

Read: How to answer common fee questions**DO INVESTORS TRULY BENEFIT?**

Is there a true tax advantage when an investor can deduct advisor service fees directly? And does owning a security directly, as opposed to owning mutual funds, provide a distinct tax advantage?

To answer those questions, consider the following situations.

1. In the chart below, the first column illustrates when someone holds a traditional embedded mutual fund, with bundled management and advisor fees that are paid directly by the fund. The MER of the fund is 2.3%, and no fee is deductible by the investor on his or her personal tax return.
2. The second column illustrates when holds a non-embedded mutual fund, where the management and advisor fees are separated and the advisor fee is paid directly by the investor. The fund's MER is lower (1.3%), reflecting the fact that the investor directly pays an advisor fee of 1%, allowing him to deduct the advisor service fee directly on his income tax return.
3. The third column illustrates when someone invests with a full-service broker and directly owns the securities. His full service broker charges 2.3% in advisory, administration and management of securities fees. Since the investor owns all securities personally, he will be able to deduct the full 2.3%.

For the sake of comparison, it is assumed all three investors own balanced portfolios that are sold after one year, generating capital gains on disposition.

	Embedded Mutual Fund	Non-Embedded Mutual Fund	Direct Ownership of Securities
Initial investment	\$ 100,000	\$ 100,000	\$ 100,000
Capital gains (6%)	\$ 6,000	\$ 6,000	\$ 6,000
Interest income (4%)	\$ 4,000	\$ 4,000	\$ 4,000
Minus MER @ 2.3% (1.3% for non-embedded)	<u>(\$ 2,300)</u>	<u>(\$ 1,300)</u>	<u>(\$ 0)</u>
Generated capital gains	\$ 6,000	\$ 6,000	\$ 6,000
Taxable capital gains	\$ 3,000	\$ 3,000	\$ 3,000
Interest distributed after paying MER	<u>\$ 1,700</u>	<u>\$ 2,700</u>	<u>\$ 4,000</u>
Total taxable income before deduction	\$ 4,700	\$ 5,700	\$ 7,000
Deduction of advisor fee @ 1% (2.3% for direct ownership):	-	<u>(\$ 1,000)</u>	<u>(\$ 2,300)</u>
Total taxable income	\$ 4,700	\$ 4,700	\$ 4,700
Tax paid @ 45 %	<u>(\$ 2,115)</u>	<u>(\$ 2,115)</u>	<u>(\$ 2,115)</u>
Net income after MER, advisor fee deduction and taxes	\$ 5,585	\$ 6,585	\$ 7,885
✱ Minus advisor fees paid out of pocket by investor	-	<u>(\$ 1,000)</u>	<u>(\$ 2,300)</u>
✓ Net cash flow generated	\$ 5,585	\$ 5,585	\$ 5,585

When investing in a mutual fund, whether the advisor fee is deducted from income generated within investor level personally, the net after-tax result is the same.

Even with a full-service broker, the after-tax effect is identical. That is, owning securities directly does not confer an after-tax advantage.

E.O.E.