



THE INVESTMENT FUNDS INSTITUTE OF CANADA
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By fax to (613) 995-5176

September 18, 2008

Mr. Brian Ernewein
General Director
Tax Policy Branch
Finance Canada
140 O'Connor Street
Ottawa, ON K1A 0G5

Dear Mr. Ernewein:

Re: Alternative Minimum Tax (“AMT”) and Unit Trusts

We are writing further to our submission of November 14, 2007 and IFIC's meeting with you and Gérard Lalonde on May 8, 2008 regarding our request for relief from AMT for unit trusts. We thank you for the time you spent with our Taxation Working Group Members and for your insightful comments and good questions. The discussion allowed us to understand the issue from the perspective of the Department of Finance, including your concern about the prospect of abuse by persons outside of our industry.

As a result of the meeting, we have reconsidered the nature of the relief that we seek. While we would still prefer an exemption from AMT for unit trusts, we are writing to put forward an alternative amendment that would have the effect of “flowing through” the AMT base of a unit trust to the unitholders of the trust. Such an amendment would be consistent with the premise upon which we sought an exemption from AMT and should also address Finance's concern about the potential for abuse arising from an outright exemption. As we believe that this change should be non-contentious, we hope that the Department of Finance will consider including the necessary amendment in the bill that will embody the draft July 14, 2008 *Legislative Proposals and Explanatory Notes relating to the Income Tax Act, the Excise Act, 2001 and the Excise Tax Act* (the “Draft Proposals”), when introduced to the House of Commons later this fall.

Below we briefly summarize some of the circumstances in which a unit trust can incur AMT, why the AMT is never recoverable and why we believe that this result is not appropriate from a policy perspective. We then provide draft legislation for your consideration.

Background

A unit trust that does not meet certain exemption conditions (such as mutual fund, segregated fund or master trust status) is subject to AMT. Unit trusts, like mutual fund trusts, are generally flow-through vehicles that are required by their declaration of trust to

distribute to unitholders in each taxation year sufficient net income and net realized capital gains so that they will not be liable for income tax under Division E of Part I of the *Income Tax Act* (Canada) (the "Act"). A unit trust may have an AMT liability under Division E.1 of Part I of the Act where deductions available in computing income, such as management fees and losses from derivative transactions and short sales, result in capital gains being retained by the unit trust rather than being distributed to unitholders. The reason for this is that the AMT base is higher than the ordinary Part I tax base (due to the different inclusion rate for capital gains) yet the deduction allowed for income and gains distributed to unitholders is capped at the amount deductible for ordinary Part I tax purposes.

AMT has adverse tax consequences for a unit trust and its unitholders for a number of reasons.

- First, AMT payable in a particular year is, practically speaking, never recoverable by the unit trust in a subsequent taxation year. AMT is only recoverable to the extent that ordinary income tax exceeds AMT in a subsequent taxation year. However, a unit trust would actually have to pay some tax in order to obtain a credit for AMT paid in a previous year (because the Part I tax rate is 46% whereas the AMT rate is significantly less since it is based on the lowest marginal tax rate). As noted, declarations of trust require that a unit trust pay sufficient distributions to its unitholders such that it will not be liable for ordinary income tax under Part I of the Act.
- Second, the unitholders of a unit trust would not generally incur AMT if they were considered to have realized directly the various sources of income, gains and losses of a trust that had an AMT liability (e.g., a unitholder who had capital gains and ordinary income losses would not typically incur AMT). Taxable individuals should not incur AMT because they would not derive most of their income from unit trusts and because they have a \$40,000 exemption. Tax-exempt investors, such as registered retirement savings plans (RRSPs) and pension plans, are not liable for AMT.
- Finally, the application of AMT to a unit trust is inconsistent with the flow-through nature of unit trusts provided by the Act in respect of the characterization of income and gains.

Proposed Amendments to the Act

To address the problems described in this letter, we respectfully suggest the following legislative changes:

1. Amend the preamble to subsection 127.52(1) of the Act as follows:

Subject to subsections (1.1) and (2), an individual's...

2. Add subsection 127.52(1.1):

For the purposes of subsection (1) and this subsection, where a trust is a unit trust resident in Canada throughout a taxation year, such portion of the amount by which the trust's adjusted taxable income for the year exceeds the

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trust's taxable income for the year shall, if so designated by the trust in respect of a particular beneficiary in its return of income under Part I for the year, be deductible in computing the adjusted taxable income of the trust for the year and shall be added in computing the adjusted taxable income of the particular beneficiary for the year.

These legislative changes would provide a unit trust with a mechanism to flow-through its AMT tax base to its unitholders and would be consistent with the flow-through nature of a unit trust.

As noted above, we believe that this change should be non-controversial because it should address the Department of Finance's abuse concern while correcting what we see as an inappropriate outcome of the current wording. For these reasons, we hope that Finance Canada will recommend including the necessary amendment in the bill that will reflect the July 14, 2008 Draft Proposals, when it is introduced in Parliament following the upcoming election. We thank you for your attention to this matter, and would be pleased to discuss any aspect of the foregoing with you at your earliest convenience.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

Joanne De Laurentiis
President and Chief Executive Officer

cc: Mr. Gérard Lalonde, Tax Policy Branch, Department of Finance