert the outlays and expenses to Canadian dollars using the exchange rate in effect at the time they were incurred

## How do you calculate capital gains and capital losses?

To calculate your capital gain or capital loss, subtract the total of your property's ACB, and any outlays and expenses you incurred to sell it, from the proceeds of disposition.

### How do you calculate your ACB?

Mutual fund units or shares are identical properties because each property in the group is the same as all the others. You may buy and sell several identical properties at different prices over a period of time. This occurs, for example, when you immediately reinvest your distributions in the mutual fund.

To calculate your capital gain from the units or shares you sell or redeem, you first have to calculate your ACB. To calculate the ACB of the units or shares sold or redeemed, multiply the average cost per unit of all units or shares held immediately before the sale or redemption by the number of units or shares redeemed (see Chart 1 on page 4).

The average cost per unit or share of your total investment increases or decreases when you buy new units or shares, or reinvest your distributions, depending on the price when the transaction occurred. Every time you buy additional units or shares, or reinvest your distributions, you should recalculate the average cost per unit or share. Do this for each of your mutual funds.

If you receive a T3 slip with an amount in **box 42 – Amount resulting in cost base adjustment**, the ACB of that mutual fund trust identified on the slip will change. If box 42 contains a negative amount, add this amount to the ACB of the units of the trust. If box 42 contains a positive amount, subtract this amount from the ACB of the units of the trust. See the example on page 3.

If the ACB of the trust units is reduced below zero during the tax year, the negative amount is deemed to be a capital gain in the year. Enter the amount of the capital gain on line 13200 of your Schedule 3. Place a zero on line 13199 since there is no actual sale of units. The new ACB of the trust units is deemed to be zero.

For example, Evgeni bought RST Mutual Fund Trust units for $1,000 in 2013 and received a $200 return of capital in each of the 2016 to 2020 tax years. Because of these returns of capital, totalling $1,000, the ACB of the units is zero by the end of 2020. This year, Evgeni received an additional $200 return of capital for the units. Since the ACB of these units is already zero, he must include this $200 in the calculation of his capital gains and losses for the year.

In the case of shares of a mutual fund corporation, amounts distributed on the shares as a return of capital will reduce the ACB of the shareholder's shares in a way similar to that described above. Although any amounts distributed as a return of capital on such shares will not be reported on the T5 slip, you should keep track of such amounts so that you can correctly calculate the ACB of your shares.

### How to calculate the proceeds of disposition?

The second step for determining your capital gain is to calculate the proceeds of disposition. Do this by multiplying the number of redeemed units or shares by the redemption price.

Report the capital gain (or loss) on lines 13199 and 13200 of Schedule 3.

You should also report capital gains from information slips on Schedule 3. Capital gains from a T3 slip are reported at line 17600 while capital gains from all other information slips (for example, a T5 slip) are reported at line 17400.

## How do you use a capital loss?

If you have a capital loss, you can use it to reduce any capital gains you had in the year. If your allowable capital loss is more than your taxable capital gain, you may have a net capital loss. You cannot use this loss to reduce other income. However, you can use a net capital loss to reduce taxable capital gains in any of the three previous years or in any future year. For more information on capital losses, read Chapter 5 of Guide T4037, Capital Gains.

## Can you claim a capital gains deduction?

You cannot claim a capital gains deduction for capital gains from mutual funds. However, if you filed Form T664 or T664 (Seniors), Election to Report a Capital Gain on Property Owned at the End of February 22, 1994, for any of your units or shares, the unused balance of your exempt capital gains balance (ECGB) that expired after 2004 can be added to the ACB of your units and shares. For more information, go to **canada.ca/taxes-capital-gains** or see Guide T4037, Capital Gains.

**Example**
Kate has mutual fund investments in XYZ Mutual Fund Trust and STU Mutual Fund Corporation. Over the years, she bought units in XYZ Mutual Fund Trust and reinvested her distributions from the trust to buy more units.

On June 30 of the year, Kate redeemed 200 units from XYZ Mutual Fund Trust at a price of $17.42 per unit, for a total of $3,484. Her redemption fees were $70. Kate records her redemption and her reinvested distributions, and she recalculates her ACB for XYZ Mutual Fund Trust as shown in Chart 1 on page 4.

