Written Submission for the Pre-Budget Consultations in Advance of the 2019 Budget

By: The Investment Funds Institute of Canada

The Investment Funds Institute of Canada ("IFIC") submits the following recommendations:

Recommendation 1: That the government implement changes to the safe harbour rule in section 115.2 of the *Income Tax Act* (Canada) to enhance the ability of Canada's asset management industry to provide its services globally.

Recommendation 2: That the government implement changes to improve the tax neutrality of Canadian collective investment vehicles ("CIVs") to encourage investment by foreign resident investors.

Introduction

We are writing on behalf of the members of The Investment Funds Institute of Canada with respect to the House of Commons Standing Committee on Finance's (the Committee) pre-budget consultations for the 2019 Federal Budget.

IFIC is the voice of Canada's investment funds industry. 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. By connecting Canada's savers to Canada's economy, our industry contributes significantly to economic growth and job creation.

We are encouraged by the Committee's consultation theme on the topic of **Economic Growth: Ensuring Canada's Competitiveness**. IFIC's recommendations contribute to this objective. Specifically, we are recommending changes to the safe harbour rule and improving the tax neutrality of Canadian CIVs in order to increase consumption of Canadian asset management services and products. We believe these recommendations will encourage the growth and competitiveness of Canada's asset management industry.

The Value of a Globally Competitive Canadian Asset Management Industry

The asset management industry is global. Canada's asset management industry competes in this global marketplace through distribution of its asset management services and products. To improve the ability of Canadian asset managers to compete globally, we have identified changes to the Canadian income tax framework that will level the playing field and better position the industry to compete for mandates globally.

A more globally competitive Canadian asset management industry will benefit Canada in the following ways:

- <u>Reduced fees for Canadian investors</u>

  Attracting more foreign investment into Canadian CIVs which will create economies of scale for Canadian asset managers, which in turn will reduce management expense ratios and provide Canadian investors with lower cost investment solutions.

- <u>Increased Canadian tax revenues</u>

  Attracting more foreign investment will also create opportunities to increase taxable fee income earned by Canadian asset managers. This will support the Canadian asset management industry as a whole, including the back office services and service providers, such as custodial firms, trust companies, accounting firms and law firms that sustain well-paying middle class jobs.

IFIC Recommendation 1 - The Safe Harbour Rule

The safe harbour rule was introduced in 1999 to permit foreign CIVs to retain the services of Canadian asset managers without the risk of attracting Canadian tax on any earned investment income. The rule was introduced at the request of Canada's asset management industry which was trying to compete with service providers in other jurisdictions that had safe harbour rules.

Since that time, those countries have amended their tax rules and others have introduced safe harbour rules in an effort to support the competitiveness of their domestic asset management industry. Canada has not kept pace with these developments and, as a result, our safe harbour rule is more restrictive and less competitive than most.

To support the global competitiveness of Canada's asset management industry, we are proposing that the rule be amended to:

- Expand the definition of qualified investment;
- Extend the one-year-seed capital period;
- Expand the list of designated investment services;
- Amend the limitation on affiliated persons; and
- Eliminate the prohibition on Canadian investors to permit a *de minimis* number of Canadian investors.

With respect to the prohibition on Canadian investors, IFIC believes that the recent implementation of international global tax exchange agreements – such as the Foreign Account Tax Compliance Act and the Common Reporting Standard – will give governments, including Canada, greater access to information regarding foreign investments held by their residents. As a result, the prohibition against Canadian investors is not as necessary as it once was. These tax information exchange agreements give the government the opportunity to make the safe harbour rule less restrictive.

IFIC Recommendation 2 - Improve the Tax Neutrality of Canadian CIVs

Canada's favoured collective investment structure is the trust, which is inefficient for foreign investors. Foreign investors in Canadian trusts must pay withholding tax on distributions of income from a trust. Our proposal is to eliminate the Canadian withholding tax on distributions from Canadian trusts to the extent that the tax would not otherwise apply if the foreign investor had held the underlying assets directly and not through the trust.

In addition, we propose that the Canadian tax framework be broadened to accept legal structures for CIVs that are better understood by foreign investors. Generally, foreign retail investors are more comfortable with corporate class CIVs over the trust structure favoured in Canada. Other jurisdictions have changed their tax and legal frameworks to attract foreign investors into their local CIVs.

Tax Reforms in Other Jurisdictions

The Australian Example

In general, the Australian legislative tax reforms have two key elements. The first element is Australia's safe harbour rule, the Investment Manager Regime, which enhances the opportunities for Australian firms to manage assets of foreign funds. The second element allows Australia's investment management industry to offer a broader range of CIVs along with enhancements to the tax treatment of its existing funds which are typically structured as trusts. It was recognized that to have the greatest impact on Australia's global competitiveness, it was necessary to address both of these elements.

The UK Example

The UK's safe harbour rule (the Investment Management Exemption) ensures that foreign funds utilizing UK investment managers are not considered to be carrying on business in the UK. The foreign fund is therefore not subject to UK taxes solely because of its relationship with the UK investment manager. The fees earned by the UK investment manager for services performed for the foreign fund are subject to UK tax.

Both UK investment managers and the UK Treasury benefit from this safe harbour rule. The UK investment manager is able to increase fee income, which generates greater tax revenues for the UK Treasury.

The key elements of the exemption include:

- Independent capacity and customary remuneration – the manager must operate on an arm's length basis from the CIV and receive customary remuneration
- 20% test: the manager and persons connected with the manager must not be entitled to more than 20% of the income in the foreign CIV. Any income entitlement above the 20% threshold is not eligible for the safe harbour and is subject to UK tax.

The UK has also made their asset management industry more globally competitive through:

- Flexibility of corporate form
    - Authorised unit trusts
    - Open-ended investment companies (OEICs)
    - Authorised contractual scheme
- Modernization of the tax rules
    - Consistent treatment of trusts and companies
    - Contractual structure designed as a flow-through

Conclusion:

Asset management is a highly competitive global industry. For the Canadian asset management industry to continue to effectively compete both domestically and abroad, changes to Canada's income tax framework are necessary. These changes will benefit Canadian investors, the Canadian government and the individuals that comprise and support the Canadian asset management industry.

Thank you for the opportunity to participate in the pre-budget consultation. IFIC would be pleased to meet with the Committee to discuss these recommendations. We welcome your questions and feedback.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

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