



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

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November 20, 2009

Ms. P. Tsang
Income Tax Rulings Directorate
Policy and Legislation Branch
Canada Revenue Agency
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Dear Ms. Tsang:

Re: Tracking #2009-031107 – Explanation to Supplement Technical Interpretation Request on Deferred Sales Charge (DSC) Rebate Made to a Tax-Free Savings Account (TFSA)

Further to your recent request for more information in connection with our technical interpretation request letter, dated February 13, 2009, on DSC rebates made to a TFSA, we are pleased to provide your department with the explanation and details that follow.

The DSC Commission referred to under Fact #6 in our request letter and paid by the fund manager to the fund dealer typically ranges from 2-5% of the purchase value of the Securities. The maximum DSC Commission rate is not regulated, but rather is determined principally by market forces within the mutual funds industry. Mutual fund managers normally pay a maximum DSC Commission rate of 5% and, in order to remain profitable, would not pay higher than this rate for the distribution of their mutual fund products. Dealers may sometimes rebate a portion of the DSC Commission they receive to the investor. If they receive a maximum of a 5% commission, they would not rebate more than the 5% as otherwise they would lose funds/be out of pocket.

As explained in our February 13 letter, these transactions occur in an open market in which all parties (the mutual fund manager, the dealer and the investor) deal with each other at arm's length and the purpose is to reduce the amount of deferred sales charge that was incurred or may be incurred by the investor's account upon the redemption of Securities (please refer to the two following illustrations). We would like to emphasize again that 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 *Income Tax Act* (Canada) of any amount in respect of the investor's account.

DSC rebate scenarios for illustration purposes only:

• **Scenario 1: Transfer of assets from one mutual fund manager to another**

This is the most common scenario for DSC rebates and it involves the transfer of TFSA assets from one mutual fund manager (“Manager A”) to another mutual fund manager (“Manager B”):

A TFSA holds Securities of Mutual Fund A, managed by Manager A, that were bought under the deferred sales charge purchase option for \$5,000.

The applicable deferred sales charge rates for redemptions of Securities of Mutual Fund A as a percentage of the purchase value are as follows:

<u>Time of redemption</u>	<u>DSC redemption fee rate</u>
During Year 1	6.0%
During Year 2	5.5%
During Year 3	5.0%
During Year 4	4.5%
During Year 5	4.0%
During Year 6	3.5%
After Year 6	Nil

For ease of illustration, assume that there is no market growth. In the middle of Year 5, the dealer redeems the Securities of Mutual Fund A from the investor’s TFSA and uses the proceeds to buy Securities of Mutual Fund B under the deferred sales charge purchase option for the TFSA. The value of the Securities of Mutual Fund A was \$5,000 at the time of redemption but, after paying the 4% DSC (redemption) fees of \$ 200, the net proceeds of only \$4,800 are used to buy Securities of Mutual Fund B for the TFSA. Manager B will pay the dealer a 5% DSC Commission or \$240. The dealer, in turn, pays a DSC rebate, equal to a portion of (but not exceeding) the DSC redemption fees paid, to the TFSA and the rebate is used to buy additional Securities of Mutual Fund B. Therefore, the rebate cannot be greater than the DSC commission or the DSC fees paid upon redemption (the DSC redemption fees are publicly available in fund prospectuses filed with www.sedar.com and in other documents). If we assume that the rebate is equal to the maximum of \$200, this amount will be used to buy Securities of Mutual Fund B and in total \$5,000 of Securities of Mutual Fund B would have been purchased in the TFSA.

In conclusion, the value of the assets of the TFSA immediately after the transfer will be equal to or less than the value of the assets before the transfer because the rebate from the dealer will make up for all or a portion of the DSC fees charged by Manager A.

• **Scenario 2: DSC Rebate for Potential Future Redemption**

This scenario is possible when discount brokers that normally sell “no-load” proprietary

mutual funds (no upfront commissions or redemption fees are paid by the investors) also distribute third-party mutual funds that are sold under the deferred sales charge purchase option.

When the discount broker sells the deferred sales charge option third-party mutual funds to their clients, the broker gets a 2-5% DSC Commission from the third-party fund manager and rebates a portion (usually half) of the commission to the client's account. If the client redeems the third-party funds from its account in the future, the rebate will make up for some or all of the redemption fees.

Under both scenarios, the amount of the rebate is reasonable and does not exceed the DSC Commission. We wish to emphasize that, in the first example provided above, the DSC Rebate was not greater than the DSC Commission received by the Dealer or the DSC fees paid by the TFSA. In most cases, the DSC Rebate would only be a portion of the commission received by the dealer or discount broker.

We hope that the above details and illustrations will answer your questions and clarify any outstanding queries that your department may have. Should you require further clarification or additional information, please contact Barbara Amsden (bamsden@ific.ca: (416) 309-2323). Thank you for your consideration of the technical interpretation request.

Yours sincerely,

A handwritten signature in blue ink, consisting of a series of loops and a long horizontal stroke extending to the right.

Cc: André Gauthier



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

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February 13, 2009

Income Tax Rulings Directorate
Policy and Legislation Branch
Canada Revenue Agency
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Place de Ville, Tower A
320 Queen Street
Ottawa, ON K1A 0L5

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

The position adopted for TFSAs is based on CRA’s current position concerning trustee 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.

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8. In an open market in which parties deal with each other at arm's length and act prudently, knowledgeable 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