THE INVESTMENT FUNDS INSTITUTE OF CANADA
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA
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July 9, 1998

**VIA COURIER**

Mr. Simon Thompson & Mr. Len Farber
Tax Policy Branch
Government of Canada`
140 O'Connor, 17E
Ottawa, ON K1A 0G5

Dear Sirs:

**Re: Year-End Distributions for Mutual Fund Trusts**

I am writing on behalf of The Investment Funds Institute of Canada ("IFIC") to request that your Ministry review the current legislation regarding year-end distributions for mutual funds and quasi-mutual funds with a view to amending the same.

IFIC is the national organization for the mutual fund industry in Canada. Its Members represent almost 100% of all open-end mutual funds in the country. IFIC's Members also include an ever-increasing number of retail distributors, as well as affiliate Members drawn primarily from law, accounting and other professional firms. At present, IFIC's Member funds have in excess of $329.7 billion in assets under management in more than 38.8 million security holder accounts. Recent research indicates that approximately 4.5 million households (slightly over 40% of Canadian households) and approximately 7 million individual Canadians own one or more mutual funds, making mutual funds the fastest growing sector of the Canadian financial services industry. One of the primary functions of IFIC is to ensure that Canadian investors who trust their retirement savings and financial goals to the mutual fund industry receive the maximum possible return through the promotion of standards, legislative or otherwise, that in turn promote efficiency and fairness throughout industry operations.

As you are aware, the Taxation Steering Committee of IFIC has been reviewing alternatives to solve the problems created by the requirement that mutual fund trusts and quasi mutual fund trusts distribute their taxable income for the year ended December 31 to unitholders by December 31.

This letter is intended to provide a basis for discussion. It outlines our objectives and recommendations, followed by a detailed analysis of problems with the current legislation which provides a background to our recommendations (Appendix A), and then our recommendation is reviewed in detail in Appendix B.

The distribution requirements originated in 1971. At that time the industry was in its infancy and the financial instruments used were straightforward. Since then, the industry has grown exponentially and as outlined above, IFIC Members alone have more than $329.7 billion dollars currently under management. Along with this growth there has been an explosion of financial products available, ranging from zero coupon bonds to complex derivatives - of which many weren't even around in 1971. In 1971, the tax rules did not present a heavy or unreasonable burden on the industry. If, however, the rules were being introduced today we feel confident that the complexity of the industry and enormity of the amounts involved would be considered in drafting legislation more suitable to the current reality.

**General Objectives**

In determining our recommendations for changes to the legislation, the following objectives were identified:

**1.** To optimize tax efficiency for investors, to prevent excess distributions and double taxation.

**2.** To provide timely, accurate information to users (investors - directly or through their brokers, financial advisors, management and Revenue Canada.)

**3.** To ensure there is a level playing field. Currently to provide an effective flow through, the mutual fund industry is held to a higher standard than is required of any other industry or taxpayer. Income must be calculated at year-end, not after, in order to flow through the tax liability to investors.

**4**. To be as tax revenue neutral as possible, while meeting the practical needs and constraints of the industry.

**5.** To minimize the need for significant current system changes since the financial services industry system resources are constrained by the upcoming conversion to the Euro currency and the Year 2000 computer problem.

**Recommendations**

To meet the above objectives, IFIC is recommending changes to the legislation which would allow mutual fund trusts and quasi-mutual fund trusts the following:

**1.** The option to elect a cut off date of December 15 to determine:

**i)** income for the period ended December 15, with the exception of income from

partnerships and other trusts. The tax year-end would remain December 31;

**ii)** the refundable capital gains tax on hand and capital gains refund.

By allowing Funds the flexibility to elect the cut off date, Funds that have regular pay out dates, such as money market funds or Funds with fixed distributions, have the choice not to make the election and can continue using a cut off date of December 31. Once the election has been made then a Fund must be consistent in its cut off date.

For purposes of taxable income and distributions the tax year-end would remain December 31.

