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

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Honorable Senators:

Re: Senate Finance Committee's Request for Input on Improving the U.S. Tax Code - Comments regarding Territorial Taxation and the Passive Foreign Investment Corporation Rules

The Investment Funds Institute of Canada ("IFIC") supports the efforts of the Senate Finance Committee to seek ways to make the United States ("U.S.") Tax Code simpler, fairer and more efficient and appreciates the opportunity to provide our comments on this initiative. We believe this initiative offers the prospect of resolving our concerns with the Passive Foreign Investment Corporation ("PFIC") rules which discourage the one million Canadian-resident U.S. taxpayers from owning Canadian mutual funds.

About IFIC

IFIC is the association representing Canada's investment funds industry. The organization is proud to have served the industry and its investors for more than 50 years. IFIC brings together 150 organizations, including fund managers, distributors and industry service organizations, to foster a strong, stable investment sector where investors can realize their financial goals. Over 34% of Canadian households hold mutual funds. Mutual funds currently account for 31% of Canadians' financial wealth. Recent independent research confirms that, to meet their financial goals, Canadians have greater confidence in mutual funds (85%) than other financial products such as bonds (55%) and stocks (65%).

As of February 27, 2015, the mutual fund industry in Canada represented about $1.22 trillion CAD in total assets under management in highly-regulated, publicly offered mutual funds.

A Territorial Approach

We understand the Committee is considering the merits of moving the U.S. tax system to a territorial regime as a possible approach to advancing Chairman Hatch's Seven Principles for Comprehensive Tax Reform (the reform should embrace economic growth, fairness, simplicity, permanence, competitiveness, promoting savings and investments, and revenue neutrality). A territorial tax regime would eliminate the difficulties that the PFIC rules create for Canadian-resident U.S. taxpayers, and the disincentive these rules create for investments by these taxpayers in Canadian mutual funds (one of the most relied upon investment vehicles for Canadians), and the potential loss of investment and savings opportunities that these mutual funds provide.

We receive significant feedback from U.S. taxpayers living in Canada about the complexity and cost of complying with their U.S. tax obligations – especially since the introduction of the Foreign Account Tax Compliance Act ("FATCA"). The tax compliance regime for U.S. foreign nationals has continued to grow more complex with the introduction of new forms and requirements – this growing complexity adds expansionary pressures on the IRS' resources responsible for administering the regime.

As the Committee is aware, the U.S. is the only nation to tax its citizens on worldwide income regardless of where they are resident.

It is estimated that there are five to seven million U.S. taxpayers who live abroad - approximately one million of them live in Canada. Due to the complexity involved with preparing and filing U.S. tax returns and determining the forms required based on a taxpayer's investment portfolio, Canadian-resident U.S. taxpayers must often retain tax professionals versed in cross-border tax issues to prepare their U.S. tax and disclosure returns. This is an expensive annual proposition for millions of U.S. persons worldwide for a process that often results in only nominal incremental U.S. tax revenue.

Canada is one of a number of countries having higher federal marginal tax rates than the U.S. In addition to federal tax, taxpayers living in Canada pay provincial income tax. A Canadian-resident U.S. taxpayer is liable in the U.S. for federal and not state taxes. Therefore, once the credit for foreign taxes paid is factored in determining the liability for U.S. taxes there is often little or no additional tax owing to the IRS.

In the spirit of the Seven Principles, IFIC respectfully asks the Committee to examine whether the administration of tax reporting by non-residents and the additional compliance costs for U.S. taxpayers living abroad is fair, simple or even fiscally worthwhile? Converting to a Territorial Tax System that taxes based on residence would meet the Committee's fairness and simplicity objectives, while eliminating much of the cost burden for non-resident U.S. taxpayers.

Request for Assistance regarding PFIC Rules

A U.S. move to a Territorial Tax System would resolve the current PFIC issue. However as this would require a significant legislative change which might not be achieved, we are, in the alternative, seeking a legislative amendment to exempt certain Canadian mutual funds (as defined below) from the definition of "passive foreign investment companies"[1] in the U.S. tax legislation.

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[1] A PFIC is a non-U.S. corporation that earns at least 75% of its income in the form of passive income, such as interest and dividends in a taxation year. Alternatively a corporation is a PFIC if the average percentage of assets it holds which produce passive income is at least 50% during a taxation year.

We believe that Canadian mutual funds ("CMFs") regulated under National Instrument 81-102, *Investment Funds* (the main regulation governing investment fund formation and operations - the functional equivalent of the Investment Company Act of 1940) should not be subject to the PFIC rules for non-U.S. resident U.S. taxpayers who are residents of Canada; CMFs should be expressly excluded from the definition of "PFIC" in 26 U.S. Code § 1297.

CMFs, like U.S. regulated investment companies ("RICs"), are highly popular, mainstream financial products that provide the advantages that come from the pooling of assets, affordable professional fund management and advice, and risk diversification that millions of Canadians have long depended on to save through participation in the capital markets. In most cases Canadian residents cannot purchase U.S. mutual funds from U.S. broker/dealers because of restrictions in the Canadian securities laws and the U.S. state "blue sky" laws. The unavailability of U.S. funds and the disincentive to own Canadian funds truly restricts these taxpayers' access to retail mutual funds. As residents of Canada, such U.S. taxpayers should have unrestricted access to CMFs; they should not have to arbitrarily avoid them due to the impact of the PFIC rules.

CMFs operate, and flow through their income to unitholders, on substantially the same basis as RICs and therefore do not provide investors with significant income deferral opportunities. The regulatory and tax comparability of RICs and CMFs should provide comfort from a policy perspective that granting the requested exemption would not unfairly place non-resident U.S. investors in a better position than U.S. resident investors.

The implementation of FATCA adds urgency to resolution of this issue since more such U.S. persons are becoming better aware of their U.S tax reporting obligations and the negative tax implications of holding a CMF that is taxed as a PFIC, which may cause them to seek to eliminate their CMF investment holdings.

Exempting CMFs from the PFIC rules would permit U.S. persons who are Canadian residents to continue to invest in CMFs and would simplify their U.S. tax reporting[2] without providing them with any significant tax deferral. We estimate the maximum impact to the U.S. Treasury of such an exemption to be $1.44 million USD a year. An exemption should also produce cost savings for the IRS as it would be able to administer a simpler reporting process in relation to Canadian-resident U.S taxpayers. There would be no loss in information being received, since the Canada Revenue Agency will, under the FATCA Intergovernmental Agreement ("IGA") between Canada and the U.S., be providing the IRS with annual information on accounts held in Canada by Canadian-resident U.S. taxpayers.

