



THE INVESTMENT FUNDS INSTITUTE OF CANADA
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA
151 YONGE ST., 5TH FLOOR, TORONTO, ONTARIO, M5C 2W7 TEL 416 363-2158 FAX 416 861-9937

June 5, 2001

DELIVERED

Mr. Len Farber
Tax Legislation Division
Department of Finance
140 O'Connor Street
Floor 17E
Ottawa, Ontario

Dear Mr. Farber:

Re: Section 115.2 of the *Income Tax Act (Canada)* (the "Act")

We are writing to describe our concerns with one aspect of the safe harbour rule respecting the provision of "designated investment services" by "Canadian service providers" to "qualified non-residents" (referred to in this letter as "non-resident funds" or in the singular, a "non-resident fund") provided in section 115.2 of the Act (the "safe harbour rule").

We understand that the safe harbour rule was introduced for the purpose of allowing Canadian investment services providers to compete effectively in international markets (against, in particular, U.S. and U.K. investment services providers) in attracting non-resident funds as clients. We also understand that, to avoid creating an incentive to serve Canadian investors offshore, the Department restricted the application of the safe harbour rule such that it does not apply where, among other things, a non-resident fund has sold an interest in itself to a Canadian resident.

As currently drafted, the benefit of the safe harbour rule does not extend to a non-resident fund if the fund, at any time in the past, sold investments in itself to a person it knew or ought to have known, was a Canadian resident – even if the fund no longer has any Canadian investors.

We can see no tax policy reason why a non-resident fund that has no Canadian investors should not receive the benefit of the safe harbour rule. More to the point, we believe that denying the benefit of the rule to a non-resident fund that has no Canadian investors puts Canadian investment services providers at a disadvantage against its U.S. and U.K. competitors when soliciting the non-resident fund's business since (a) without the benefit of the safe harbour rule, the provision of certain designated investment services to the fund by a Canadian investment services provider may result in the non-resident fund becoming subject to Canadian tax, and (b) the fund would not face U.S. or U.K. domestic taxation if

instead it hired a U.S. or U.K. investment services provider. Accordingly, we believe that the safe harbour rule should be expanded to eliminate this unnecessary disadvantage.

In informal discussions between Mark Lobsinger of the IFIC Tax Steering Committee and Jim Greene of the Department, it was contemplated that the problem associated with this particular aspect of the safe harbour rule could be rectified by amending subsection 115.2(2) of the Act to expand the application of the rule, such that it benefits non-resident funds that have no Canadian investors. The desired result could be achieved by amending subsection 115.2(2) of the Act by adding, after subparagraph 115.2(2)(b)(iii) the following words:

“or,

- (c) where the Canadian service provider commences providing designated investment services to the qualified non-resident at a particular time, after reasonable inquiry made at such time, the Canadian service provider has concluded that no person resident in Canada or partnership that has one or more members that are resident in Canada beneficially owns any shares of or interests in the qualified non-resident; and
- (d) throughout the period that the Canadian service provider provides designated investment services to the non-resident, the non-resident does not, directly or through its agents, direct any promotion of investments in itself principally at, or sell investments to, persons that the non-resident knows or ought to know after reasonable enquiry are resident in Canada or partnerships that the non-resident knows or ought to know after reasonable enquiry had members that are resident in Canada.”

The proposed technical amendment would not detract from the tax policy underlying the safe harbour rule and would put Canadian investment services providers on a more level playing field when competing for non-resident fund business.

Thank you for your consideration of this matter.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

“ORIGINAL SIGNED BY T. HOCKIN

The Hon. Thomas A. Hockin,
President and Chief Executive Officer