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

Joanne De Laurentiis
PRESIDENT & CEO
416-309-2300
JDELAURENTIIS@IFIC.CA

June 23, 2010

Mr. Stephen E. Shay
Deputy Assistant Secretary for International Tax Affairs
(Int'l) United States Department of the Treasury
1500 Pennsylvania Ave, NW
Washington, DC 20220

Mr. Steven A. Musher
Internal Revenue Service
Office of the Associate Chief Counsel
1111 Constitution Avenue, NW
Washington, DC 20224

Ms. Manal Corwin
International Tax Counsel
United States Department of the Treasury
1500 Pennsylvania Ave, NW
Washington, DC 20220
Fax: (202) 622-6415

Mr. Michael Danilack
Deputy Commissioner (Int'l) LMSB
Internal Revenue Service (IRS)
1111 Constitution Avenue, NW
Washington, DC 20224
Fax: (215) 516-2555

Dear Ms. Corwin and Messrs. Shay, Musher and Danilack:

Re: IFIC Request for Relief re Foreign Account Tax Compliance Act

The Investment Funds Institute of Canada ("IFIC") hereby requests prescriptive relief or exemption from the *Foreign Account Tax Compliance Act* ("FATCA") regime enacted as part of the *Hiring Incentives to Restore Employment Act* in respect of widely held investment funds resident in Canada. Specifically, we request that such funds be excluded from the definition of "foreign financial institution" ("FFI"). We understand that other organizations or countries have sought similar relief and that the IRS at present may be in the process of drafting the legislative relieving provisions. The purposes of this submission are twofold.

- First, we explain why, in our view, the requested exemption would not undermine the objectives of FATCA.
- Second, we articulate our preferences regarding the scope of the exemption and the criteria that a particular fund must satisfy to come within the exemption from FFI status.

IFIC represents Canada's investment funds industry, including 150 fund managers, distributors and industry service organization members. IFIC proactively influences and advances industry issues within members' regulatory framework and promotes members' efficiencies, knowledge and proficiency. IFIC enables dealer and manager members to work together in a co-operative forum to enhance the integrity and growth of the industry and strengthen investor confidence in mutual funds. A significant majority of mutual fund investors in Canada hold their investments in registered retirement savings vehicles – over 70% of mutual fund investments are held in registered retirement savings plans, registered retirement income funds and similar retirement products.

1. Nature of and Basis for Prescriptive Exemption from FATCA

Nature of prescriptive exemption

As you are aware, there are a number of FATCA provisions that provide the Secretary with the discretion to exclude certain holders of U.S. securities from the information reporting and withholding regime of FATCA. For example, clause 1471(d)(5) provides the authority to exclude certain entities from the definition of the term "financial institution". We would request that the Secretary exercise that discretion with respect to widely held investment vehicles resident in Canada or that the FATCA legislation or regulations themselves be amended or drafted to provide such an exemption.

Why provide relief to Canadian resident mutual funds

We understand that the principal objective of the FATCA regime is to assist the IRS in ensuring that U.S. persons report any income or gains derived from investments in securities held outside of the United States. We would like to demonstrate why, in our view, that objective would not be frustrated or compromised by providing an exemption for widely held Canadian resident mutual funds.

- The principal basis for our submission is that U.S. persons represent a very small percentage of the investors in such Canadian mutual funds.
- Furthermore, as explained below, there should not be much potential for overall tax leakage associated with U.S. persons that may own investments in Canadian mutual funds.

There are thousands of mutual funds in Canada that would be FFIs, as that term is currently defined. Based upon an informal survey of our members and other information, we believe that virtually all of those funds that are widely held would have few, if any, U.S. citizens that would be the target of the FATCA provisions. Of the members that responded to the survey:

- Non-resident investors in total held only 1% of the value of the units of their funds.
- Only 0.13% were residents in a non-treaty country.

However, we can understand that you would require additional objective and logical support for our assertions regarding the number of U.S. investors in Canadian funds and the submission that the goals of FATCA would not be compromised.

1. Canada imposes a 25% withholding tax on income distributions from a trust and certain dividends. While there is no withholding tax on capital gains or "capital gains dividends", withholding tax is a deterrent to non-residents investing in Canadian funds (in the same way that U.S. withholding tax on distributions from U.S. funds deters foreign investors).