Such an exemption from the PFIC rules could be applied globally if retail mutual funds in the country of origin meet the following criteria:

- Annual income and capital gains must be flowed through to investors in substantially the same way as RICs (to ensure that deferral of taxation does not occur);
- Marginal income tax rates (federal and state/provincial combined) in the country of origin must be substantially at the same level as, or higher than, U.S. federal marginal income tax rates;
- The tax regime in the country of origin must be similar to the U.S. regime (including that the country of origin taxes capital gains); and
- The retail mutual funds in the country of origin are regulated in a comparable manner to RIC's.

[2] Under our proposal, in preparing their U.S. tax returns, Canadian-resident U.S. taxpayers would use the interest, dividend, capital gains and return of capital amounts as reported on the Canadian tax information slips provided by the CMFs. These investors have the information they require to calculate capital gains and losses in dispositions of CMF holdings in the manner that conforms to U.S. tax principles.

In 2014, IFIC met with senior staff from the Senate Finance Committee, the House Committee on Ways and Means, the U.S. Treasury and the Joint Committee on Taxation to discuss the issue. These officials generally agreed that IFIC has identified a legitimate policy issue that impacts Americans living abroad. We hope this support can translate into a legislative initiative to resolve this issue through an exemption.

Background on Treatment of PFICs

U.S. tax law imposes a special regime governing the taxation of income earned by U.S. citizens, green card holders, corporations, and other U.S. residents (collectively referred to as "U.S. taxpayers") on income earned from a PFIC. For each investment in a PFIC U.S. taxpayers are required to file Form 8621*, Information Return of a Shareholder in a Passive Foreign Investment Company or Qualified Electing Fund*, as part of their U.S. federal income tax return each year. The IRS generally treats CMFs as foreign corporations for U.S. tax purposes. As a result, given the nature of the income earned, and the assets held by such funds, CMFs are typically treated as PFICs for U.S. tax purposes unless they are held in Canadian Registered Retirement Savings Plans or Registered Retirement Income Funds.

This result has a significant adverse impact on Canadian-resident U.S. taxpayers who invest in CMFs. It is generally accepted that over one million Canadian residents hold U.S. citizenship through birth or ancestry. U.S. tax law treats these Canadians as U.S. taxpayers, and they are subject to U.S. tax on their worldwide income including their investments in CMFs. Moreover, the PFIC provisions can impose significant administrative burdens upon the CMFs themselves, as they try to meet the U.S. specified information requirements to support the QEF election that Canadian-resident U.S. investors may want to make. It is important to emphasize that the Canadian-resident U.S. taxpayer cannot influence whether or not the CMF will provide the specified PFIC Annual Information Statements.

How the PFIC Rules Tax Canadian-Resident U.S. Taxpayers' Holdings in CMFs

On the sale of CMFs, or upon certain distributions from CMFs, the PFIC rules generally tax Canadian-resident U.S. taxpayers at the highest tax rates that apply to earned income (see Appendix B for U.S. tax rates), as opposed to the lower tax rates that apply to capital gains (i.e., up to 20%), regardless of the Canadian-resident U.S. taxpayer's tax bracket. Further, the gain is deemed to be earned on a *pro-rata* basis throughout the Canadian-resident U.S. taxpayer's holding period of the CMF, and amounts allocated to prior years cannot be reduced by any available deductions. Finally, a tax-deficiency interest charge is added to the Canadian-resident U.S. taxpayer's tax liability.

This method of taxation has the effect of discouraging Canadian-resident U.S. taxpayers from investing in CMFs. A Canadian-resident U.S. taxpayer is able to elect out of this tax regime by one of two elections: (a) the "mark-to-market" election, or (b) the QEF election or "section 1295 election". The "mark-to-market" election is generally unattractive to Canadian-resident U.S. taxpayers (even when it is an available option) since the gains are taxed as ordinary income and not as capital gains. While the QEF election is intended to make the PFIC comparable to a RIC, the ability to make this election depends on whether the Canadian fund manager can obtain and is willing to provide the necessary information relating to the PFIC. This is an administrative burden not all Canadian fund managers are prepared to assume. Further, even if the QEF election is available and is made, the tax compliance costs to the Canadian-resident U.S. taxpayer can be significant - each Form 8621 that needs to be prepared raises the costs of tax return preparation. Thus, even if the QEF information is available, there is a disincentive to own CMFs.

Distribution of Mutual Fund Securities to Canadian Residents

As was noted earlier, Canadian-resident U.S. taxpayers do not have the option of simply purchasing U.S. mutual funds to avoid the PFIC tax and reporting obligations. To explain why, we provide some background on the Canadian securities laws and the regulatory structure governing mutual funds and their distribution.

Structure for Regulating Distribution of Mutual Funds

Appendix A contains an analysis showing the high degree of comparability in the structure, operations and investor protections, and in the product regulatory oversight, between Canadian and U.S. mutual funds. The analysis below will show that, despite some differences in structure, the regulatory regime by which the distribution of mutual funds in Canada is regulated also compares very closely to the regime in the U.S. applying to U.S. funds.

In Canada the securities commission in each province and territory regulates the distribution in its jurisdiction of securities, including mutual fund securities. The securities regulators under the umbrella of the Canadian Securities Administrators ("CSA") described in Appendix A, have achieved consistent rules governing the industry, and reasonably coordinated oversight. The securities commissions have established requirements governing the admission of firms and representatives, notably the education, qualification and compliance requirements of mutual fund dealer firms, key firm personnel and all sales representatives. The securities commissions have delegated the day-to-day oversight of dealers and representatives to self-regulatory organizations ("SROs"). Oversight of dealers and representatives who offer mainly mutual fund securities is the responsibility of the Mutual Fund Dealers Association of Canada ("MFDA"), except in Quebec where oversight falls uniquely to the Chambre de la sécurité financière ("CSF"). National oversight of investment dealers and their representatives is the responsibility of the Investment Industry Regulatory Organization of Canada ("IIROC").

The primary functions of these SROs include setting regulatory standards for their members; auditing members for compliance with those standards; investigating complaints and taking enforcement action when necessary. IIROC also confirms that advisors and sales representatives meet minimum educational and qualification standards to be licensed. The SROs have the power to impose standards that are higher than the broad standards set by securities laws.

General Requirements for Distribution

Firms that wish to publicly distribute securities in Canada must register as dealers if they are "in the business of trading in securities". This usually occurs when firms are: carrying on the kinds of activities normally performed by a broker or dealer; intermediating trades in securities between sellers and buyers; engaging in regular trading activities; receiving compensation for such activities, or contacting anyone to solicit trades in securities.

Depending on the type of securities to be traded, firms will need to register in one or more of the categories of investment dealer, mutual fund dealer and/or exempt market dealer.

