

IFIC

Annual

Leadership

Conference

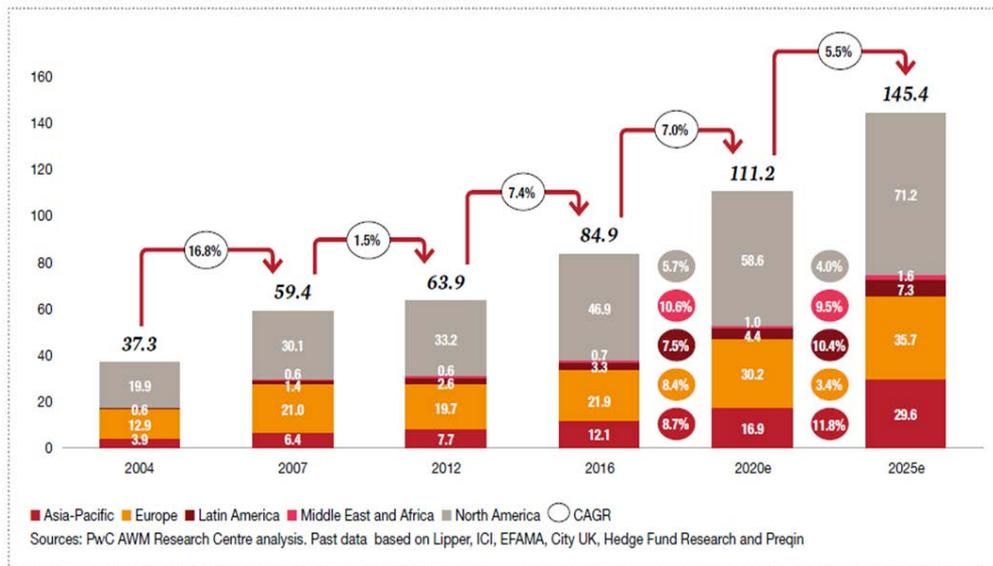
Proposed Tax Reforms to Promote International Competitiveness in Canada's Asset Management

TOPICS DISCUSSED

- The Value of a Globally Competitive Canadian Asset Management Industry
- Provision of Canadian Asset Management Services Globally
- Modernization of Investment Funds

EXPECTED GROWTH IN THE INDUSTRY

Figure 2: Global AuM by region in USD trillion Base scenario



Source: PwC Asset & Wealth Management Revolution: Embracing Exponential Change Report (2017)

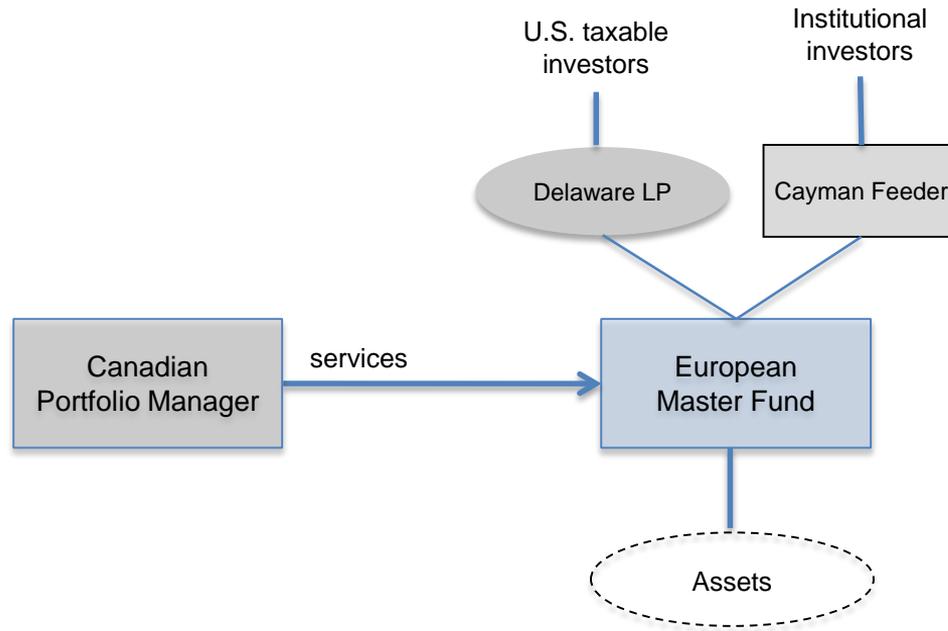
SUBMISSIONS TO FINANCE ON COMPETITIVENESS