For the first year a transition rule would be required to account for the period from January 1 to December 15. Subsequent years would cover a full twelve months, from December 16 to December 15 of the following year.

**2.** Amounts paid or payable to unitholders during the Fund's taxation year ending December 31 will continue to be deductible to the Fund and taxable to the unitholders in the year paid or made payable.

**3**. The ability to carry forward indefinitely, distributions paid that are in excess of that which is required to eliminate any income tax payable by a Fund in a year (excluding the 1/4 non-taxable portion of capital gains distributed), and to claim such excess as a deduction from taxable income in future years. This could follow rules similar to those for loss carry forwards. In the event of a merger of two Funds, the excess distributions would not be allowed to carryover to the successor Fund.

Excess distributions paid in a year will be included in the income of the recipient unitholder for that year.

This adjustment is required since all income cannot be fully estimated by December 31 even when a December 15 cut off date is used due to, for example, holding of investments in other trusts with December 31 year ends when information is not available.

An analysis of the current problems the industry faces is outlined in Appendix A, followed by a detailed analysis of our recommendations in Appendix B.

If we can come to an agreement with respect to changes in the legislation, we would like the changes to be effective for this tax year. Due to the timing of drafting and introducing legislation, we are also requesting administrative relief from Revenue Canada to follow these recommendations

for this year-end. This is especially important given that on December 31, 1998, a significant number of European securities will be converting to the new Euro currency, thus creating a need for reconciliation with foreign sub-custodians on all securities held on December 31, 1998. Then, in the next year, on December 31, 1999, we will be facing the Year 2000 problem and staff will be on standby to ensure all systems are processing properly to handle the date conversion.

We appreciate your time and attention to this matter and we look forward to meeting with you in July to discuss our recommendations. If you have any questions in the meantime please contact one of the following people:

Alex Bright Chair of IFIC's Year-End Distribution Sub-Committee (416) 922 - 5322,
Peter Bowen Chair of IFIC's Taxation Steering Committee (416) 307-5230, or
Lori Lalonde Staff Counsel, IFIC (416) 363-2150, ext. 246.

**Problems With The Current Legislation - Appendix A**

**1) Desire to optimize tax efficiency for investors, to prevent excess distributions and double taxation**

Our aim is to achieve better tax integration and an improved flow-through ability. Mutual funds generally act as flow through vehicles. However, the concept doesn't work as well as it should. This is highlighted with current problems with the capital gains refund mechanism.

The capital gains refund is based on three factors which cannot be determined until after the close of business on December 31:

- value of redemptions during the year;
- unrealized appreciation at year end;
- taxable income for the year.

Each of these cannot be determined until after the close of business on December 31. Most Funds close when the Toronto Stock Exchange closes at 4:00 p.m., however, pricing the Funds generally takes two hours, (some fund companies have more than 2,000 securities to price, of which some prices must be obtained manually). Pricing is usually completed by 6:00 p.m. Toronto time. However, in order to make the distribution on December 31, companies do not have sufficient time to wait until the markets close and pricing is completed, therefore estimates on all three items must generally be made.
There are three alternatives available to a Fund when faced with estimating the amount to distribute:

i) To ensure that a Fund does not pay tax, many Funds do not fully utilize the capital gains refund. Retaining a "cushion" of 10% is common. This results in double taxation which the capital gains refund mechanism was designed to eliminate.

ii) Other Funds over distribute and have a tax free return of capital as part of the distribution. Unitholders and accountants alike have difficulties in understanding the nature of a return of capital, and the fact that the adjusted cost base of the unitholders investment needs to be reduced. While the systems of some companies can account for the return of capital, the exact amount is not known usually for about ten days after December 31. This poses its own special problems as it relates to foreign content calculations at December 31, and to the cost of the investment shown on clients' annual statements, most of which are mailed within ten days of year end.

iii) If a Fund decides instead to pay the tax on the under distributed capital gains and obtain a refund in the following year, the variables may not allow for a full refund, or any refund at all, if as an example, the Fund is in an unrealized depreciation position the following year end. This results in the Fund having an unproductive asset which reduces the return of the Fund, an unacceptable position for a Fund to be in. In addition, paying a refundable capital gains tax may be contrary to the Fund's Declaration of Trust if it states that the Fund will make sufficient distributions such that the Fund will not pay tax.