A U.S. registered broker-dealer can seek qualification as an international dealer in Canada, but this will allow it to trade only securities of non-Canadian companies or funds to Canadian institutional investors and high-net-worth individuals who qualify as permitted clients. International dealer status is essentially an exemption from registration, so none of the usual requirements to register as a dealer in Canada will apply. However, sales to retail clients are only permitted by firms that are fully registered as dealers in Canada, meeting all of the structural and operational requirements, including appointing an ultimate designated person and chief compliance officer who meet the necessary education and experience requirements. In addition, all individuals who act as salespersons for the firm will have to meet the registration and minimum education and experience requirements applicable to the desired category of representative in each case. The applicable requirements are listed in National Instrument 31-103 *Registration Requirements and Exemptions* and, for investment dealers and their representatives, in the IIROC Dealer Member Rules.

In parallel, U.S. State "blue sky" laws create essentially the same regulatory structure governing the distribution of securities to residents of each State. Typically a dealer firm and its sales representatives cannot sell a security to a U.S.-resident investor absent compliance with the blue sky laws of the State in which the investor lives. These laws typically require that the dealer and the dealer's representatives, who wish to offer securities to investors within that State, must formally register as a dealer and as representatives with that State's securities commission. Some States impose no requirements, while others offer qualified exemptions that require the dealer and its representatives to make regulatory filings and meet other requirements before being permitted to transact with a resident of the State.

Mutual Fund Sales to Canadian-Resident U.S. Taxpayers

Canadian-resident U.S. taxpayers are able to purchase CMF securities through registered representatives of Canadian registered dealers on the strength of their Canadian residence address. The account opening process, including due diligence for anti-money laundering, know-your-client and suitability, will be the same as for any other Canadian resident. However, for FATCA compliance purposes, dealers will now be obtaining more information regarding U.S. tax status; in the event special monitoring or reporting may be required in relation to a particular client.

By contrast, securities of U.S. mutual funds are not typically available to Canadian residents, whether or not they are U.S. citizens, due to a combination of the Canadian law product requirements (described below and in Appendix A) and the dealer registration reasons described earlier. Canadian securities laws do not permit U.S. mutual fund securities to publicly offer their securities to Canadian residents unless the funds are first qualified as mutual funds in Canada, and unless the manager is duly registered as an investment fund manager, in each applicable province, as outlined in Appendix A. These fund qualification requirements include the need to file a prospectus., annual information form and a Fund Facts that are compliant with National Instrument 81-101, the need for the fund to operate in accordance with the investment restrictions and operational requirements of National Instrument 81-102 and the need for the fund to meet all of the continuous disclosure requirements in National Instrument 81-106. These fund qualification requirements are typically too burdensome for U.S. funds to attempt for what may be limited sales in Canada.

In addition, and likely because of the absence of U.S. mutual funds qualified to be distributed in Canada as noted above, most U.S. broker-dealers do not bother with the Canadian dealer registration process described earlier. These entities tend to participate only in the Canadian exempt market, offering prospectus-exempt products to qualified investors.

It is a fact that Canadian residents do have some access to U.S. Exchange-Traded Funds ("ETFs") that are listed on the New York Stock Exchange. Such funds can be purchased without advice through an online account with a Canadian discount broker that has met the dealer requirements in the U.S. and that has direct trading access to the NYSE. We would submit that this availability of U.S. ETFs for U.S. citizens living in Canada is not a genuine substitute for the vast selection of CMFs that are available to them locally and the professional advice which they receive when purchasing CMFs through registered dealers. The international dealer registration exemptions, by which prospectus.-exempt U.S. securities can be offered to certain Canadian high net worth or qualified investors are not available to those investors most impacted by PFIC, the individual retail investors. As such, our analysis focuses on individual retail investors who wish to purchase prospectus-qualified mutual funds.

Comparison of the Taxation of RICs and CMFs

There are many similarities in the methods by which RICs and CMFs are taxed. Fundamentally RICs and CMFs are both designed as flow-through vehicles[3].

In order to qualify for flow-through status, a U.S. mutual fund must distribute at least 90% of its ordinary income in any taxable year. While a U.S. mutual fund is not required to distribute its net long-term capital gains, any such gains and up to 10% of ordinary income retained is taxed at the regular corporate tax rates. Therefore, there is a disincentive for the fund to retain income. The amounts

[3] Canadian mutual fund corporations are generally flow-through vehicles, however the mechanics of the flow-through differ from mutual fund trusts. Mutual funds structured as trusts comprise 80% of the Canadian market.

distributed to the investor are taxed in the investor's hands at the ordinary income rate or capital gains rate as applicable.

Although not required by statute, as a matter of practice and fiduciary responsibility, CMFs flow current year's income and capital gains through to the investor. As with RICs, there is a disincentive to retain income and capital gains in the fund so as to avoid the top marginal tax rate that would otherwise be applied to the amounts retained. The investor pays Canadian income tax on the distribution received based on the individual's own marginal tax rate for dividends, interest and capital gains as applicable (see Appendix C for Canadian tax rates).

As similar as the tax regimes are for funds in the U.S. and Canada there are some notable differences of both a timing and permanent nature.

Timing Differences

Calculation of Cost Basis

The U.S. tax rules generally require gains and losses on investments held by a RIC to be accounted for on a first-in first-out ("FIFO") basis, in contrast to the average cost method used for Canadian tax reporting by CMFs. Accordingly, although gains or losses will, in aggregate, be equal in both jurisdictions, the timing of recognition of these gains and losses will most likely differ. Whether or not FIFO accelerates the recognition of a gain or loss is dependent on the directional movement of the markets.

Capital Gains Refund Mechanism

Funds can accumulate large unrealized capital gains in their portfolios – referred to as "tax overhang". New investors in effect "buy" those potential future taxes when they invest in the fund. Although there is no double tax, these investors pay tax earlier than would otherwise have been required. Using a prescribed formula known as the Capital Gains Refund Mechanism ("CGRM"), a Canadian fund may retain capital gains and not have these gains subject to tax in the fund. The CGRM recognizes the gains realized in the year attributable to the redeeming investor.

"Equalization" is available to RICs as part of the dividends-paid deduction to equalize the share of earnings and profits between investors who hold their units at the end of the year and those who redeem during the year. However, the rules for the computation of equalization payments are not as well developed as the Canadian CGRM, though they appear to function in roughly similar ways. "Equalization" is discretionary on the part of the fund manager and is not widely adopted in the industry.

Permanent Difference

U.S. tax rules require that capital gains and losses on the sale of investments be segregated into short-term capital gains (i.e. where the holding period was one year or less) and long-term capital gains. Short-term capital gains are taxed as ordinary earnings and are not eligible for the capital gains tax rate. There is no corresponding Canadian requirement to segregate capital gains on the basis of holding period. However, as FIFO is used for purposes of determining the holding period, it is likely the holding periods will be longer because FIFO requires the disposition of the earliest property first.

