



THE INVESTMENT FUNDS INSTITUTE OF CANADA  
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA  
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February 16, 2001

Tax Legislation Division  
Department of Finance Canada  
17<sup>th</sup> Floor, East Tower  
L'Esplanade Laurier  
140 O'Connor Street  
Ottawa ON  
K1A 0G5

Dear Sirs and Mesdames:

**Re: Proposed Sections 94, 94.1 and 94.2 of the *Income Tax Act* (Canada) - Taxation of Non-Resident Trusts and Foreign Investment Entities**

The Investment Funds Institute of Canada ("IFIC") wrote you on September 1, 2000 to provide comments on the draft legislation to amend the *Income Tax Act* (the "Tax Act") with respect to the taxation of non-resident trusts and foreign investment entities. Since we submitted that letter, we have become aware of additional concerns with the proposed legislation, and are writing today to advise you of those concerns.

Our first additional concern relates to the impact of proposed section 94 on the ability of Canadian investment managers to take advantage of the provisions of section 115.2 of the Tax Act. As you are aware, section 115.2 was added last year and was intended to allow Canadian investment managers to compete internationally in the provision of their services. We are concerned that proposed section 94 of the Tax Act will erode this recently granted ability, by exposing legitimate non-resident mutual funds which are offered to non-Canadians to Canadian income tax by deeming them to be resident in Canada for Canadian tax purposes.

In this regard, we have read the submission made to the Minister of Finance by Blake Goldring of AGF Management Limited, dated December 19, 2000, and we support and endorse it. We join AGF in urging that section 94 be amended to except funds established offshore which fall under section 115.2 of the Tax Act.

Subsection 94(3) does not apply to non-resident trusts unless there is either a resident contributor to the trust, or a resident beneficiary of the trust at the trust's year-end. Our concern is that under the current draft legislation, a resident contributor will exist where the Canadian resident investment manager has provided initial seed capital to establish the fund. However, a resident contributor does not exist where the contribution falls under the definition "arm's length transfer".

We understand that your Department is considering amending the definition of “arm’s length transfer” so that (a)(iv) would be a standalone component of the definition. That is, if “the particular transfer or loan was made in the ordinary course of the business of the transferor” then the transfer would be an “arm’s length transfer” without the requirement that paragraph (b) of the definition apply.

We fully support this amendment. As investment managers regularly provide seed funding to newly established funds, such activity would be in the ordinary course of such manager’s business.

Our second additional concern relates to foreign based funds that are established in jurisdictions in which they are subject to taxation on the basis that mutual funds in Canada are taxed. The tax policy rationale for proposed section 94.1 is to ensure that offshore investments made by Canadian taxpayers are not given an effective tax deferral by being invested in an entity that does not distribute its income and gains annually. As has been acknowledged through the decision to exempt U.S. based mutual funds from these provisions, a tax deferral is not possible for Canadian investors when foreign jurisdictions impose tax on funds similar to the way that Canada does.

We note that more and more Canadians are purchasing offshore funds through acquisitions made by their Canadian mutual funds. Canadian funds invest in foreign funds for a variety of reasons, such as in cases where direct investment is not permitted under the laws of a jurisdiction, or where the amount to be invested in a jurisdiction does not justify the costs associated with direct investment. The provisions of proposed section 94.1 will potentially stop this form of investing, with the result that Canadian investors are disadvantaged by increased cost and reduced access to foreign markets.

We are aware of the submission of Debbie Pearl-Weinberg of Canadian Imperial Bank of Commerce, to you on December 19, 2000, and support that submission. We join CIBC in urging that the draft provision be amended to allow all funds purchased by Canadians that are based in jurisdictions which tax funds in a manner similar to Canada be granted the same exemption that has been granted to U.S. based funds.

We would be happy to discuss our concerns with you or your officials at your convenience.

Yours truly,

“ORIGINAL SIGNED BY J. MOUNTAIN”

John Mountain

Vice President, Regulation