- **May 9, 2017 submission**
 - Requested targeted amendments to Canada’s “safe harbour” rule in section 115.2 and a wider consideration of how to make the taxation of non-resident investors in Canadian investment funds more competitive
- **Having ongoing discussions with Finance officials**

SAFE HARBOUR RULE

- The safe harbour rule in section 115.2 of the *Income Tax Act* is intended to allow non-Canadian funds to employ Canadian service providers (e.g. portfolio managers) without the risk of the funds' income becoming subject to tax in Canada
 - The safe harbour rule is important to the industry because it allows Canadian companies to sell their services to non-resident funds, thereby expanding their market
- There are a number of tests that need to be met
 - prohibition on Canadian investors
 - affiliated person restrictions
 - limited seed capital period
 - restricted to “qualified investments” and “designated investment services”

HOW THE SAFE HARBOUR RULE APPLIES



IMPACT OF THE CURRENT SAFE HARBOUR RULE

- The safe harbour rule should be updated for Canadian companies to be competitive
 - The rule, which was introduced in 1999, is too restrictive when compared with equivalent rules in other countries
- Other jurisdictions have focused on the creation of workable safe harbour rules
 - Aimed at promoting the services of their domestic industry participants to non-resident funds
 - Other countries take a much more business friendly approach

“SAFE HARBOUR” RULE COMPARED GLOBALLY

						
Conditions to be met by Asset Manager	✓	✓	✓	✓	✓	✓
Excludes Local Investor	X	✓	Certain Regime	Limited	Limited	Limited
Limitation on related party investments	X	✓	Yes, if other conditions not met	Yes, if other conditions not met	✓	X
Limitation on types of assets/scope of services	✓	✓	Yes, but much broader scope	Yes, but much broader scope	✓	Yes, but much broader scope

EXAMPLE: UK SAFE HARBOUR RULE

- According to the HMRC, the U.K.'s safe harbour rule (i.e., the Investment Management Exemption) ensures that:
 1. Overseas investors are not charged U.K. tax, and
 2. Fees received by a UK investment manager for services performed for the non-resident are fully chargeable to UK tax
- Some of the key tests include:
 - Independent capacity and customary remuneration: the manager must operate on an arm's length basis from the fund 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 fund