Potential Impact on Income Tax Receipts of the U.S. Treasury

The PFIC rules were introduced to deter U.S. taxpayers from deferring tax by investing in foreign investment entities and to limit the deferral of U.S. tax on passive income. The QEF election was provided to mitigate the negative impacts of holding a PFIC. Under the QEF regime, investors are taxed on their pro-rata share of the PFIC's ordinary earnings and net capital gains in U.S. dollars computed according to U.S. tax principles, as opposed to being subject to the punitive results of the "Excess Distribution" or default regime. Therefore, in quantifying the impact to the U.S. Treasury of exempting CMFs from the PFIC rules, tax collected under the QEF election is used as the frame of reference.

The most significant difference between Canadian and U.S. taxation methods is the treatment of capital gains. To determine the potential leakage to the U.S. Treasury there are four components that need to be considered. First, one must determine the amount of market growth within the fund that investors realize when they redeem their units. Second, one must calculate the taxation of net capital gains realized within the fund as it trades its portfolio of securities. These net capital gains are flowed through to investors and are reported to them on their Canadian tax reporting slips. Third, one needs to apply differences in the marginal income tax rates between Canada and the U.S. Tax rates are generally higher in Canada, particularly when taking into account that U.S. persons living in Canada pay provincial income taxes in addition to federal taxes on their capital gains, whereas there would be no corresponding U.S. state taxes. Fourth, one must apply the currency conversion into U.S. dollars of capital gains earned in Canadian dollars.

Investors have the information they require to calculate the gains or losses on dispositions of their CMF holdings in a manner that conforms to U.S. tax principles, including determining the cost basis and segregating between short-term and long-term capital gains. Therefore, there should be no leakage to the U.S. Treasury with respect to the tax on capital gains or losses of CMF holdings. However, it is only with respect to the flow through of the gains realized within a CMF where leakage to the U.S. Treasury may occur. Nevertheless, our detailed calculations in Appendix D, supported by the reasonable assumptions itemized below the calculations, indicate that the total exposure to the annual income tax receipts of the U.S. Treasury resulting from the provision of an exemption from PFIC to Canadian-resident U.S. taxpayers holding CMFs is approximately $1.44 million USD, before taking into account the IRS administrative cost savings that would result from an exemption.

Conclusion

As noted at the outset of this submission, if the U.S. were able to move to a territorial tax system then the PFIC issue would be resolved. Taxing based on residency would be beneficial in that it would remove a significant amount of administration for both U.S. taxpayers living abroad and the IRS. Failing that, providing Canadian-resident U.S. taxpayers who hold CMFs with an exemption from the PFIC requirements would be good public policy. We acknowledge such an exemption would have a revenue impact to the U.S. Treasury, however our calculations suggest this impact will be nominal as noted above.

Compliance simplification would benefit U.S. taxpayers resident in Canada by eliminating their unique PFIC filing obligations, while still providing their tax and account information to the IRS through the procedures agreed upon in the U.S./Canadian IGA for FATCA. The exemption would allow the IRS to substantially reduce the resources devoted to PFIC administration, at a time when additional resources will be required to manage the additional data generated by global FATCA reporting. We have provided background to demonstrate that from a regulatory and taxation perspective, CMFs are substantially similar to RICs. We have also provided the most complete industry-wide numbers available to U.S. to demonstrate that the impact of providing an exemption would not have a significant negative revenue impact.

The tax consequences and compliance burden of holding CMFs and the inability to purchase U.S. mutual funds certainly deter Canadian-resident U.S. taxpayers from investing in retail mutual funds. The implementation of FATCA, which began on July 1, 2014, is exacerbating the issue further.

IFIC was encouraged that our meetings with key stakeholders: Senate Finance Committee Staffers, the House Ways and Means Committee Staffers, the U.S. Treasury and the Joint Committee on Taxation officials led to a general recognition by the parties that the current PFIC regime is making it difficult for Canadian-resident U.S. taxpayers to invest in CMFs. IFIC believes it is good public policy to allow these investors to have access to CMFs and the benefits they bring through the pooling of assets, professional advice, management and diversification.

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If after reviewing our submission you should have any questions, or if you require any additional information please contact James Carman, IFIC's Senior Policy Advisor, Taxation by email at jcarman@ific.ca or by phone at 416-309-2323.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

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Appendix A

Comparability of CMFs to RICs

Securities Law Perspective

IFIC is providing this information to demonstrate the comparability to U.S. mutual funds (open-ended investment companies registered under the Investment Company Act of 1940) of Canadian open-ended investment funds substantively regulated under National Instrument 81-102, *Investment Funds* (referred to in this submission as Canadian mutual funds or CMFs), being among the most common of the savings and investment vehicles offered to the public in Canada.

As shown below, CMFs follow regulatory rules that have a high level of comparability with the rules regulating U.S. mutual funds. Part I below presents the characteristics of U.S. mutual funds. Part II presents the characteristics of CMFs and how they compare to U.S. mutual funds.

I. Key Regulatory Characteristics of U.S. mutual funds.

U.S. mutual funds are registered under the Investment Company Act of 1940 as "open-end investment companies." Shares of U.S. mutual funds are generally available for purchase every day pursuant to a public offering. In all cases, U.S. mutual fund shares are redeemable upon shareholder demand.

U.S. mutual funds are regulated under four U.S. securities laws; the Securities Act of 1933 (which requires registration of the fund's shares and the delivery of a prospectus); the Securities Exchange Act of 1934 (which regulates the trading, purchase and sale of fund shares and establishes anti-fraud standards governing such trading); the Investment Advisers Act of 1940 (which regulates the conduct of mutual fund investment advisers and requires them to register with the SEC); and the Investment Company Act of 1940 ("Investment Company Act") (which requires all mutual funds to register with the SEC and to meet certain operating standards).

Each U.S. mutual fund is a separate legal entity, organized under state law either as a corporation or a business trust. Mutual funds have officers and directors (if the fund is a corporation) or trustees (if the fund is a business trust). The Investment Company Act requires at least 40 percent of the members of a fund board to be independent from fund management.