For the year, Kate received the following information slips:

- a T3 slip from XYZ Mutual Fund Trust showing capital gains (reinvested distributions) of $750 in box 21 and a return of capital of $500 in box 42
- a T5 slip from STU Mutual Fund Corporation showing capital gains dividends of $330 in box 18 and a taxable amount of eligible dividends of $200 in box 25

### Step 1 – Capital gains resulting from the redemption
The first step Kate takes is to calculate her ACB. Chart 1 on page 4 shows how she does this.

The average cost of the units at the time of redemption is $15.20 per unit. She calculates the ACB for the redeemed units by multiplying the number of units redeemed by the average cost per unit (200 × $15.20 = $3,040). To calculate her proceeds of disposition, Kate multiplies the number of redeemed units by the redemption price (200 × $17.42 = $3,484).

### Step 2 – Completing Schedule 3
When she completes her income tax and benefit return for the year, Kate records her ACB ($3,040), proceeds of disposition ($3,484), and redemption fee of $70 on Schedule 3, under the heading "Publicly traded shares, mutual fund units, deferral of eligible small business corporation shares, and other shares." To determine her capital gain (or loss) on this transaction, she subtracts the ACB and redemption fee from the proceeds of disposition [$3,484 – ($3,040 + $70)]. In this example, her gain is $374.

Kate also reports the capital gain of $750 from the T3 slip on line 17600 of Schedule 3 and the capital gains dividend of $330 from her T5 slip on line 17400 of Schedule 3. Kate does not report the amount of $500 from box 42 of the T3 slip on Schedule 3 or as income on her income tax and benefit return. This box 42 amount does result in an adjustment to her ACB as shown in Chart 1 on page 4.

Kate's total capital gains on line 19700 are $1,454 ($374 + $750 + $330). To calculate her total taxable capital gains, she multiplies this amount by 50%, for a result of $727. This is the amount she will enter on line 19900 of Schedule 3 and line 12700 of her return.

The appropriate areas of Schedule 3 are reproduced on page 4, as Kate would have completed them. Kate records her redemption and any future buys or reinvested distributions, and she recalculates her ACB as shown in Chart 1 on page 4.

If, instead of a capital gain, Kate had a capital loss of $1,454 on line 19700, 50% or $727 would be her net capital loss. Kate would file Schedule 3 with her return to register her loss. She can use this net capital loss to reduce taxable capital gains in any of the three previous years or in any future year.

### Step 3 – Completing the Federal Worksheet
Kate completes "Line 22100 – Carrying charges, interest expenses, and other expenses" of the Federal Worksheet, and includes the $200 from box 25 of the T5 slip on line 8 under the section "Lines 12000 and 12010 – Taxable amount of dividends from taxable Canadian corporations."

## Chart 1 – Recalculation of Adjusted Cost Base (ACB)

| Date | Description | Total Cost in $ (A) | Number of units (B) | Average cost per unit (A÷B) |
|---|---|---|---|---|
| March 12, 2018 | Purchase at $14.75 per unit | 20,000.00 | 1,355.9322 | $14.75 |
| December 31, 2018 | Reinvested distribution at $16.40 per unit | + 1,427.82 | + 87.0622 | $16.40 |
| | **ACB** | **21,427.82** | **1,442.9944** | **$14.85** |
| April 15, 2019 | Purchase at $17.29 per unit | + 5,000.00 | + 289.1845 | $17.29 |
| | **ACB** | **26,427.82** | **1,732.1789** | **$15.26** |
| December 31, 2020 | Reinvested distribution at $13.77 per unit | + 962.11 | + 69.8700 | $13.77 |
| | **ACB** | **27,389.93** | **1,802.0489** | **$15.20** |
| June 30 of the year | Redemption of 200 units at $17.42 per unit[1] | – 3,040.00 | – 200.0000 | $15.20 |
| | **ACB** | **24,349.93** | **1,602.0489** | **$15.20** |
| | | | | |
| December 31 of the year | Reinvested distribution at $15.00 per unit[2] | + 750.00 | + 50.0000 | |
| December 31 of the year | Return of capital of $500[2] | – 500.00 | | |
| | **ACB** | **24,599.93** | **1,652.0489** | **$14.89** |

[1] Kate determines her proceeds of disposition based on the selling price of $17.42 per unit. To calculate her ACB on June 30 of the year, when she redeemed her units, Kate multiplies the average cost of units held immediately before the redemption ($15.20) by the number of units redeemed (200). This gives Kate an ACB of $3,040 ($15.20 × 200).

[2] As a result of the reinvestment and return of capital reported in boxes 21 and 42 respectively of her T3 slip from XYZ Mutual Fund Trust, she increases her total cost by $250 and recalculates her ACB on December 31 of the year to be $14.89 per unit.

