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

cetfa Canadian ETF Association

April 4, 2022

Delivered By Email: Consultation-Legislation@fin.gc.ca

Tax Policy Branch – Tax Legislation Division
Finance Canada 90 Elgin Street
Ottawa, ON K1A 0G5

Dear Sirs and Mesdames:

RE: February 4, 2022 Draft Proposals – Mutual Funds: Allocation to Redeemers

We are writing to provide comments on the proposed allocation to redeemers (**ATR**) rules contained in draft legislation to amend the *Income Tax Act* (Canada) (**the ITA**)[1] released on February 4, 2022 ("Proposed Rules").

The Canadian ETF Association (**CETFA**) represents Canadian managers of exchange traded mutual funds (**ETFs**) and other participants in the ETF industry in Canada. The Investment Funds Institute of Canada (**IFIC**) is the voice of Canada's retail mutual fund industry. CETFA and IFIC (the **Organizations**, or **we**) bring together Canadian fund managers, distributors and service providers to foster a strong, stable investment sector where Canadian investors can realize their financial goals.

Following the 2019 introduction of paragraph 132(5.3)(b), which allows mutual fund trusts to utilize ATR for capital gains only to the extent of the investor's inherent gain in their units, we engaged in extensive discussions with the Department of Finance (Canada) and the Ministry of Finance (Ontario) regarding that provision's impact on ETFs, which generally lack access to information necessary to know about their retail unitholders' gain/loss position. In those discussions, both sides explored the question of what an equitable and operationally practical ATR should look like. We understand that proposed new subsection 132(5.31) is the government's response to that question. We are grateful that the government is proposing an ETF-specific alternative to paragraph 132(5.3)(b), that it took into account not only "pure ETFs" but also hybrid ETF/mutual funds, and that it has also proposed a helpful modification to the capital gains refund mechanism (**CGRM**).

Even though we appreciate the changes made to address the issues raised by the industry we still have concerns regarding certain aspects of the Proposed Rules. While we do not wish to maintain the status quo, where the only capital gain ATR rule in the ITA is paragraph 132(5.3)(b)), we do note that the subsection 132(5.31) formula does not relieve double taxation as fully as some of the alternatives that had previously been discussed with the Department of Finance.[2] Those alternatives aimed to produce results closer to those that would obtain for a conventional mutual fund. In contrast, as it only takes into account realized gains and beginning-year net asset value (**NAV**) and end of year NAV, the proposed formula will result in a material amount of double taxation / accelerated taxation in certain circumstances – especially for ETFs with no (or low) unrealized gains at year-end in a declining market, where CGRM does not provide

[1] Unless otherwise noted, all statutory references herein are to the provisions of the ITA as proposed to be amended by the Proposed Rules.

[2] See CETFA/IFIC submission (July 29, 2020) (**Appendix B**) and follow-up email response (August 28, 2020) to questions from the Department of Finance.

material relief such that the ATR mechanism is most needed. In such a down market scenario, the new proposed ATR would provide little relief in circumstances where—

- a significant portion of the net capital gains realized by an ETF is related to redemptions rather than trading/rebalancing gains, and
- the amount of redemption proceeds is only a small fraction of the amount equal to the year-end NAV of the ETF.

In that case, only a small portion of realized gains will be deductible under the proposed formula. That is to be compared to a conventional mutual fund, which is not subject to the vagaries of beginning and end of year NAV numbers impacting the point-in-time allocation to redeeming unitholders.

In our view, it would have instead been more equitable to non-redeeming unitholders if the ATR formula for ETFs were to take unrealized gains and/or cumulative month-end calculations into account. Please see **Appendix A** for how the proposed ATR formula compares to alternative approaches.

We appreciate that a considerable amount of work has gone into the development of proposed subsection 132(5.31) and would appreciate if further consideration was given to alternatives. One such alternative would be to preserve the basic architecture of the Proposed Rules but have the formula operate on a month-by-month basis, with the twelve monthly results of applying such formula being added up for a total amount that would apply to the whole taxation year.