U.S. mutual funds are characterized by the following features:

a) **Object:** U.S. mutual funds are created with the sole object of collective investment of capital raised through public and non-public offering in transferable securities and other liquid financial assets; they operate on the principle of risk-spreading by pooling investments from many investors and permitting investors to acquire interests in diversified fund portfolios.

b) **Valuation and Liquidity:** U.S. mutual funds offer shareholders liquidity and objective, market-based valuation of their investments. Mutual fund shares can be purchased or sold on a daily basis at a price that reflects the current market value of the fund's portfolio securities; these values are calculated according to the requirements of the Investment Company Act and the policies established by each fund's board of directors. The daily valuation process results in a net asset value (NAV) for the mutual fund - the price used for share transactions (purchases, sales (redemptions), and exchanges from one fund to another within the same fund family. Mutual funds must price their shares at least once per day at a time determined by the fund's board. Many funds price at 4:00 p.m. Eastern time or when the New York Stock Exchange closes.

c) **Regulatory Supervision:** They carry out their activity on the basis of a registration process with competent financial market authorities and their activity is directly supervised by these competent financial market authorities.

d) **Investment Policy:** U.S. mutual funds can be offered to the public based on certain restrictions, notably in terms of permitted investments and investment restrictions, and strict asset diversification requirements. The use of leverage and borrowing are limited. Under the tax laws, all mutual funds seeking to qualify as regulated investment companies (RICs) must meet a portfolio diversification test every quarter in addition to certain gross income, asset, and distribution requirements.

e) **Custody of Assets:** A core principle is the strict separation of the mutual fund's assets from the fund's investment adviser through explicit rules requiring the assets to be entrusted to a custodian subject to supervision for safe-keeping. Nearly all mutual funds use a bank custodian for domestic securities and certain eligible foreign banks or securities depositories for foreign securities.

f) **Administration and Management:** Independent fund directors oversee fund operations and have the primary responsibility for looking after the interests of the fund's shareholders. They also oversee the performance of the fund, fair valuation determinations for securities held by the fund, and voting of proxies for the fund's portfolio securities. They also approve the fees paid to the investment adviser for its services, and oversee the fund's compliance program. Fund boards retain third parties or service providers - either affiliated organizations or independent contractors – to invest fund assets and carry out other business activities. Portfolio management services are performed by investment advisers carrying on their activities on the basis of registration under, and strict supervision by, the SEC.

g) **Point of Sale and Continuous Disclosure:** U.S. mutual funds publish a registration statement, (comprised of a prospectus and statement of additional information), annual and semi-annual shareholder reports as well as quarterly portfolio holdings disclosure among other documents. Registration statements are amended at least once each year to ensure the information has not become stale and they are amended whenever necessary to reflect material changes in the disclosure. Audited annual and unaudited semi-annual reports contain updated financial statements, a list of the fund's portfolio securities, management's discussion of financial performance, and other information current as of the date of the report. This information is publicly available on the SEC's EDGAR system.

II. Key Regulatory Characteristics of CMFs

All investment funds that are publicly offered in Canada are regulated by the securities regulators of the 10 provinces and 3 territories of Canada who work in collaboration under the umbrella of the Canadian Securities Administrators (CSA). Through the CSA the regulators have achieved consistent rules governing the industry, and reasonably coordinated oversight of the industry, across the country under a passport regime[4].

CMFs offered for sale in Canada are subject to a network of policies and regulations designed by the CSA, and notably:

- National Instrument 81-102 Investment Funds: Details important investment restrictions and

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[4] The CSA has developed a "passport system" through which a Canadian market participant has access to markets in all passport provincial and territorial jurisdictions within Canada by dealing only with its principal regulator and complying with one set of harmonized laws. The provincial and territorial jurisdictions which make up the CSA are as follows:

- British Columbia Securities Commission;
- Alberta Securities Commission;
- Financial and Consumer Affairs Authority of Saskatchewan;
- The Manitoba Securities Commission;
- Ontario Securities Commission;
- Autorité des marchés financiers (Québec);
- Financial and Consumer Services Commission (New Brunswick);
- Nova Scotia Securities Commission;
- Office of the Superintendent of Securities, Service Newfoundland & Labrador;
- The Office of the Superintendent of Securities (Prince Edward Island);
- Northwest Territories Securities Office;
- Office of the Yukon Superintendent of Securities;
- Nunavut Securities Office

other requirements regarding the creation of new funds, conflicts of interest, security holder voting rights and meetings, custody of assets, incentive fees, subscriptions and redemptions, and sales communications.

- National Instrument 81-105 Mutual Fund Sales Practices: Imposes rules prohibiting sales practices and compensation arrangements that may induce dealers and advisors to sell mutual funds on the basis of those incentives rather than what is suitable for the investor.
- National Instrument 81-106 Investment Fund Continuous Disclosure: Outlines requirements regarding the on-going calculation of a fund's net asset value.
- National Instrument 81-107 Independent Review Committee for Investment Funds: Requires investment funds to appoint an independent review committee that is responsible for reviewing the fund manager's conflicts of interest.

CMFs can be structured as trusts or as corporations. The majority of CMFs are structured as trusts. Regardless of the structure, mutual fund trusts and mutual fund corporations are subject to the same set of regulations and supervision rules from a regulatory perspective and the comments below apply to both forms.

In substance, CMFs share all the same regulatory characteristics as U.S. mutual funds listed in Part I above.

a) **Object:** CMFs are created with the sole object of collective investment of capital raised through public and non-public offering in transferable securities and other liquid financial assets and they operate on the principle of risk-spreading by pooling investments from many investors and permitting investors to acquire interests in diversified fund portfolios. From a Canadian federal tax perspective, a CMF must limit its activities to the investing of its funds; comply with certain minimum investor and broad ownership thresholds and the public trading of its units in order to maintain its preferential tax treatment, such as qualifying for investment within tax-deferred plans.

b) **Valuation and Liquidity:** Investors can redeem CMF units or shares at any time for their proportionate interest of the fund's net asset value. CMFs are usually priced daily, at 4:00 PM Eastern time, when the Toronto Stock Exchange closes, based on a process of fair valuation of the portfolio securities which results in a net asset value for the fund; essentially the same as in the case of a U.S. mutual fund.

c) **Regulatory Supervision:** All investment funds that are publicly offered in Canada are subject to a registration process with their principal regulator and their activities are regulated and supervised by the securities regulators within the CSA.

d) **Investment Policy**: CMFs offered to the public are subject to strict rules under National Instrument 81-102 Part 2 "Investments" regarding their investments. These rules include, notably, concentration restrictions, control restrictions, restrictions on the use of borrowing and derivatives and restrictions concerning the type of investments and their liquidity as well as investment practices and investments in other funds.

e) **Custody of Assets**: The assets of CMFs must be entrusted to a custodian for safe-keeping. The custodian is a regulated firm, independent of the investment fund manager, responsible for holding and safekeeping the cash and investments belonging to the fund and ensuring they are used only for the benefit of unitholders. The custodian is also responsible for holding the income earned by the fund until it is reinvested or distributed to fund investors. The custodian makes payments and receives monies or securities as directed by the fund manager. A custodial agreement between the fund and the custodian outlines how the custodian holds the fund assets and how the two parties interact with each other. Custodians can appoint a sub-custodian to hold assets of the fund. This is more common for funds that have assets in other countries.

