By e-mail to itrulingsdirectorate@ccra-adrc.gc.ca

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Income Tax Rulings Directorate
Policy and Legislation Branch
Canada Revenue Agency
16th Floor
Place de Ville, Tower A
320 Queen Street
Ottawa, ON K1A OL5

Dear Sir/Madam:

Re: Technical Interpretation Request on Deferred Sales Charge ("DSC") Rebate Made to a Tax-Free Savings Account ("TFSA")

As suggested by the Registered Plans Directorate, I am writing to you on behalf of The Investment Funds Institute of Canada ("IFIC") to request a technical interpretation on the tax treatment of a deferred sales charge rebate made to the newly introduced Tax-Free Savings Account. IFIC is the voice of Canada's investment funds industry and includes fund managers, retail distributors of funds and service organizations that work in a co-operative forum to enhance the integrity and growth of the industry and strengthen investor confidence. The Canadian mutual fund industry has been instrumental in helping individuals save for their future for over seventy-five years and we anticipate that mutual fund securities will become a popular investment for TFSAs to hold.

Following is an excerpt from a document published on the Canada Revenue Agency's ("CRA's") website titled "Questions and answers about Tax-Free Savings Accounts – Information for issuers" setting out the CRA's position on the tax treatment of certain TFSA fees:

> ***"Q 6.1 How will TFSA fees be treated****?*
>
> *A 6.1 The payment of management fees by the holder that relate to a TFSA trust will not constitute a contribution to the TFSA and the payment of investment counsel fees by a TFSA trust will not result in a distribution from the TFSA trust. Any fees paid are not deductible for income tax purposes.*
>
> *Note*
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> *The position adopted for TFSAs is based on CRA's current position concerning trusteed RRSP fees. If there are questions on the treatment of other types of fees, please write to the Income Tax Rulings Directorate."*

The purpose of this request is to ask your department to confirm that a DSC rebate (as described in paragraph 8 below) to a TFSA is not an advantage as defined under subsection 207.01(1) of the *Income Tax Act (Canada)* ("ITA") and is not a contribution made by the holder of the TFSA.

Facts:

1. "Mutual Fund" means an open-end mutual fund trust or corporation within the meaning of subsections 132(6) and 131(8) of the ITA and "Securities" means units or shares of a Mutual Fund.

2. "Securities Dealer" or "Dealer" means a registered securities dealer as defined in subsection 248(1) of the ITA.

3. The manager of a particular Mutual Fund ("Manager") is responsible for the management and administration of the Mutual Fund including the distribution of Securities.

4. The capital of a Mutual Fund is divided into Securities, which are offered for sale to the public, pursuant to the terms of a prospectus, on a continuous basis through the Manager or by Securities Dealers as distribution agents. The Securities are sold or redeemed at a price that is generally equal to the net asset value per Security as of the date of the purchase or redemption respectively. Securities can only be purchased from, and sold to, the Mutual Fund.

5. A Securities Dealer acts as an agent for its clients.

6. Mutual Fund Securities sold through Dealers can be purchased by investors under the deferred sales charge purchase option. Under this option, an investor does not pay any fees or commission at the time of purchase of Securities but the Dealer is paid a commission (the "DSC Commission") by the Manager at the time of purchase. The DSC Commission is typically in the range of two to five per cent of the purchase value. An investor generally agrees at the time of the purchase to pay a deferred sales charge at the time of redemption if the Securities are redeemed within a specified period of time. Generally, the deferred sales charge declines every year such that, if the Securities are not redeemed until after the specified time period, no deferred sales charge is levied.

7. An example of a transaction where an investor purchases Securities under the deferred sales charge option is as follows:

    (i) The investor requests the Dealer to purchase a specified dollar value of Securities of a particular Mutual Fund. The investor agrees to purchase the Securities on the basis of the terms and conditions set out in the relevant prospectus.

    (ii) The Dealer executes the purchase by transferring the investor's money to the Mutual Fund and transferring Securities of the Mutual Fund to the investor's account with the Dealer.

    (iii) The Manager pays the applicable DSC Commission to the Dealer in respect of the purchase.

8. In an open market in which parties deal with each other at arm's length and act prudently, knowledgeably and willingly, a Dealer may sometimes make a reasonable payment (the "DSC Rebate"), equal to a portion of the DSC Commission received in 7(iii), to the investor's account in connection with the purchase. The Dealer normally satisfies the rebate payment through the purchase of additional Securities of the applicable Mutual Fund in the investor's account. The account can be any type of account, including a registered retirement savings plan ("RRSP"), a registered retirement income fund ("RRIF") or a TFSA. The purpose of the DSC Rebate is to reduce the amount of deferred sales charge that was or may be incurred by the account upon redemption of Securities. Rebating of deferred sales charges generally occurs when an investor is encouraged by a Dealer to redeem Securities of one Mutual Fund Manager and use the proceeds to purchase Securities offered by another Mutual Fund Manager. The DSC Rebate partially or wholly compensates the account for the deferred sales charge levied by the first Manager. A DSC Rebate may also be paid where there is no redemption of Securities. In both cases, the Dealer makes the payment in the course of providing an improved service to its clients and generating income for the Dealer. For certainty, the main purpose of the DSC Rebate is not to enable the investor, or a person related to him or her, to be exempt from tax under Part I of the ITA of any amount in respect of the investor's account.

Please note that your department previously provided a ruling on the tax treatment of a similar DSC Rebate to an RRSP by a securities dealer on November 29, 1999 (document number 9830623). CRA concluded that the rebate was not an advantage or a gift, that it did not give rise to taxation of the annuitant and was not a premium. A similar ruling (document number 9832893, dated November 29, 1999) was provided in the context of a RRIF where the rebate was concluded not to be consideration under the plan nor a gift to the plan. Both rulings were subject to the proviso that the DSC Rebate was paid directly into the RRSP or RRIF and not to the annuitant.

As our Members are currently promoting and supporting TFSAs, we would appreciate if the Income Tax Rulings Directorate could confirm at its earliest convenience that a DSC Rebate made directly to a TFSA is not an advantage as defined under subsection 207.01(1) of the ITA and is not a contribution made by the holder of the TFSA. Should you require any clarification or additional information on this issue, please contact Barbara Amsden (bamsden@ific.ca; (416) 309-2323). Thank you for your consideration of this request.

Yours sincerely,

Cc: André Gauthier