Without some such changes, the Proposed Rules have the potential to distort market choices. We expect that if proposed subsection 132(5.31) were enacted, tax-savvy investors may view Canadian ETFs as uncompetitive relative to their U.S. counterparts and to Canadian mutual funds. We are concerned this will in turn lead to some amount of capital being diverted out of Canadian capital markets into those of the United States or from some domestic investment products to others. To reduce such distortionary effects, we would ask the Department of Finance to consider modifying the proposed formula in one or more of the ways we have suggested.

We offer these comments with appreciation of efforts made by the Department of Finance in providing some ATR for ETFs and in the spirit of providing suggestions for improvement. Our preference is for modifications to the Proposed Rules to be considered and, if necessary, as part of that process, for the grant of further one-year deferral of the application of paragraph 132(5.3)(b) to ETFs. However, to be clear, if the choice is between enactment of the Proposed Rules and having no ATR for ETFs, we would prefer that the Proposed Rules be enacted. We ask only that you consider potential modifications.

We thank the Department of Finance for considering our submission, and would be grateful for the opportunity to meet with the relevant Finance officials to discuss our concerns. To set up a meeting at a time of your convenience or if you have further questions, please do not hesitate to contact either of the undersigned, at PatDunwoody@cetfa.ca and jbaillargeon@ific.ca.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

"Josée Baillargeon"

Josée Baillargeon
Senior Policy Advisor, Taxation

CANADIAN ETF ASSOCIATION

"Pat Dunwoody"

Pat Dunwoody
Executive Director

Cc: Trevor McGowan, Director General, Finance Canada (Trevor.McGowan@fin.gc.ca)

APPENDIX A

Summary of Alternative ATR Formulas Comparison by IFIC/CETFA

	Submission Proposal (Alternative 1) - Point in time & URG	Alternative 2 - Avg & URG	Alternative 3 - Point in time & RG	Alternative 4 - Avg & RG	Alternative 5 - NAV & RG (Finance Proposal)
	- # units redeemed in the year / total units before redemptions x unrealized gains before redemptions;	***- # units redeemed in the year / average units x average unrealized gains for the year***	***- # units redeemed in the year / total units before redemptions x net realized gains;***	***- # units redeemed in the year / average units x net realized gains for the year***	***- lesser of redemptions & greater of PY or CY NAV / (lesser of redemptions & greater of PY or CY NAV + YE NAV) x RG***
	Point in time calculation and aggregate annually	***- data to be collected periodically (e.g. daily), computed annually***	***Point in time calculation and aggregate annually***	***- data to be collected periodically (e.g. daily), computed annually***	***Point in time calculation and aggregate annually***
Scenario A: Trading gains before redemption and market is down at the year-end					
Net capital gains for the year	71,777	71,777	71,777	71,777	71,777
Net capital gain/loss from redemptions	26,777	26,777	26,777	26,777	26,777
Trading capital gain/(loss)	45,000	45,000	45,000	45,000	45,000
Investor gain/loss (if held from beginning) on redemption	34,177	34,177	34,177	34,177	34,177
ATR (realized capital loss on redemption cannot be allocated out)	31,191	33,131	2,295	7,709	6,866
Capital gains retained with CGRM only	*NIL*	*NIL*	*NIL*	*NIL*	*NIL*
Scenario B: More redemption during periods when the market is steady					
Net capital gain for the year	78,931	78,931	78,931	78,931	78,931
Net capital gain/loss from redemptions	33,931	33,931	33,931	33,931	33,931
Trading capital gain/(loss)	45,000	45,000	45,000	45,000	45,000
Investor gain/loss (if held from beginning) on redemption	40,821	40,821	40,821	40,821	40,821
ATR (realized capital loss on redemption cannot be allocated out)	36,096	34,055	2,617	8,408	7,550
Capital gains retained with CGRM only	*NIL*	*NIL*	*NIL*	*NIL*	*NIL*
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady					
Net capital gain for the year	132,696	132,696	132,696	132,696	132,696
Net capital gain/loss from redemptions	72,696	72,696	72,696	72,696	72,696
Trading capital gain/(loss)	60,000	60,000	60,000	60,000	60,000
Investor gain/loss (if held from beginning) on redemption	65,863	65,863	65,863	65,863	65,863
ATR	57,218	57,250	3,378	13,428	12,184
Capital gains retained with CGRM only	57,356	57,356	57,356	57,356	*57,356*