For the reasons stated above mutual fund trusts need additional time to determine the three factors mentioned. The capital gains refund mechanism is sufficiently complex that it requires the review of senior personnel. With the growth of the industry many of the larger fund companies have 40 to 50 funds; to fully utilize the capital gains refund and to avoid paying refundable tax, senior staff require significantly more time for review. As an example of the magnitude of the problem the industry faces, one fund company alone distributed more than half a billion dollars at year end in 1997. Allowing only a few hours for review is unreasonable, unfair and increases the chance of significant errors being made.

**2) Provide accurate information to users (investors, financial advisors, management and Revenue Canada)**

This objective comprises two distinct points. The first, is that the Fund should be able to determine its taxable income and distributions required with accuracy, and second, that the information received by unitholders and other users of the Fund's information is accurate. Each point of this objective is discussed separately next.

A) Determination of Taxable Income and Distributions Required

As at the close of business on December 31, fund managers do not have all the information required to accurately determine the taxable income of a Fund at year end, and are therefore unable to calculate the per unit distribution.

There is a time lag in obtaining information on income, the capital gains refund, and the number of units outstanding.

i) Income unknowns:

- foreign dividends and securities trades that have, or have not, settled in emerging markets.

- Information from overseas custodians is not received on the same day a transaction occurs, and in emerging markets there is not a high degree of certainty as to when the money will be received. Therefore, often several days are required to establish if an event, such as a settlement of a trade, has occurred.

- information on corporate actions, such as corporate reorganisations where there is a share split or dividend received in kind late in the year, may not be received in a timely manner, in both foreign and domestic markets.

- The amount of income allocated from underlying trusts (i.e., Fund on Fund structures or income trusts) or income allocated from partnerships is not known.

  When a Fund holds units of a partnership or of another trust, the income allocated and the tax characteristics may not be known for up to three months after year-end. Note that the filing date for most trusts and partnerships is the end of March of the following year and there is no requirement for these entities to provide the information earlier.

Currently, some companies provide verbal estimates of the income to be allocated at year-end to their unitholders or partners, and some do not. However, even for those that do, the amounts provided are only estimates.

This problem would continue to exist with our recommendations, however, implementing the ability to carry forward excess distributions for future deduction would minimize the impact.

ii) Capital Gains Refund - three factors are not known:

a) taxable income - see the previous point i);

b) value of redemptions

For some fund companies, orders for redemptions received on December 31 before 4:00 p.m. are excluded from the number of units outstanding at the end of the day and the units redeemed are not eligible for the distribution. A fund company does not know that day's redemptions as they are processed overnight and therefore estimates based on "normal" daily redemptions of the units outstanding may be used.

c) unrealized appreciation

This is equal to the market value of the investments less their cost. To determine the market value we have to wait until that day's pricing is completed which is usually around 6:00 p.m. Eastern Standard Time.

iii) Number of units outstanding are not known.

As mentioned in the previous point ii), unitholder purchase and redemption orders received before 4:00 p.m. will result in units being purchased or redeemed based on the net asset value per unit on the day the order is received. For those Funds whose record day for a distribution is the same day as the payment date, the units purchased or redeemed on that day are included or excluded, as the case may be, in that day's outstanding unit balance and are part of the record day units. Therefore, for purchase orders

received before 4:00 p.m., the units are included in the record day units and are entitled to receive that day's distribution, whereas units that are redeemed that day are excluded from the record day units and are not entitled to the distribution. The problem arises because the processing of the purchase and redemption orders occurs during the night and therefore the units outstanding for that day are not known until the next morning.

