



March 13, 2015

Delivered By Email: Alexandra.Maclean@fin.gc.ca

Ms. Alexandra MacLean
Director, Tax Legislation
Department of Finance
90 Elgin Street
Ottawa, ON K1A 0G5

Dear Ms. MacLean:

RE: Alternative Minimum Tax and Unit Trusts

We are writing to request that amendments be made to the Income Tax Act (Canada) (“the Act”) to provide relief from alternative minimum tax (“AMT”) for certain unit trusts. We appreciate the continuing willingness you and your colleagues at the Department of Finance (“Finance”) have demonstrated since this issue was first raised to identify and implement a solution. From our recent discussions with you and Grant Nash, we understand that Finance is willing to bring forward a recommendation to the Minister for relieving amendments that IFIC generally supports. In this letter we set out our understanding of the nature and scope of the proposed amendments.

We understand Finance is prepared to recommend amendments generally as follows:

A unit trust that would otherwise be liable for AMT in a particular year may elect to allocate all or some portion of its adjusted taxable income (“ATI”) for the year to persons who were unitholders of the trust during the year. In the calculation of its AMT liability for the year, the unit trust would be permitted to deduct the allocated ATI (presumably the allocated ATI will be that amount required to reduce its AMT liability to nil). The allocated ATI amounts would be reflected on the T3 slips issued to the beneficiaries/unitholders of the trust. The unitholders would be required to include their share of the ATI allocated to them in the calculation of their potential liability for AMT.

Two matters needed to be addressed and resolved before the relieving amendments could be put into legislative form.

- Which type of unit trust would be entitled to this flow-through treatment (i.e., to address Finance’s concern about potential abuses)? and,
- How to allocate the ATI of a unit trust for a particular year among its beneficiaries?

Unit Trusts that Would Qualify for AMT Flow-Through

We are agreeable to Finance’s recommendation regarding the type of unit trust that would be permitted to make the AMT flow-through election. All of the beneficiaries who may receive any of the income or capital of the trust for any reason must be beneficiaries whose interests under the trust are “fixed interests” (using that term as defined in either subsection 94(1) or section 251.2).

Method for Allocating the ATI among Unitholders of the Trust

Most of the provisions that “flow through” the characterization of amounts at the trust level to the trust’s unitholders are based upon the amount of the income allocated to beneficiaries under subsection 104(13). However, in many cases a unit trust that is liable for AMT does not have any income to allocate to a unitholder under 104(13). A unit trust can incur AMT where expenses and/or income account losses completely offset the trust’s taxable capital gains. In this case, no amount can be included in the unitholders’ income under 104(13) because of the limitation in subsection 104(6). However, the trust may be liable for AMT. A unit trust can also incur AMT where similar deductions partially offset a trust’s taxable capital gains but the balance of those gains is distributed to beneficiaries. In this case some amount will be included in the unitholders’ income under 104(13) but the trust is also liable for AMT.

If the method for allocating ATI were to be based upon the amount of the trust’s income allocations under 104(13) and the unitholders that received them, there would have to be a notional income allocation concept where a trust does not otherwise have any income to allocate. The ATI would be allocated to those unitholders that would have been allocated some of that notional income under the terms of its trust indenture (e.g., something similar to definition of “specified Canadian entity” in 233.3(1) where a fictional, deemed amount of income is used). Alternatively, the allocation could be made pro rata to those persons who were unitholders of the trust on a particular day on or before the end of the year, based upon either the number or value of the units owned.

Possible Legislative Wording to Effect the Amendments

We propose for your consideration the following suggested amendments to the Act:

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

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

2. Amend paragraph 127.52(1)(a) of the Act to read:

(a) *it included the total of all amounts each of which is an amount that is designated in respect of the individual under subsection (1.1) by a unit trust for a particular year of the trust that ends in the year.*

3. Add subsection 127.52(1.1):

For the purposes of subsection (1) and this subsection, where a trust was a unit trust described in paragraph (b)(ii) of the definition of “investment fund” in subsection 251.2(1) throughout a particular taxation year, the trust may deduct in computing its adjusted taxable income for the particular year such portion of its adjusted taxable income otherwise determined as is designated by the trust in respect of a particular beneficiary of the trust in its return of income under Part I for the year provided that the amount so designated in respect of a particular beneficiary does not exceed the amount determined by the formula

$$A \times B/C$$

where:

- A *is the aggregate of all amounts designated by the trust in respect of its adjusted taxable income for the year;*
- B *is the fair market value of the units of the trust held by the beneficiary at the end of the year; and*
- C *is the fair market value of all outstanding units of the trust at the end of the year;*

Alternative Proposal for Consideration

The comments above reflect our understanding of the legislative amendments Finance was prepared to recommend, based upon our last discussions with you. IFIC's original submission to Finance sought an exemption from AMT for unit trusts. An exemption would still be preferred, as there are significant administrative, systems and investor educational issues associated with doing the ATI tax reporting that the above amendments would entail. Finance has recently shown a willingness to define a class of commercial investment fund that should be exempt from anti-avoidance provisions applicable to other trusts (e.g., the trusts that will be exempted from the loss restriction event ("LRE") rules).

We request that Finance consider proposing, as an alternative to the above amendments, an exemption from AMT for the same quasi-mutual fund trusts that will be exempted from the LRE rules.

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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. Please feel free to contact me at rhensel@ific.ca or 416-309-2314, or James Carman, our Senior Policy Advisor, Taxation at jcarman@ific.ca or 416-309-2323.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA



By: Ralf Hensel
General Counsel, Corporate Secretary & Vice-President, Policy

cc: Brian Ernewein, General Director, Tax Policy Branch
Grant Nash, Senior Chief, Tax Policy Branch