APPENDIX A

Current Proposal/Alternative 1: Annual aggregate of (Redeemed units at point in time / units outstanding before redemption x unrealized gains before redemption)

Assumptions:		**Investor initial cost**
NAV at start of the year	5,200,000	
Unrealized gain at start of the year	500,000	
Units outstanding at start of the year	520,000	**9.04**
Unrealized gain is constant except where indicated otherwise in the scenarios below		
Quarterly redemptions occurring mid-quarter, so there is a quarterly calculation		

	15-Mar	15-Jun	15-Sep	15-Dec	31-Dec	Total	*Observations*
Scenario A: Trading gains before redemption and market is down at the year-end							
Redemptions $ at the end of period	100,000	130,000	150,000	170,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	9.91			
NAV per unit for the redemption	10.00	10.00	9.91	8.98			
Units redeemed (A)	10,000	13,000	15,143	18,927		**57,070**	
NAV before redemption $	5,260,000	5,280,000	5,260,000	4,860,000	4,690,000		
Units outstanding before redemption	526,000	528,000	531,000	541,095	522,168		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	(50,000)	(500,000)	-		
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	9,316	11,343	10,533	(4,414)		**26,777**	
Unrealized gain/loss before redemptions $ (C)	490,000	460,684	369,342	(126,191)	(121,777)		
Unrealized gain/loss after redemption $	480,684	449,342	358,809	(121,777)			
Investor gain/loss (if held from beginning)	9,615	12,500	13,134	(1,073)		34,177	
Net capital gain/loss for the year						**71,777**	
Gross limitation on ATR = A / B * C	9,316	11,343	10,533	-	-	**31,191**	
Capital gains refund mechanism - short cut formula						-	*NIL*
Scenario B: More redemption during periods when the market is steady							
Redemptions $ at the end of period	120,000	150,000	150,000	130,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	10.00			
NAV per unit for the redemption	10.00	10.00	10.00	9.07			
Units redeemed (A)	12,000	15,000	15,000	14,335		**56,335**	
NAV before redemption $	5,260,000	5,260,000	5,270,000	4,870,000	4,740,000	-	
Units outstanding before redemption (B)	526,000	526,000	527,000	537,000	522,665		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	-	(500,000)			
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	11,179	13,084	11,833	(2,165)		**33,931**	
Unrealized gain/loss before redemptions $ (C)	490,000	458,821	415,737	(81,096)	(78,931)		
Unrealized gain/loss after redemption $	478,821	445,737	403,904	(78,931)			
Investor gain/loss (if held from beginning)	**11,538**	**14,423**	**14,423**	**436**	**-**	**40,821**	
Net capital gain/loss for the year $						**78,931**	
Gross limitation on ATR = A / B * C	11,179	13,084	11,833	-	-	**36,096**	
ATR adjusted by s.104(21)(d) - not to exceed net capital gains for the year						**36,096**	
Capital gains refund mechanism - short cut formula $						-	*NIL*
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady							
Redemptions $ at the end of period	120,000	140,000	150,000	140,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.19	10.21	10.28			
NAV per unit for the redemption	10.19	10.21	10.28	10.38			
Units redeemed (A)	11,776	13,713	14,585	13,490		**53,564**	
NAV before redemption	5,360,000	5,370,000	5,430,000	5,580,000	5,440,000	-	
Units outstanding before redemption	526,000	526,000	527,959	537,682	524,192		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	100,000	10,000	40,000	50,000		**200,000**	
Trading gain for the period $	20,000	20,000	20,000			**60,000**	
Net capital gain/loss from redemption $	12,985	30,000	15,111	14,600		**72,696**	
Unrealized gain/loss before redemptions $ (C)	580,000	557,015	547,015	581,904	567,304		
Unrealized gain/loss after redemption $	567,015	527,015	531,904	567,304			
Investor gain/loss (if held from beginning)	**13,562**	**16,054**	**18,179**	**18,069**		**65,863**	
Net capital gain/loss for the year $						**132,696**	
Gross limitation on ATR = A / B * C	12,985	14,522	15,111	14,600	-	**57,218**	
Capital gains refund mechanism - short cut formula $						**57,356**	*>ATR*