Currently, on December 31, the exact number of units outstanding is not known, therefore estimates are made and over-distributions are made to provide a "cushion." To fully utilize the tax credits available and determine the exact per unit distribution, we require at least 18 hours to determine the units outstanding.

For unitholder order processing and pricing of a Fund's units, we can't have a day that has a net asset value per unit calculation in between the record date and the payment date. This is because a distribution payable lowers the net asset value which determines the price paid or received on the purchase or redemption of units. Therefore, if we had the ability to determine the absolute dollar value of the distribution using an earlier cut off date of December 15 and had until December 31 to make the distribution, it would allow the manager to select a Friday record date, determine the units outstanding on Saturday morning and still have time to process the distribution on their systems over the remainder of the weekend. Currently, if December 31 is not a Thursday or Friday, we could determine the units outstanding on New Years Day, but then there is insufficient time to process the distribution before the opening of business on January 2.

As an example, if a Fund determines that it needs to distribute $1,000.00, and it knows that the day before there were 1,000 units outstanding, the per unit distribution would be $1.00, however, if 10 additional units were purchased on December 31 that had the right to receive the December 31 distribution and the $1.00 distribution was made, then $1,010.00 would actually be distributed. If in the event there were net redemptions that day of 10 units, only $990 would be distributed and the Fund would pay tax on the $10 that was not distributed.

To ensure the Fund does not under distribute and pay tax, many Funds purposely over distribute. In actual fact there is double taxation because rather than tax receipting the excess distribution as a return of capital, many Funds do not utilize the full amount of the capital gains refund. This is

because of difficulties in communicating to clients the return of capital adjustment to their cost base and the problems encountered with foreign content reporting.

B. Information received by users, (investors, financial advisors, management and Revenue Canada)

i) Investors and Financial Advisors

Many investors hold their mutual funds in the name of their broker (in "nominee form.") The brokers receive information from the issuers of the investments their clients hold with them and report the information in a consolidated format on the clients' annual statements.

The brokerage community has problems in getting all the year end transactions processed and reported on their statements due to the large volume of transactions, which include dividends paid on shares as well as distributions from mutual funds. Typically, millions of transactions are processed by each of the large brokerage firms. As a result of the inability to process, and therefore capture the year end distributions and related reinvestments, broker statements do not reflect the correct market value of the mutual fund holdings at year end, rather they report a lower market value. The lower market value is derived as follows:

Example

Assume the number of mutual fund units held by an investor on December 31 prior to a distribution was 100.

The net asset value per unit immediately before the distribution was $6.00. The market value of the holdings before the distribution is therefore $600.00.

A distribution of $1.00 per unit is paid on December 31. Therefore, the total distribution received by the investor equals $100.

The net asset value per unit immediately after the distribution is $5.00 ($6 - $1)
If the distribution is reinvested in additional units, the investor would receive 20 units ($100 distribution / $5 navpu). In total, the investor would hold 120 units at $5 each for a market value of $600.

The brokers' statements do not pick up the purchase of the additional units that results from the reinvestment on December 31, but they do pick up the lower net asset value per unit. Therefore, the brokers' statements show holdings of 100 units with a navpu of $5.00 for a total market value of $500.

Implications

Clients receive inaccurate, misleading information on which to base their financial planning decisions. The annual year end client statements are arguably the most important statements clients receive since many clients use them for annual reviews, and it is the beginning of RRSP season.

The foreign property cost calculation based on the information the brokers have is wrong. Many investors rely on their brokers to compute the excess and this leads to a liability issue if the calculation is incorrect.

The minimum pay out calculations for RRIF's for the following year are wrong since the December 31 market values are understated.

Trustees are not able to comply with their reporting statement obligations under pension law for locked in plans.

Inaccurate information affects the level of confidence investors have in the industry. In addition, it affects the business relationship between the brokerage community and the mutual fund managers.

ii) Revenue Canada

In addition to incorrect client statements, inaccuracy causes other problems as well.

