



THE INVESTMENT FUNDS INSTITUTE OF CANADA  
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

**BY EMAIL**

July 20, 2011

Mr. Gérard Lalonde  
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Dear Mr. Lalonde:

**Re: Definition of "Excluded Property" in Subsection 116(6) of the *Income Tax Act* (Canada)**

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I am writing as a follow-up to our meeting on June 2, 2010 and a discussion in March 2011 between Annemarie Humenuk and one of our members to request that subsection 116(6) of the *Income Tax Act* (Canada) (the "Act") be amended to expand the definition of "excluded property" to include "a share of a mutual fund corporation" or alternatively "a share of a public corporation" so that such shares would be "excluded property" even if they are not listed on a recognized stock exchange. This would put the shares of a mutual corporation on equal footing with the units of a mutual fund trust (as well as listed shares of a corporation) for the purposes of the withholding and notice obligations imposed under section 116 of the Act upon the acquisition of "taxable Canadian property".

**Background:**

As of December 2010, there were approximately \$636 million of assets held in Canadian mutual funds – being those investment funds regulated under National Instrument 81-102 ("NI 81-102") whose securities are not listed on a stock exchange but are redeemable daily on demand by the holder. Approximately \$36 million of those assets were held in mutual fund corporations. The remaining \$600 million were held in mutual fund trusts. There has been a 40% and 38% growth in assets held in mutual fund corporations in each of the two prior years, as compared to a 12% and 18% growth in mutual fund assets overall. Accordingly, tax issues that affect an investment in a mutual fund corporation are becoming increasingly important.

The application of section 116 to a mutual fund corporation where it does not apply to a comparable mutual fund trust has been identified by IFIC's members as an issue that unfairly favours a trust structure over a corporate structure from an investor's perspective and unduly burdens a mutual fund that is established as a corporation (as compared to a mutual fund with an identical investment mandate that is established as a trust). There does not appear to be any policy reason to treat the



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shares of a mutual fund corporation differently than the units of a mutual fund trust (and the listed shares of a corporation) in the context of the imposition of withholding tax under section 116.

Section 116 imposes a withholding tax obligation on the purchaser of "taxable Canadian property" (as defined in subsection 248(1) of the Act) when the vendor is a non-resident unless the property is "excluded property" (as defined in subsection 116(6) of the Act), the property is treaty-protected property as contemplated by subsection 116(5.01) or a certificate has been issued by the CRA pursuant to subsection 116(4). A person who acquires "excluded property" from a non-resident is exempt from the withholding and notification obligations imposed under section 116 of the Act and further is relieved of any obligation to determine the non-resident's entitlement to treaty benefits.

### **Definitions:**

"Taxable Canadian property" is defined in subsection 248(1) of the Act to include:

- (a) a share of the capital stock of a corporation that is listed on a designated stock exchange, a share of the capital stock of a mutual fund corporation or a unit of a mutual fund trust, if, at any particular time during the 60-month period that ends at that time,
- (b) 25% or more of the issued shares of any class of the capital stock of the corporation, or 25% or more of the issued units of the trust, as the case may be, were owned by or belonged to one or any combination of:
  - (A) the taxpayer; and
  - (B) persons with whom the taxpayer did not deal at arm's length; and
  - (C) more than 50% of the fair market value of the share or unit, as the case may be, was derived directly or indirectly from one or any combination of properties described under subparagraphs (d)(i) to (iv) [which are: (i) real or immovable property situated in Canada, (ii) Canadian resource properties, (iii) timber resource properties, and (iv) options in respect of, or interests in, or for civil law rights in, property described in any of subparagraphs (i) to (iii), whether or not the property exists].

"Excluded property" is defined in subsection 116(6) of the Act to include, among other things, shares listed on a recognized stock exchange, units of a mutual fund trust and treaty-protected property. Shares of a mutual fund corporation are not "excluded property" (unless listed on a recognized stock exchange or treaty-protected property).

"Mutual fund corporation" is defined in sub-section 131(8) of the Act, which requires, among other things, that the corporation be a public corporation and that at least 95% of the fair market value of the issued shares of the corporation be redeemable on demand of the holders. "Public corporation" is defined in subsection 89(1) of the Act to mean a Canadian resident corporation where either:



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- (a) a class of its shares are listed on a designated stock exchange in Canada, or
- (b) the corporation has elected in respect of a class of its shares that are qualified for distribution to the public under securities law and which have a sufficient number of shareholders.

NI 81-102 mutual fund corporations achieve their "public corporation" status under the Act by election. Their shares are not listed on a stock exchange.

**Rationale:**

A mutual fund can be established as a trust or a corporation. In either case, the mutual fund is subject to the same securities law regulation. In either case, securities of the mutual fund must be redeemable on demand of the holder so, when securities are redeemed, the mutual fund is the purchaser and the person liable to withhold tax under section 116. A mutual fund can readily determine whether more than 50% of the fair market value of the security derives its value from Canadian real property or Canadian oil, gas, mineral or timber properties. However, a mutual fund cannot determine whether 25% of its issued shares are or have been within the last 60 months held by a related group that includes a particular shareholder. In other words, a mutual fund (whether a corporation or a trust) cannot usually determine with certainty whether its securities are taxable Canadian property to a particular security holder. Further, it is difficult to determine with certainty whether a particular security holder is eligible for treaty benefits -- especially given the new Limitation of Benefits clause in Article XXIXA of the Canada-US Tax Convention. The risk associated with the failure to withhold is imposed on the mutual fund and the cost is effectively borne by the security holders who remain invested in the mutual fund after the non-resident redeemer has departed. To eliminate this risk, a mutual fund corporation would be required to either delay the processing of a redemption request made by a non-resident by several months until a section 116 certificate can be obtained or to withhold 25% of the proceeds of redemption. Both of these alternatives act as an impediment to investing in a mutual fund corporation especially when compared to an investment fund with an identical investment mandate that is established as a mutual fund trust or that has listed its securities on a designated stock exchange.

I would be pleased to discuss this with you at your convenience.

Yours sincerely,



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