APPENDIX A

Alternative 2: # of Redeemed Units in the year/Weighted Daily Average # units outstandingx Weighted Average Unrealized Gains

Assumptions:		**Investor initial cost**
NAV at start of the year	5,200,000	
Unrealized gain at start of the year	500,000	
Units outstanding at start of the year	520,000	**9.04**
Unrealized gain is constant except where indicated otherwise in the scenarios below.		
Quarterly redemptions occurring mid-quarter, so there is a quarterly calculation		

	15-Mar	15-Jun	15-Sep	15-Dec	31-Dec	Total	*Observations*
Scenario A: Trading gains before redemption and market is down at the year-end							
Redemptions $ at the end of period	100,000	130,000	150,000	170,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	9.91			
NAV per unit for the redemption	10.00	10.00	9.91	8.98			
Units redeemed (A)	10,000	13,000	15,143	18,927		**57,070**	
NAV before redemptions $	5,260,000	5,280,000	5,260,000	4,860,000	4,690,000		
Units outstanding before redemption	526,000	528,000	531,000	541,095	522,168		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	(50,000)	(500,000)	-		
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	9,316	11,343	10,533	(4,414)		**26,777**	
Unrealized gain/loss before redemptions $	490,000	460,684	369,342	(126,191)	(121,777)		
Unrealized gain/loss after redemption $	480,684	449,342	358,809	(121,777)			
Investor gain/loss (if held from beginning)	9,615	12,500	13,134	(1,073)	-	**34,177**	
Net capital gain/loss for the year						**71,777**	
Weighted average # units outstanding (B)						**531,365**	
Weighted average unrealized gains (C)						**308,474**	
Gross limitation on ATR = A / B * C						**33,131**	
Point in time ATR = A/B*C	9,316	11,343	10,533	-	-	31,191	***Point in time < Average***
Capital gains refund mechanism - short cut formula						-	***NIL***
Scenario B: More redemption during periods when the market is steady							
Redemptions $ at the end of period	120,000	150,000	150,000	130,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	10.00			
NAV per unit for the redemption	10.00	10.00	10.00	9.07			
Units redeemed (A)	12,000	15,000	15,000	14,335		**56,335**	
NAV before redemptions $	5,260,000	5,260,000	5,270,000	4,870,000	4,740,000	-	
Units outstanding before redemption	526,000	526,000	527,000	537,000	522,665		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $				(500,000)			
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	11,179	13,084	11,833	(2,165)		**33,931**	
Unrealized gain/loss before redemptions $	490,000	458,821	415,737	(81,096)	(78,931)		
Unrealized gain/loss after redemption $	478,821	445,737	403,904	(78,931)			
Investor gain/loss (if held from beginning)	11,538	14,423	14,423	436		**40,821**	
Net capital gain/loss for the year $						**78,931**	
Weighted average # units outstanding (B)						**528,848**	
Weighted average unrealized gains (C) $						**319,694**	
Gross limitation on ATR = A / B * C						**34,055**	
ATR adjusted by s.104(21)(d) - not to exceed net capital gains for the year						**34,055**	
Point in time ATR subject to *s.104(21)(d)*	11,179	13,084	11,833	-	-	36,096	***Point in time before limitation > Average ATR***
Capital gains refund mechanism - short cut formula $						-	***NIL***
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady							
Redemptions $ at the end of period	120,000	140,000	150,000	140,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.19	10.21	10.28			
NAV per unit for the redemption	10.19	10.21	10.28	10.38			
Units redeemed (A)	11,776	13,713	14,585	13,490		**53,564**	
NAV before redemptions	5,360,000	5,370,000	5,430,000	5,580,000	5,440,000	-	
Units outstanding before redemption	526,000	526,000	527,959	537,682	524,192		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	100,000	10,000	40,000	50,000		**200,000**	
Trading gain for the period $	20,000	20,000	20,000	-		**60,000**	
Net capital gain/loss from redemption $	12,985	30,000	15,111	14,600		**72,696**	
Unrealized gain/loss before redemptions $	580,000	557,015	547,015	581,904	567,304		
Unrealized gain/loss after redemption $	567,015	527,015	531,904	567,304			
Investor gain/loss (if held from beginning)	13,562	16,054	18,179	18,069	-	**65,863**	
Net capital gain/loss for the year $						**132,696**	
Weighted average # units outstanding (B)						**529,327**	
Weighted average unrealized gains (C)						**565,748**	
Gross limitation on ATR = A / B * C						**57,250**	
Point in time ATR = A/B*C	12,985	14,522	15,111	14,600	-	57,218	***Point in time < Average***
Capital gains refund mechanism - short cut formula $						**57,356**	***>ATR***