If an error has been made and there is an under distribution of income other than capital gains, there is no refund mechanism for tax paid on account of income like there is for capital gains, which itself is imperfect. Therefore, there is not any method currently available to correct an error or oversight with respect to the amount of income distributed.
With respect to the capital gains refund mechanism, in the next year when the under distribution is paid out, a refund of the full amount of tax paid is not guaranteed. This is because the refund formula is based on the three variables mentioned

earlier. Payment of capital gains tax results in an unproductive asset for an indeterminate time. Again this lowers the return to investors and their future income.

To avoid the payment of tax, whether it is refundable or not, many managers purposely over distribute and have either a return of capital to investors or they do not fully utilize the capital gains refund mechanism. This results in tax inefficiencies.

Depending on the timing of when an error has been discovered, if tax receipts have already been mailed to investors, amended tax receipts will be issued. This results in substantial additional costs including postage, paper, printing, staffing etc., which are ultimately borne by the investors.

Amended tax receipts also cause additional work and costs for Revenue Canada as tax returns already filed are amended and reprocessed.

iii) Staff

The significant time constraints increase the stress levels of the staff involved which in turn causes more errors, staff burnout, increased absenteeism and associated costs.

Due to the large monetary values involved, a small error or oversight can result in significant tax payable. This has a direct negative impact on the return the investors receive.

It is also important to keep in mind that December 31 is New Year's Eve and is part of the Christmas holiday season, an important time for people everywhere. Fund accounting, tax, reporting and system staff do as much preparation work as they can, often working twelve hour days starting on Boxing Day and stopping when the distribution run is complete, which is usually very late on New Year's Eve or early in the morning on New Year's Day. The work requirements prevent these people from being with their families. This has a negative impact on the recruitment and retainment of skilled staff in these areas.

**3. The mutual fund industry is held to a higher standard than is required by any other industry or taxpayer vis a vis the time allowed to determine taxable income.**

The mutual fund industry is held to a higher standard than is required by any other industry or taxpayer, with respect to the time lag between year-end and when the final taxable income has to be determined. As a comparison, regular corporations have two months after year-end to pay their tax and six months to finalize their taxable income and file their tax returns. Individuals have four months to file their returns and pay their tax. The additional time after year-end allows for a thorough review by senior personnel to ensure the information and calculations are correct.

Most information required to determine the amount to be distributed is available in advance, however, even though most companies do "dry runs" in advance, the final data must be reviewed thoroughly to ensure accuracy.

While the distribution process varies from company to company, with some companies being very automated while others are totally manual, there is always some form of manual intervention and data input required. Manual intervention in the process necessitates the need for review. This presents a time problem since there are insufficient senior personnel available on staff that are familiar with the issues; we can't hire full time staff in order to overcome a one day a year hurdle, and assistance can't always be hired since the accounting firms face the same staff crunch that the industry faces at that time of year.

Complexity arises from the use of financial instruments such as derivatives for which the tax treatment can vary depending on their use, (i.e., whether they are used for hedging or not). As a result, even when the calculation has been automated there are usually manual reclassifications required to account for the exceptions.

At least four days to review the information is reasonable.

**4. The recommendation has to be as tax revenue neutral as possible, while meeting the practical needs and constraints of the industry.**

The Year-End Distribution Sub-Committee of IFIC reviewed many alternatives, knowing that if there was a significant tax deferral, the alternative would not be acceptable to the Department. We are aware that we are requesting a potential ongoing two-week deferral of income and capital gains. However, the absolute value deferred is small compared to the total distributions made and may also be offset to a degree by capital losses and losses from derivatives realized in the last two weeks of the year. We were also unable to identify any other acceptable alternative that meets the needs of the industry and that minimizes the potential for tax deferral.

In identifying alternatives we reviewed the practices in other countries, notably the United

States and the United Kingdom.

