

Corporate Class Funds and Linked Notes – New Tax Changes Take Effect on January 1, 2017

Two significant changes to the tax legislation take effect on January 1, 2017 and could impact investors who own Corporate Class Funds or Linked Notes. The following is an overview of the upcoming changes.


Corporate Class Funds

The new tax legislation seeks to curtail the current tax deferral in the case of mutual fund “switches,” by creating a taxable disposition at fair market value when shares of a mutual fund corporation are exchanged upon switching between funds.

Currently, certain Canadian mutual funds structured as a corporation allow the tax-deferred exchange of shares of one class of the mutual fund corporation for shares of another class in order to switch their economic exposure between the mutual fund corporation’s different funds. As of January 1, 2017, proposed tax legislation will curtail this deferral such that an exchange of shares of a mutual fund corporation that results in the investor switching between funds will be considered a disposition at fair market value for tax purposes. However, this proposed measure will not apply to switches where the mutual fund shares received in exchange differ only with respect to management fees, and otherwise derive their value from the same portfolio or fund within the mutual fund corporation (i.e., the switch is between different series of shares within the same class).

Linked Notes

Linked Notes are debt obligations whose return is linked in some way to the performance of one or more reference assets or indexes over the term of the obligation, such as a “principal-protected note” or “principal at-risk note.” Currently, any gains on the sale of a Linked Note in the secondary market prior to maturity is generally treated as a capital gain for tax purposes, while the gains of a Linked Note at maturity would be treated as interest income. If the proposed legislation is implemented in its current form, effective January 1, 2017 any gain realized on a secondary market sale of a Linked Note would be deemed to be the interest that accrued on the Linked Note up to the date of sale, and would not be treated as a capital gain. In effect, the positive return on a Linked Note would always retain the same character, whether earned at maturity or received as proceeds in a secondary market sale by the holder of the Linked Note.

 If you own Corporate Class Funds or Linked Notes, you may wish to speak to your BMO financial professional and tax advisor to discuss any planning strategies to undertake before the end of the year, in light of these upcoming changes.



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