

# PHILANTHROPY ON PURPOSE

## “T CLASS FUNDS”

In today’s low interest rate environment, traditional income producing investments such as bonds and Guaranteed Investment Contracts (GICs), pay rates of interest that barely keep up with inflation once tax has been factored in. If you are looking to generate tax-efficient income and you’re willing to accept the additional volatility that comes with balanced mutual fund investing, T Class mutual funds are an option worth considering when formulating your philanthropic plan.

### What is a T Class Fund?

T Class funds are a special class of a mutual fund that is designed to pay you a prescribed amount of cash flow on a monthly basis, based on a target distribution rate, typically anywhere from 5% to 8% of your mutual fund’s net asset value per year. Designed to help you create tax-efficient income streams from investments in non-registered accounts (i.e. not RRSPs or RRIFs), T Class funds work like Systematic Withdrawal Plans (SWPs). However, there’s an important difference: T Class funds are designed to help defer capital gains tax until some point further down the road. This is accomplished through a unique structure. When you receive income from a T Class fund, the cash flow distribution that you receive consists primarily of a return of capital that is not taxed at all. This is because you are receiving your original investment back, on which you have already paid tax before it was invested.

On top of reducing the tax you pay, the tax efficiency of these payments can provide additional benefits. Lowering the income you report on your tax return can be very beneficial in terms of income-tested government benefits, such as Old Age Security (OAS) and income-tested tax credits, such as Age Credit, which are typically clawed back as you report higher levels of income.

### Where does Philanthropy fit in?

In addition to the reduced tax liability of the monthly distributions, if you were to allocate these funds (philanthropy on purpose) to your favourite charity you would receive the additional benefit of the fifty per cent (50%) charitable tax credit. This tax credit can be used to eliminate income tax that you have already incurred on other source of income. Therefore, you use a tax-efficient investment to fuel your philanthropy that provides significant benefits for our community and reduces income tax that you would otherwise pay. This is the absolute of a win/win/win.

The T Class strategy of making payments of “return of capital” ultimately ends with your investment in T Class mutual funds having a cost base for tax purposes of zero. Any additional distributions are taxed entirely as capital gains. A capital gain receives preferred tax treatment in that only 50% of the gain is taxed. Recent tax legislation has eliminated the capital gains tax on gifts of listed securities, including T Class funds, to registered charities. As a result, for those families creating a “philanthropy on purpose” strategy your best course of action would be to donate this investment to charity and receive a further tax credit against other income of 50%.

An original investment of \$100,000 in 1990 in a T Class mutual fund comprised of 65% Cdn Equity, 35% Cdn Bond and 5% T-Bills over the last 15Yrs would have generated an average of \$9,733/yr for charity (\$146,830 total donations) and your investment would have still have a pre-tax market value of \$132,056. A further donation of the \$132,056 would generate an additional tax credit of \$66,028.

With this “Philanthropy on purpose” strategy, over that time frame you would have donated a total of \$278,886 to charity and received tax relief of \$139,443 against other income.

