THE INVESTMENT FUNDS INSTITUTE OF CANADA
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BY FAX (613-992-4450)

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Mr Brian Ernewein
Director
Tax Policy Branch
Department of Finance Canada
140 O'Connor Street
Ottawa, Ontario
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Dear Brian:

Re: Alternate Minimum Tax on Unit Trusts

This submission addresses technical issues with respect to the Alternative Minimum Tax ("AMT") contained in Division E.1 of the *Income Tax Act* (Canada).

AMT is not applicable to certain trusts including a mutual fund trust, a segregated fund trust and a master trust, to name a few, but is applicable to a unit trust. Like mutual fund trusts, a unit trust is a flow through vehicle that pays out all its income to its unitholders to eliminate being taxed in the trust. The unitholders will then pay tax on this income based on their marginal tax rate. An example of where AMT can arise is when management fees are applied against capital gains.

AMT can only be recovered by the trust by applying against regular taxes owing.

Tax Consequences to Unit Trusts

Requiring unit trusts to pay AMT causes the following unintended consequences:

- Cash leaves the trust causing decreased performance.
- A unit trust is intended to be a flow through vehicle and AMT goes against this principle.
- As a flow through vehicle, the trust will have difficulty in recovering the AMT. This is inconsistent with the principle that AMT should be recoverable if regular tax is paid in the future.
- The trust can only recover the AMT if it employs the strategy of distributing less than its net income causing the trust to be subject to regular taxes owing. Should it employ this strategy, there is a mismatch in unitholders between when the strategy is employed and when the AMT is paid.

- Many declarations of trusts require that the trust pay enough distributions to avoid Part I tax and therefore the trust may have no means of recovering the AMT.
- The tax causes unintended results to non-taxable investors, such as pension funds, which the government has exempted from paying tax. Due to the AMT paid by the fund, the non-taxable investor has now been subject to tax.
- Double taxation could result as the investor and unit trust are both subject to AMT.

Recommendations

For the reasons noted above, we request that Units Trusts be exempted from AMT. In addition, given the continued growth in the investment fund industry since 1986, when the AMT came into existence, the tax will become more of an issue for the industry and its investors.

Should the exemption from AMT not be granted, we propose other alternatives including:

(1) Look through provisions be allowed for unit trusts to allow them to count the individual pensioners that comprise a pension plan towards the existing 150 unitholder requirement since currently the pension client only counts as one client, or

(2) The current requirement of 150 unitholders to attain mutual fund trust status should be reduced to 20 investors for unit trusts as unit trust investors are required to invest larger amounts as compared to retail mutual funds. This would be consistent with the request made last year by the Investment Counsel Association of Canada.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

John Parker
Vice President & CFO