IFIC
THE INVESTMENT FUNDS INSTITUTE OF CANADA
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BY: FAX (613) 992-4450 and MAIL

February 26, 2007

Department of Finance
L'Esplanade Laurier
140 O'Connor Street
Ottawa, Ontario
K1A 0G5

Attn: Mr. Brian Ernewein
General Director, Finance Canada

Dear Sir:

Re: Notice of Ways and Means Motion Released November 9, 2006 (the "Notice of Ways and Means Motion") – Foreign Investment Entities

We note that pursuant to subsection 18(11) of the Notice of Ways and Means Motion (which is now contained in Bill C-33), proposed subsection 94.1(3) of the Income Tax Act (the "Act") will not be effective until taxation years that begin after 2006. Previous drafts of the Foreign Investment Entity Rules (the "FIE Rules"), including the draft legislation released on July 18, 2005, indicated that these rules would be effective for taxation years beginning after 2002. We understand that the delay in implementation will be of benefit to many Canadians, and we support such delay in implementation. However, we want to point out the impact to the Canadian funds industry of such delay in implementation and request relief for our members and their investors who in good faith relied upon the proposals.

Historically, the convention in the Canadian tax community has been to treat draft income tax legislation as law as of its proposed effective date. As such, Canadian mutual fund trusts and quasi-mutual fund trusts (collectively "Trusts") have filed Canadian T3 Income Tax Returns and accompanying T3 Supplementaries for taxation years commencing in 2003, 2004 and 2005 on the basis that the FIE Rules were in effect for such years. Trusts generally distribute all net taxable income to unitholders annually. As such, any income for tax purposes resulting from the application of the FIE rules was distributed to unitholders and reported on T3 Information Returns for such years. The

unitholders would have then included such amounts in their taxable income when preparing their tax returns.[1]

Based on the FIE Rules as they read in the Notice of Ways and Means Motion, such Trusts overstated their income in their T3 Tax Returns before deducting distribution under subsection 104(6), and overstated income distributions on T3 Supplementaries for the years in question. This cannot be rectified by such Trusts merely refiling T3 Tax Returns for the years in question, as it was the unitholders who ultimately paid tax on such reported income. In addition, it would be extremely difficult, if not impossible, for the Trusts to file amended T3 Supplementaries, and advise unitholders to refile previous years tax returns on the basis of the amended T3 Supplementaries, as this would require recalculated NAVs for the funds in question as the income distributed would have been in the form of a distribution of units.

On the other hand, providing a current year deduction for Trusts in respect of the 2003 to 2005 over inclusion will not alleviate the situation where there has been a turnover in unitholders of the Trust, if the Trust has been terminated, or no longer has taxable income.

As such, we request that the Department of Finance provide a legislative method of relief to unitholders in 2007 based on taxes previously paid. Precedent for such an approach is found in subsection 20(21) of the Act which provides that where a debt obligation is disposed of, and the total amount of interest previously included in income on the basis that it had accrued to the taxpayer on such debt obligation is not in fact received, the taxpayer is entitled to a deduction for the difference between the amount accrued and the amount of interest received.

We recommend that Trusts be permitted to either claim a deduction in the 2007 taxation year for amounts previously included in income under the FIE Rules, or be permitted to elect to permit unitholders who reported this income to claim a 2007 deduction. A Trust could elect to claim the deduction at the Trust level where there has either not been a material turnover in unitholders, or where the amount of FIE income included per unitholder is not material. Alternatively, where the amount of FIE income was more material, a Trust could elect to advise unitholders of the availability of this deduction and refrain from a claim at the Trust level.

Please find attached (Appendix I) suggested language for legislative amendments to implement this proposal.

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[1] If Trusts had not proceeded on this basis and the FIE Rules were implemented effective as of 2003, the Trusts would have a tax liability that had not been reflected in calculating net asset value ("NAV"). Accordingly, it was prudent practice for them to have made such allocations.

We would like to discuss this issue with you at your earliest convenience.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Joanne De Laurentiis
President and CEO

Attachment

APPENDIX I

Draft Legislation

1. Revise the preamble to subsection 18(2) of the Draft Legislation to read:

"Subject to subsection (3), subsection (1) applies to taxation years that begin after 2006, except that ...

2. Include as new subsection 18(3) the following:

"A trust that is not exempt from tax under Part I of the Act at any time in its first taxation year beginning after 2006 (referred to in this subsection as the "election year") may elect in its return of income under Part I of the Act for the election year that subsection (1) apply to each taxation year of the trust that begins after 2002 and ends before 2007 and throughout which the trust was not exempt from tax under Part I of the Act (each such year referred to in this subsection as a "relevant year") and if the trust so elects :

(a) The trust may deduct in computing its income for the election year, an amount not exceeding the aggregate of all amounts each of which is an amount included in computing the income of the trust under subsections 94.1(4), 94.2(4) or 94.3(4) of the Act in a relevant taxation year; or

(b) The trust may designate an amount in a prescribed form filed with its return of income under Part I of the Act for the election year in respect of each beneficiary of the trust in a relevant year to whom an amount of income of the trust was payable in such relevant year, not exceeding the amount determined by the formula:

(A/B) x C

where

A is the amount included in computing the income of the beneficiary by reason of subsection 104(13) of the Act in respect of income of the trust payable to the beneficiary in such relevant year

B is the aggregate of all amounts each of which is an amount included in computing the income of a beneficiary of the trust by reason of subsection 104(13) of the Act in respect of income of the trust payable to the beneficiary in such relevant year

C is the aggregate of all amounts each of which is an amount included in computing the income of the trust for such relevant year by reason of subsection 94.1(4), 94.2(4) or 94.3(4) of the Act

and the amount so designated:

(i) May be deducted by the beneficiary in computing the income of the beneficiary for the first taxation year of the beneficiary beginning after 2006, and

(ii) Shall be deducted by the beneficiary in computing the adjusted cost base to the beneficiary of the beneficiary's interest in the trust."