   By law, to protect investors, custodial functions of a mutual fund must be kept separate from the functions of the fund manager. This way the securities held by the mutual fund are not available for any purpose other than the investment objectives of the fund.

Administration and Management: CMFs structured as Mutual Fund Trusts have a trustee who (a) has a fiduciary obligation to hold title to the fund's investments in trust for the unitholders, (b) is responsible for overseeing the operations of the fund and ensuring it adheres to its investment objectives and (c) has the authority to hire a management team or company to direct the fund's day-to-day affairs and any others from whom services are required. CMFs structured as corporations have boards of directors that have a role similar to that of trustees for Mutual Fund Trust CMFs, whether they are Mutual Fund Trusts or Mutual Fund Corporations rely on service providers to perform necessary operational and management functions.

In fulfilling their responsibility for overseeing management of the fund's day-to-day operations, including management of its investment portfolio, the trustees or the board of directors typically hire an investment fund manager, registered and regulated by the securities regulators, to provide all general management and administrative services to the fund, either in-house or by retaining external firms to perform these services on its behalf.

In addition, a portfolio advisor is responsible for making the investment decisions for a fund, including buying and selling investments on behalf of the CMF and determining the mix of assets consistent with the fund's investment objectives and strategies. Portfolio advisors are guided by, and must adhere to, the fund's investment objectives as stated in its prospectus...

Finally, an Independent Review Committee (IRC) is appointed to report and provide advice to the funds' manager on potential conflicts of interests as between the manager and the funds. The IRC publishes an annual report on conflicts of interest and how they were handled.

Investors are not excluded from the governance of the fund. They must be consulted before any material change can be made to the fund including to its investment objectives or fee structure as explained in National Instrument 81-102, Part 5 "Fundamental Changes". Material changes refer to a change in the business, operations or affairs of the fund that would be considered important by a reasonable investor in determining whether to purchase or continue holding securities of the fund.

If a material change occurs, an investment fund is obligated to provide public disclosure in a news release, material change report and prospectus amendment.

f) **Point of Sale and Continuous Disclosure:** CMFs, in order to sell securities to the public, are required by National Instrument 81-101, Mutual Fund Prospectus Disclosure to prepare and file:

- a simplified prospectus,
- an annual information form (AIF), and
- a Fund Facts document for every class or series of the mutual fund.

Information on the disclosure required in a simplified prospectus, AIF, and Fund Facts document is set out in Form 81-101F1 Contents of Simplified Prospectus, Form 81-101F2 Contents of Annual Information Form, and Form 81-101F3 Content of Fund Facts Document.

A mutual fund manager that manages multiple mutual funds may consolidate the simplified prospectuses of its mutual funds into a multiple simplified prospectus. If the simplified prospectuses of a group of mutual funds are consolidated, the AIFs for those mutual funds must also be consolidated into a multiple AIF.

NI 81-101 also sets out other requirements for mutual fund prospectuses, including requirements regarding the annual renewal of prospectus and AIF, the filing of prospectus amendments, and the incorporation by reference of specified documents, audit and review requirements for financial statements incorporated by reference and document delivery to investors.

In addition a CMF must issue audited financial statements within 90 days after the end, and unaudited semi-annual reports within 60 days of the mid-point, of the fund's fiscal year. CMFs' annual financial statements must be audited by independent firms of public accountants to ensure they have been prepared in accordance with generally accepted accounting principles. The auditors of a fund may not be changed without the approval of the fund's investors.

CMF disclosure documents are available on the CSA's System for Electronic Document Analysis and Retrieval, or SEDAR (www.sedar.com), and on the websites of the applicable fund managers.

Appendix B – U.S Tax Rates (2014)

Single Filing Status

[Tax Rate Schedule X, Internal Revenue Code section 1(c)]

- **10%** on taxable income from $0 to $9,075, plus
- **15%** on taxable income over $9,075 to $36,900, plus
- **25%** on taxable income over $36,900 to $89,350, plus
- **28%** on taxable income over $89,350 to $186,350, plus
- **33%** on taxable income over $186,350 to $405,100, plus
- **35%** on taxable income over $405,100 to $406,750, plus
- **39.6%** on taxable income over $406,750.

Capital Gains tax rates vary depending on whether the gains are short-term or long-term.

Short-term gains are taxed at the ordinary income tax rates listed above.

Long-term gains and qualified dividends are taxed at

- **0%** if taxable income falls in the 10% or 15% marginal tax brackets
- **15%** if taxable income falls in the 25%, 28%, 33%, or 35% marginal tax brackets
- **20%** if taxable income falls in the 39.6% marginal tax bracket
- **25%** on Depreciation Recapture
- **28%** on Collectibles
- **28%** on qualified small business stock after exclusion

Appendix C - Canadian Tax Rates

Individuals

Individual marginal rates

This table shows 2014 combined federal and provincial (or territorial) marginal tax rates – the percentage of tax paid on the last dollar of income, or on additional income.