United States

Under the United States tax rules, the equivalent of a mutual fund trust is not subject to income tax, provided all taxable income is distributed within 12 months after the end of the tax year. Distributions are carried back to reduce taxable income of the previous year but are taxed in the investors hands when they are received. However undistributed amounts are subject to an excise tax if a required amount is not distributed, in order to reduce the deferral of tax.

In the U.S., a mutual fund trust is required to distribute the sum of:

- 98% of the ordinary income (excluding capital gains) for the calendar year, and
- 98% of the capital gains for the year ended October 31, plus any shortfall from the prior year. Further, income from derivatives is also cut off at October 31.

If the required amount is not distributed excise tax is imposed on the shortfall.

United Kingdom

In the U.K, capital gains realized from mutual funds are not subject to tax at all. The realized gains remain in the Fund, the money is reinvested and the growth compounds. Because the gains are not distributed to unitholders the net asset value per unit remains at the higher value. At the time a unitholder redeems they will realize a capital gain which is subject to tax at that time.

Regular income (i.e., other than capital gains) must be distributed, but may be deferred by one full taxation year.

As you can see, the U.S. legislation provides up to a twelve-month deferral of income and an additional two-month tax deferral on capital gains. The U.K. provides for an indefinite capital gains deferral. Our recommendations are not nearly as aggressive and we feel that our proposal is very reasonable.

**Detailed Analysis of Recommendations - Appendix B**

To meet the objectives set out in our letter to you and to solve the problems created with the

current legislation identified in Appendix A, IFIC is recommending changes to the legislation which would allow mutual fund trusts and quasi mutual fund trusts the following:

**1**. The ability to elect a cut off date of December 15 to determine:

**i)** taxable income for the twelve months ended December 15, with the exception of income from partnerships and other trusts*. The tax year-end would remain December 31.

* To minimize the deferral of income, income received or allocated to a Fund up to and including December 31 from investments in other trusts and partnerships must be included in the taxable income of the Fund for the year, regardless of the December 15 cut off date. Otherwise, "Fund on Fund" structures could be created to take advantage of the tax deferral opportunities. To ensure a Fund does not pay tax, the amount of income to be received or allocated to the Fund for the year from these underlying investments will need to be estimated.

Currently, estimates of income for the year are generally obtained through verbal communication with the issuers of the underlying investment. As an example, if a Fund held an investment in a real estate income trust ("REIT"), the manager of the REIT would be contacted prior to year-end to determine what percentage of the distribution for the year would be taxable. Wide ranges are provided by the manager such as "60 to 80% of the distribution will be taxable." Certainty of the income characteristics is not known until late January at the earliest. Due to this uncertainty and the estimations required, a conservative view is taken and the income inclusion is generally overstated. Therefore, in the example, 80% of the distribution would be included in a Fund's taxable income. We would expect this overstatement of income to continue and therefore our third recommendation outlined further on is to allow for the carry forward of excess distributions to be deducted in future years

**ii)** the capital gains refund available using the December 15 cut off date.

Once the election has been made then a Fund must be consistent in its cut off date.

For the first year a transition rule would be required to account for the period from January 1 to December 15. Subsequent years would cover a full twelve months, from December 16 to December 15 of the following year.

The ability to elect a December 15th cut off date is important since some Funds will not want to change the timing of their distributions. The reasons for this are outlined next.

- For those companies, such as banks, that do not utilize third party distribution channels for their Funds, reporting on client statements by external parties is not a concern and therefore they do not need to process the distribution before Christmas to have accurate reporting to their clients.

- Smaller investment management companies may have sufficient time on December 31 to determine the distribution with accuracy, particularly if they do not price their Funds daily they may be able to determine the number of units outstanding in advance.

- Money market funds distribute their income earned to unitholders daily. When money market funds are reviewed by investors, the net asset value per unit is not a concern since it remains constant, what changes is the daily yield. If a money market fund accrued and paid two weeks of income on one day the yield for that day and each subsequent day for which the distribution covered would be very distorted. Yields for these funds are published daily in the major newspapers.