2. For securities law and regulatory reasons, it is not generally practical or cost-effective for a Canadian mutual fund manager to issue or distribute units of or interests in Canadian mutual funds to non-residents of Canada. Each foreign jurisdiction has securities laws that govern the sale of funds within the jurisdiction. Our understanding of the relevant U.S. securities law may be summarized as follows:

   - An investment company organized outside the U.S. must register with the Securities and Exchange Commission ("SEC") or obtain an order from the SEC exempting it from registering under the U.S. *Investment Company Act of 1940* in order to conduct a public offering into the U.S.

   - Whether an investment fund offers its securities under a public or a private offering, it cannot have more than 300 U.S. resident securityholders without registering under section 12(g) of the *Securities Exchange Act of 1934.*

   Relatively few Canadian fund managers would incur the cost to comply with these regulatory requirements (or any exemptions therefrom) in order to compete for fund "shelf space" in the U.S. market. The few U.S. persons that are unitholders in Canadian funds generally acquired the units while they were residents of Canada and later returned or retired to the U.S. From that time onward, the Canadian fund would generally be precluded from issuing additional units to such persons.

3. If a Canadian fund manager were to make a concerted effort to seek out U.S. investors (and thereby comply with the regulatory regime), it would generally be more tax efficient to have the fund domiciled in the U.S. rather than in Canada (particularly a fund that invests in U.S. securities). Consequently, the U.S. investors would be provided with a K1.

4. There should not be very much tax leakage or opportunity for U.S. citizens to avoid detection from the U.S. In this regard, there are three categories of U.S. investor to consider: (a) those investors who have a mailing address in the U.S.; (b) investors with a mailing address outside of both Canada and the U.S.; and (c) U.S. citizens who are resident in Canada.

   a. For the first category of investor, the IRS should already have access to information that would enable it to identify any non-filers. The United States and Canada have entered into an automatic information exchange agreement under the Canada-United States Convention with Respect to Taxes on Income and on Capital. A Canadian mutual fund will issue an NR4 slip to report investment income distributed to non-resident investors, including U.S. citizens resident in the U.S. Information derived from such slips is automatically provided to the IRS by Canada each year pursuant to the exchange of information provisions.

b. There should not be a material number of investors in the second category who invest in widely held Canadian funds. First, it is likely that the regulatory burden would deter Canadian fund managers from offering the funds in foreign jurisdictions. Second, any U.S. citizens that are resident in a country that imposes income tax (i.e., a treaty country) would likely claim a foreign tax credit in the U.S. in respect of the taxes paid to that jurisdiction on income from the Canadian fund. Thus, there would not be U.S. tax leakage. Third, as noted above, Canadian source withholding tax on distributions from the fund would be a deterrent to owning Canadian funds.

c. The investors in the third category would be treated as a resident of Canada (by virtue of their mailing address) and thus would not receive an NR4 and would not be part of the information exchange. However, we believe that this is not a class of person or investor that should be of concern to the IRS. Income from Canadian mutual funds paid to Canadian residents, including U.S. citizens, is subject to Canadian tax. The Canadian tax levied would be claimed as a foreign tax credit on U.S. tax returns.

2. Criteria for Exemption from FFI Status

It will be necessary to draft the relevant wording of any prescriptive relief to exclude widely held investment funds so that the scope of the exemption is clear and it fits within the legislative policy of FATCA. We expect that you may want a single legislative exception that would apply to all countries (or possibly only countries that have an automatic information exchange agreement with the U.S.), rather than listing specific types of mutual funds as defined in the legislation of numerous different countries. The following represents those characteristics or attributes of a widely held investment fund resident in Canada that IFIC believes would be necessary to accommodate the interests of its members and the few other fund managers in Canada.

- Legal structure of the fund: trusts and corporations

- Public distribution: to include not only funds whose shares or units are traded on a recognized stock exchange, but also funds that are authorized to be distributed to the public by way of a prospectus or similar document filed with a securities regulatory authority

- Minimum number of investors: 100

- Maximum value of investments held by investors resident outside Canada: 10%.

Under our recommended proposal, Canadian resident investment funds that meet all of the above conditions would be excluded from the definition of FFI. For those funds that do not satisfy all conditions, the FATCA regime would apply.

We would be pleased to meet with you in Washington to discuss this letter. Alternatively, if you have any questions, please contact Barbara Amsden, Director, Strategy and Research, by email at bamsden@ific.ca or by calling 1 (416) 309-2323.

Yours sincerely,