Provincial brackets below $11,138 are not shown.	Taxable income $11,138 to $43,953					Taxable income $43,953 to $87,907				
	Brackets $	Ordinary income & interest %	Capital gains %	Canadian dividends[1] Eligible %	Canadian dividends[1] Non-eligible %	Brackets $	Ordinary income & interest %	Capital gains %	Canadian dividends[1] Eligible %	Canadian dividends[1] Non-eligible %
Federal	11,138	15.00	7.50	(0.03) to 0	4.70	43,953	22.00	11.00	9.63	12.96
Alberta	17,787 11,138	25.00 15.00	12.50 7.50	(0.03) to 0 (0.03) to 0	12.84 4.70	43,953	32.00	16.00	9.63	21.10
British Columbia	37,606 11,138	22.70 20.06	11.35 10.03	(3.20) to 0 (6.84) to 0	10.73 7.61	86,354 75,213 43,953	34.29 32.50 29.70	17.15 16.25 14.85	12.79 10.32 6.46 to 9.63	24.41 22.29 18.99
Manitoba	31,000 11,138	27.75 25.80	13.88 12.90	6.53 to 6.56 3.84 to 3.86	18.77 16.46	67,000 43,953	39.40 34.75	19.70 17.38	22.60 16.19	32.51 27.03
New Brunswick	39,305 11,138	29.82 24.68	14.91 12.34	3.86 to 3.89 (3.23) to 0	15.93 9.87	78,609 43,953	38.52 36.82	19.26 18.41	15.87 13.52	26.20 24.19
Newfoundland and Labrador	34,254 11,138	27.50 22.70	13.75 11.35	9.77 to 9.80[2] 3.15 to 3.17[2]	14.61[2] 8.95[2]	68,508 43,953	35.30 34.50	17.65 17.25	20.53[2] 19.43[2]	23.82[2] 22.87[2]
Northwest Territories	39,808 13,668 11,138	23.60 20.90 15.00	11.80 10.45 7.50	(4.03) to 0 (7.76) to 0 (0.03) to 0	7.77 4.58 to 4.70 4.70	79,618 43,953	34.20 30.60	17.10 15.30	10.60 5.63 to 9.63	20.28 16.03
Nova Scotia	29,590 11,138	29.95 23.79	14.98 11.90	8.39 to 8.42 (0.11) to 0	15.41 8.15	59,180 43,953	38.67 36.95	19.34 18.48	20.42 18.05	25.70 23.67
Nunavut	41,909 12,567 11,138	22.00 19.00 15.00	11.00 9.50 7.50	2.03 to 2.06 (2.11) to 0 (0.03) to 0	9.36 5.82 4.70	83,818 43,953	31.00 29.00	15.50 14.50	14.45 11.69	19.98 17.62
Ontario	40,120 11,138	24.15 20.05	12.08 10.03	(1.20) to 0 (6.86) to 0	10.19 5.35	83,236 80,242 70,648 43,953	39.41 35.39 32.98 31.15	19.70 17.70 16.49 15.58	19.86 14.31 10.99 8.46 to 9.63	28.19 23.45 20.61 18.45
Prince Edward Island	31,984 11,138	28.80 24.80	14.40 12.40	4.53 to 4.55 (0.99) to 0	17.21 12.49	63,969 43,953	38.70 35.80	19.35 17.90	18.19 14.19	28.89 25.47
Quebec	41,495 14,131 11,138	32.53 28.53 12.53	16.26 14.26 6.26	11.16 to 11.18 5.64 to 5.66 (0.02) to 0	19.21 14.49 3.92	82,985 43,953	42.37 38.37	21.19 19.19	24.74 19.22	30.82 26.10
Saskatchewan	43,292 15,378 11,138	28.00 26.00 15.00	14.00 13.00 7.50	2.73 to 2.76 (0.03) to 0 (0.03) to 0	16.03 13.67 4.70	43,953	35.00	17.50	12.39	24.29
Yukon	11,138	22.04	11.02	(11.12) to 0	8.25	82,071 43,953	32.16 31.68	16.08 15.84	1.81 to 9.63 2.18 to 9.63	19.96 19.63
Non-resident[3]	11,138	22.20	11.10	(0.04) to 0	6.96	43,953	32.56	16.28	14.26	19.18

Provincial brackets below $11,138 are not shown.	Taxable income $87,907 to $136,270					Taxable income > $136,270				
	Brackets $	Ordinary income & interest %	Capital gains %	Canadian dividends[1] Eligible %	Canadian dividends[1] Non-eligible %	Brackets $	Ordinary income & interest %	Capital gains %	Canadian dividends[1] Eligible %	Canadian dividends[1] Non-eligible %
Federal	87,907	26.00	13.00	15.15	17.68	136,270	29.00	14.50	19.29	21.22
Alberta	87,907	36.00	18.00	15.15	25.82	136,270	39.00	19.50	19.29	29.36
British Columbia	104,858 87,907	40.70 38.29	20.35 19.15	21.64 18.31	31.97 29.13	150,000 136,270	45.80 43.70	22.90 21.85	28.68 25.78	37.99 35.51
Manitoba	87,907	43.40	21.70	28.12	37.23	136,270	46.40	23.20	32.26	40.77
New Brunswick	127,802 87,907	43.84 42.52	21.92 21.26	23.21 21.39	32.48 30.92	136,270	46.84	23.42	27.35	36.02
Newfoundland and Labrador	87,907	39.30	19.65	26.05[2]	28.54[2]	136,270	42.30	21.15	30.19[2]	32.08[2]
Northwest Territories	129,441 87,907	40.05 38.20	20.03 19.10	18.67 16.12	27.18 25.00	136,270	43.05	21.53	22.81	30.72
Nova Scotia	93,000 87,907	43.50 42.67	21.75 21.34	27.09 25.94	31.40 30.42	150,000 136,270	50.00 46.50	25.00 23.25	36.06 31.23	39.07 34.94
Nunavut	87,907	35.00	17.50	19.97	24.70	136,270	40.50	20.25	27.56	31.19
Ontario	87,907	43.41	21.70	25.38	32.91	220,000 150,000 136,270	49.53 47.97 46.41	24.76 23.98 23.20	33.82 31.67 29.52	40.13 38.29 36.45
Prince Edward Island	98,143 87,907	44.37 42.70	22.19 21.35	24.56 23.71	35.20 33.61	136,270	47.37	23.69	28.70	38.74
Quebec	100,970 87,907	47.46 45.71	23.73 22.86	31.77 29.35	36.83 34.76	136,270	49.97	24.98	35.22	39.78
Saskatchewan	123,692 87,907	41.00 39.00	20.50 19.50	20.67 17.91	31.37 29.01	136,270	44.00	22.00	24.81	34.91
Yukon	87,907	38.01	19.01	9.88 to 15.15	26.86	136,270	42.40	21.20	15.93 to 19.29	32.04
Non-resident[3]	87,907	38.48	19.24	22.43	26.17	136,270	42.92	21.46	28.55	31.41

1, 2, 3 Footnotes have been deleted for purposes of presentation as part of this submission to the U.S. Senate Finance Committee. These footnotes only pertained to dividend income and low-income non-residents.

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Appendix D – Detailed Calculation of Impact of Exemption on U.S. Income Tax Revenue

A. **$69,967,419 CAD** is the total of capital gains distributed to Canadian-Resident U.S. taxpayers *(see Note 1)*

B. **Based on our assumption in Note 2, if** 50% of the total capital gains distributed to the Canadian-Resident U.S. taxpayers ($34,983,710 CAD) are deemed to be **long–term capital gains** under U.S. tax law, to calculate the gross U.S. tax liability we would apply the assumed U.S. tax rate on capital gains for those earning annual income under $406,751 (see Appendix B) of 15% ($34,983,710 x 15% = **$5,247,556 CAD**).

C. Turning to the other 50% of the total net capital gains distributed (step A) that are considered **short-term capital gains** under U.S. tax law (generated through dispositions of securities held by the mutual funds for less than 12 months), we take $34,983,710 CAD and apply the assumed tax rate for ordinary income (25%) for a total gross U.S. taxable amount on this portion of the gains of **$8,745,927 CAD.**

The combined U.S. taxable liability is calculated by adding (B) and (C) ($5,247,556 + $8,745,927 = $13,993,483 CAD)

Canada does not distinguish between short and long-term capital gains (see Note 3). We apply the assumed Canadian tax rate of 17.4% (see Note 4) to the total capital gains of $69,967,419 CAD for a total gross Canadian tax liability of **$12,174,331 CAD**.