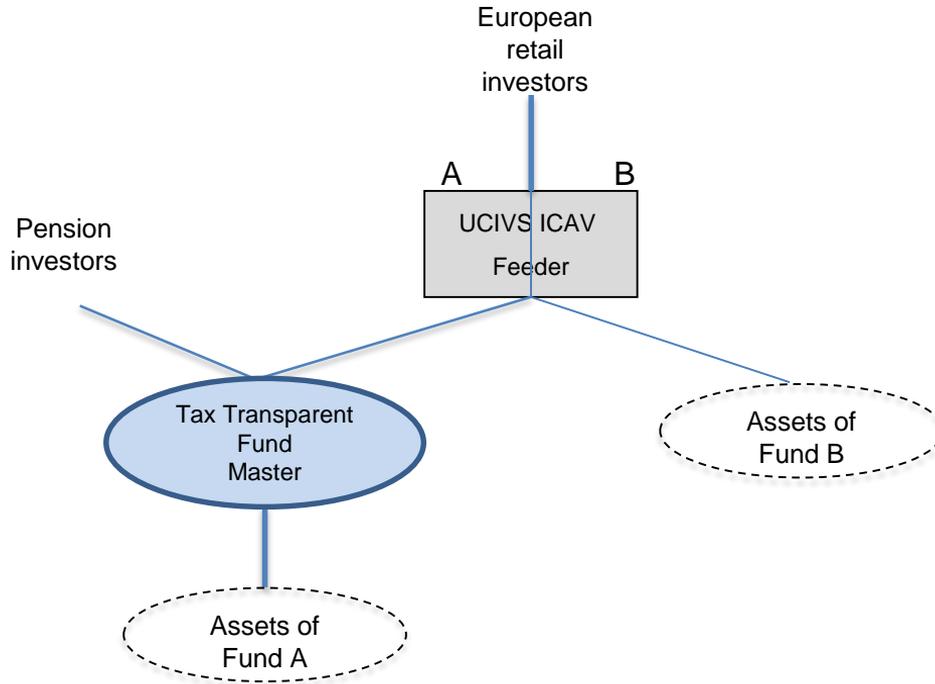
IFIC SUBMISSIONS: SAFE HARBOUR RULE

- IFIC requested an expansion of the safe harbour rule in section 115.2 to:
 - Eliminate or relax the prohibition against **Canadian investors** in offshore funds that are structured as corporations or trusts
 - Eliminate or relax the limitation on **affiliated persons**
 - Extend the one year **seed capital** period
 - Expand the definition of “**qualified investments**” to include private companies that derive their value primarily from Canadian real estate or resource properties
 - Expand the definition of “**designated investment services**”

MODERNIZATION OF FUND FORM

- Other countries have changed both the **legal form** and **taxation** of products available to investors
- One trend is towards corporate “umbrella” funds for non-resident retail investors:
 - OEICs in the U.K., ICAVs in Ireland, and more recently, CCIVs in Australia and corporate mutual funds in Hong Kong
- Another trend is towards tax transparent (flow-through) funds for non-resident institutional investors:
 - Authorized contractual schemes in the U.K., common contractual funds in Ireland, and more recently, limited partnerships in Australia

EXAMPLE OF NEW FUND STRUCTURES



U.K. EXAMPLE

- **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
- **Importance of European regulatory regime**
 - “Passporting” for distribution of funds

Source: Conference Board's study, Making Dollars and Sense of Canada's Mutual Fund Industry: An Economic Impact Analysis (August 2013).

SINGAPORE EXAMPLE

- Singapore recently extended its favourable fund tax regime to Singapore Variable Capital Companies (“S-VACCs”)
 - Prior to this change, mutual funds in Singapore were structured as unit trusts, which was not attractive for some types of investors that prefer to invest in corporations
 - Singapore recognized that by extending its fund regime to include corporations, it could grow its asset management sector
- S-VACCs require a local fund manager, local office and director, local auditor and must meet certain other regulatory requirements

IFIC SUBMISSION: TAXATION OF CIVS

- IFIC requests that Finance consider changes to improve the tax neutrality of Canadian CIVs so they work for non-resident investors, e.g.:
 - Eliminate withholding tax in certain instances (e.g., a Canadian CIV which is structured as a trust is not tax neutral for non-resident investors as the characterization of income earned by the CIV can not be flowed through to non-resident investors), **or**
 - Allow other types of structures (e.g. tax transparency/flow-through vehicles)

ECONOMIC IMPORTANCE OF THE FUND INDUSTRY

- Canada's mutual fund industry directly created **\$5.8 billion** in real GDP in 2012 – on par with air transportation
 - However, the industry's economic impact extends far beyond this direct addition to GDP
- Research by the Conference Board reveals that the total economic footprint of the industry was **\$17 billion** in 2012
- Directly and indirectly, the industry supports **192,000 jobs** while creating \$12.6 billion in primary household income and \$2.3 billion in corporate profits