- Some Funds have fixed distributions on specific days, i.e., on the last Friday of each calendar quarter. Many of these Funds already have a large return of capital component in their distribution and will continue to do so, therefore they may not be as concerned with having an earlier cut off date, but are more concerned with keeping the payment on a fixed date since many of their unitholders rely on the regular cashflow.

**2.** Amounts paid or payable to unitholders during the Fund's taxation year ending December 31 will continue to be deductible.

Recommendations 1 and 2 provide fund companies time to collect the information they need, determine the calculations and provide time for review before the distributions are made. This will significantly reduce the potential for error or oversight, as well as boost staff morale with the benefits associated with having more time.

During the meetings of IFIC's Year-End Distribution Sub-Committee, it was felt that most companies would elect to use the December 15 cut off date, would select a record date of the Friday before Christmas for the distribution, and would process the distribution during that weekend. In 1997 that would have allowed four business days for review, 1998 - three days and

in 1999 - two days. If the time constraints are too short, companies have the option of running the distribution over Christmas or on another weekend before the end of the year in time to get the information picked up on brokers' clients' statements.

**3.** The ability to carry forward indefinitely, distributions paid that are in excess of that which is required to eliminate any income tax payable by a Fund in a year, and to claim such excess as a deduction from taxable income in future years. This could follow rules similar to those for loss carry forwards.

Excess distributions paid in a year will be included in the income of the recipient unitholder for that year.

This is a key recommendation, because as outlined in point 1) i) above, excess distributions will continue to be made to ensure a Fund does not pay tax. The amount of the excess distribution however, will be somewhat less than it currently is, since it will generally only be required as a cushion for income from partnerships and other trusts.

However, to prevent double taxation, to avoid paying a refundable tax if applicable, and to avoid having a return of capital, the excess distribution can be carried forward by the Fund to reduce future years' taxable income. We are requesting an indefinite carry forward period since equity or growth type funds may not distribute every year (for instance if an extended market downturn is experienced and capital gains are not realized), rather they may distribute once every three to five years.

**Post Year-End Distribution**

We appreciate that the Department endeavoured to help the industry with the 30-day rule proposed in the February 1998 budget. However, as we have previously noted, that solution would inadvertently create more problems than it solves. Moving the distribution into the following year and tax receipting unitholders for the prior year is also contrary to the tax policy of taxing income based on receipt or on the right to receive (with the exception of certain debt instruments such as strip bonds.)

As indicated in the Taxation Steering Committee's earlier letter to you regarding Resolution 33, there cannot be a time lag between the record date and the payment date of the distribution that crosses over a day's net asset value per unit (navpu) calculation. This is because a distribution, or a distribution payable, changes the navpu, which determines the price paid for purchases and redemptions from the Fund in the time period in between the record and payment dates. Therefore, we cannot accommodate a record date of December 31 with a payment date later in January. In addition, most Funds' Trust Agreements state that the Funds will be valued daily. This

could not be changed without unitholder approval and we would not recommend it be changed, since it would delay the execution of investment decisions made by unitholders.

We also do not think it is feasible to have a record date and payment date in January and tax receipt investors for the previous year. The industry currently faces two problems with respect to year-end distributions:

1) Investors already feel it is inequitable that if they purchase units late in the year and they may receive a taxable distribution shortly thereafter for income and capital gains that were realized before they purchased their units.

2) As a result of the previous point, new investment is often delayed until January by unitholders who wish to avoid the year-end distribution.

   Moving the distribution to January hinders the free flow of capital by further delaying new investments by Canadians, especially during the beginning of “RRSP” season. Significant investor and advisor education has been undertaken over the years with respect to this issue. A January distribution would compound the problem and tax-receipting investors for the prior year would not be acceptable to investors, especially if they received a tax liability for a year in which they may not have owned the investment.

I look forward to our further discussions on this issue.

Yours sincerely,

"ORIGINAL SIGNED BY T. HOCKIN"

Honourable Thomas A. Hockin, P.C.
President & Chief Executive Officer