D. The total tax the U.S. would receive on the total capital gains distributed to Canadian-resident U.S. taxpayers is $13,993,483 minus the foreign tax credit of $12,174,331 for a tax liability of $**1,819,152 CAD**.

E. Converting this figure from CAD into U.S. dollars, at the current exchange rate of 0.7943 (the Bank of Canada Exchange Rate as of April 10, 2015), converts the amount in step D to a total potential annual revenue loss to the U.S. Treasury **$1,444,345 USD;**

Thus, there would be a potential annual $1.44 million USD shortfall, not taking into account the savings to the IRS resulting from reduced costs of simplified administration of PFIC for Canadian-resident U.S. taxpayers holding CMFs. Even if we were to assume that all of the capital gains distributed to Canadian-resident U.S. taxpayers are designated as short-term capital gains under U.S. tax principles, the total potential annual revenue loss to the U.S. Treasury would be $4.22 million USD.

Note 1 - Over the last four years, the average annual amount of capital gains distributed by CMFs to U.S. unitholders with non-registered accounts was $69,967,419 CAD. (See calculation in Appendix E).

Note 2 - In Canada, there is no segregation between short term and long term gains. However, all of the gains in Note 1 could potentially be categorised as ordinary income for U.S. tax reporting purposes if the funds held all of the assets generating those gains for less than 12 months, which is highly unlikely.

IFIC does not have access to data that would permit calculation of the percentage of those distributions relating to gains on securities held for less than a year. For purposes of this analysis, assume that half the dispositions that generated the net capital gains distributions in Note 1 were made on securities held for less than a year, the amount of net capital gains that could be considered ordinary income in the U.S. context is $34,983,710 CAD, with the other $34,983.710 CAD being considered as capital gains income.

Note 3 - For Canadian tax purposes, 50% of the total capital gain is included in taxable income. Therefore, in step C above, we have applied 50% of the marginal tax rate of 34.8% or 17.4% to the total capital gains. The 17.4% tax rate has been calculated by averaging the four tax rates for capital gains for Ontario (Canada's most populous province) that are highlighted in Appendix C.

Note 4 - *Taxation of short-term capital gains* - Assuming that the average investor in CMFs has an annual income more than $44,000 but less than $88,000, the blended federal/provincial tax rate in Ontario (the country's most populated province) on capital gains, whether considered short term or long term in the U.S., is 17.4%. (See Appendix C)

In the U.S. the entire gain (as a short-term capital gain which would be classified as 'ordinary' income) would be taxed at 25% (the federal tax rate for ordinary income of more than $36,900 but less than $89,350). Any available foreign tax credit equal to the tax amount already paid to Canada would reduce the U.S. tax liability.

Note 5 - *Taxation of long-term capital gains* – On capital gains that are long-term capital gains in the U.S., these gains are fully taxable at a rate of 15% for the assumed income bracket, and the capital gain is taxable in Canada at the assumed blended rate of 17.4%.

Moreover, any extra tax paid to Canada on such gains over what is payable to the U.S. would go into the foreign tax credit passive bucket and can be applied against the U.S. tax liability on short-term capital gains.

Appendix E

Summary of Statistics used in Submission

To determine an estimate of the amount of capital gains distributed by CMFs to Canadian-resident U.S. taxpayers a number of assumptions were made and calculations done.

First, to determine the proportion of capital gains that should be apportioned to Canadian-resident U.S. taxpayers, IFIC took the total population of Canada and divided it by the generally accepted number of U.S. citizens resident in Canada[5]. The proportional figure came out to 2.83%.

Second, to determine the amount of capital gains from retail CMFs distributed to unitholders, IFIC took the compiled figures that are reported on a monthly basis by its members over the last four years and calculated a yearly average based on those four years. These numbers were then grossed up by 20% because the statistics from IFIC's membership comprise only 82% of the CMF industry.

Third, investment in mutual funds held within Canadian Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs) are not subject to the PFIC rules. To determine how much of the capital gains were held in RRSPs and RRIFs, IFIC used statistics from Investor Economics.[6]

Proportion of Canadian-resident U.S. taxpayers holding Retail CMFs

Canada's population[7] as of January 2014 (estimate)	35,344,962
Generally Accepted number of Canadian-resident U.S. taxpayers (estimate)	1,000,000
Percentage of U.S. investors (1,000,000/35,344,962)	2.83%

IFIC Reporting Members ONLY

Capital Gains Calculations

Actual Capital Gains (CG) distributions reported from January 2010-April 2014	$17,169,076,081
Non-registered funds (RRSPs and RIFs) @ 51%	$8,756,228,801
Canadian-resident U.S. taxpayer population in Canada @ 2.83%	$247,801,275

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5 IFIC does not have access to the number of actual Canadian-resident U.S. taxpayers. Instead we have used the number of one million U.S. and Canadian dual citizens quoted by the former American Ambassador to Canada, David Jacobson as a reasonable substitute.

6 Investor Economics is a financial services research and consulting firm based in Toronto, Canada. The firm specializes in fact-based measurement and analysis of the retail financial services and wealth management industries. As of March 2013, Investor Economics operates as a subsidiary of Asset International Inc. which supplies data, tools and research to the global asset management industry.

7 http://www.statcan.gc.ca/start-debut-eng.html

Gross up the figure by 20%	$297,361,530
Annual capital gains of Canadian-resident U.S. taxpayer holding Canadian funds	$69,967,419

Assets Held in RRSPs or RRIFs

Date	2009	2010	2011	2012	2013	Average % over the last 5 years
Percentage of mutual fund industry Assets Under Management (AUM) held in RRSPs and RRIFs	48%	51%	51%	52%	52%	**51%**

***Source: Investor Economics

<u>Capital gains from CMFs Flowed Through to Unitholders</u>

To calculate the amount of capital gains from CMF companies flowed through to unitholders, IFIC Used the capital gains distributed figure in IFIC's member dataset. Because these figures are not industry totals, IFIC grossed up the values by 20% to estimate the total industry figures – as IFIC's membership represents only 82% of the total industry.

The figures are represented as actual numbers (i.e. not represented in 000s)

Total capital gains from **2010-April 2014** = $**17,169,076,081**

Apply the non-registered ratio (51%) to extract the capital gains on funds held in RRSPs or RRIFs: 51% x $17,169,076,081 = $**8,756,228,801**

Apply the American population ratio (2.38%) to determine the proportion of CG's that should be proportioned to U.S. taxpayers: 2.83% x $8,756,228,801 = $**247,801,275**

Scale up the figure by 20% to account for the proportion of the industry not included in the IFIC statistics: 120% x $247,801,275 = $**297,361,530**

Annual capital gains ($297,361,530 / 4) from the underlying fund assets = $69,967,419 CAD