## Reproduction of Schedule 3

**4. Publicly traded shares, mutual fund units, deferral of eligible small business corporation shares, and other shares**

| Number | Name of fund/corp. and class of shares | (1) Year of acquisition | (2) Proceeds of disposition | (3) Adjusted cost base | (4) Outlays and expenses (from dispositions) | (5) Gain (or loss) (column 2 **minus** columns 3 and 4) |
|---|---|---|---|---|---|---|
| 200 | XYZ Mutual Fund Trust of Canada | 2018 | 3,484 00 | 3,040 00 | 70 00 | 374 00 |
| | | | | | | |
| | | Total 13199 | 3,484 00 | | Gain (or loss) 13200 | 374 00 |

| | | | |
|---|---|---|---|
| Capital gains (or losses) from T5, T5013, and T4PS information slips | 17400 | + | 330 00 |
| Capital gains (or losses) fromT3 information slips | 17600 | + | 750 00 |
| **Total of all gains (or losses) before reserves** | 19100 | = | 1,454 00 |
| **Total capital gains (or losses)** | 19700 | = | 1,454 00 |
| Applicable rate | | × | 50% |
| Total capital gains (or losses) multiplied by the Applicable rate<br>If the result is positive, enter it on line 12700 of your return.<br>If the result is negative (loss), read the instructions on Schedule 3.<br>**Taxable capital gains (or net capital loss)** | 19900 | | 727 00 |

## Reporting instructions for T3 slips and T5 slips

### Capital gains

| | | | |
|---|---|---|---|
| Capital gains | T3 slip | Box 21 | Subtract any amount in box 30 from the amount in box 21. Include the difference on line 17600 of Schedule 3. All or part of this amount may be foreign non-business income, which will be footnoted. Include this type of footnoted amount on line 43300 of Form T2209, Federal Foreign Tax Credits. |
| Capital gains dividends | T5 slip | Box 18 | Include this amount on line 17400 of Schedule 3. |

### Dividends

| | | | |
|---|---|---|---|
| Taxable amount of dividends | T3 slip | Box 32<br>Box 50 | Include these amounts in the section called “Lines 12000 and 12010 – Taxable amount of dividends from taxable Canadian corporations” of the Federal Worksheet. |
| | T5 slip | Box 11<br>Box 25 | |
| Federal dividend tax credit | T3 slip | Box 39<br>Box 51 | Include these amounts on line 40425 of your return. See note below. |
| | T5 slip | Box 12<br>Box 26 | |
| Actual amount of dividends | T3 slip | Box 23<br>Box 49 | Do not report these amounts. |
| | T5 slip | Box 10<br>Box 24 | |

### Interest income

| | | | |
|---|---|---|---|
| Interest from Canadian sources | T5 slip | Box 13 | Include these amounts in the section called “Line 12100 – Interest and other investment income” of the Federal Worksheet. |
| Other income from Canadian sources | T5 slip | Box 14 | |

### Foreign income

| | | | |
|---|---|---|---|
| Foreign non-business income | T3 slip | Box 25 | Include these amounts in the section called “Line 12100 – Interest and other investment income” of the Federal Worksheet and on line 43300 of Form T2209, Federal Foreign Tax Credits. |
| Foreign income | T5 slip | Box 15 | |
| Foreign non-business income tax paid | T3 slip | Box 34 | Include these amounts on line 43100 of Form T2209, Federal Foreign Tax Credits. See note below. |
| Foreign tax paid | T5 slip | Box 16 | |

**Note**
If you qualify for the federal dividend tax credit or federal foreign tax credit, you may also qualify for similar provincial or territorial credits.

### Other income

| | | | |
|---|---|---|---|
| Other income | T3 slip | Box 26 | Include these amounts on line 13000 of your income tax and benefit return. |

## For more information

### If you need help

If you need more information after reading this information sheet, go to **canada.ca/taxes-capital-gains** or call **1-800-959-8281**.

### Forms and publications

The CRA encourages you to file your return electronically. If you need a paper version of the CRA's forms and publications, go to **canada.ca/cra-forms-publications** or call **1-800-959-8281**.

## Reference documents

### Form

- Form T2209, Federal Foreign Tax Credits

### Guides

- Guide T4037, Capital Gains
- Guide T4040, RRSPs and Other Registered Plans for Retirement
- Guide RC4092, Registered Education Savings Plans (RESP)