APPENDIX A

Alternative 3 '- Annual aggregate of (# units redeemed at the point in time/ total units before redemption x net realized gains)

Assumptions:		**Investor initial cost**
NAV at start of the year	5,200,000	
Unrealized gain at start of the year	500,000	
Units outstanding at start of the year	520,000	**9.04**
Unrealized gain is constant except where indicated otherwise in the scenarios below.		
Quarterly redemptions occurring mid-quarter, so there is a quarterly calculation		

	15-Mar	15-Jun	15-Sep	15-Dec	31-Dec	Total	*Observations*
Scenario A: Trading gains before redemption and market is down at the year-end							
Redemptions $ at the end of period	100,000	130,000	150,000	170,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	9.91			
NAV per unit for the redemption	10.00	10.00	9.91	8.98			
Units redeemed (A)	10,000	13,000	15,143	18,927		**57,070**	
NAV before redemptions $	5,260,000	5,280,000	5,260,000	4,860,000	4,690,000		
Units outstanding before redemption	526,000	528,000	531,000	541,095	522,168		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	(50,000)	(500,000)	-		
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	9,316	11,343	10,533	(4,414)		**26,777**	
Unrealized gain/loss before redemptions $	490,000	460,684	369,342	(126,191)	(121,777)		
Unrealized gain/loss after redemption $	480,684	449,342	358,809	(121,777)			
Investor gain/loss (if held from beginning)	9,615	12,500	13,134	(1,073)		**34,177**	
Net capital gain/loss for the year (C)	19,316	31,343	40,533	(19,414)		**71,777**	
Point in time ATR = A/B*C	367	772	1,156	-		**2,295**	*Point in time < Average*
Capital gains refund mechanism - short cut formula						-	*NIL*
Scenario B: More redemption during periods when the market is steady							
Redemptions $ at the end of period	120,000	150,000	150,000	130,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	10.00			
NAV per unit for the redemption	10.00	10.00	10.00	9.07			
Units redeemed (A)	12,000	15,000	15,000	14,335		**56,335**	
NAV before redemptions $	5,260,000	5,260,000	5,270,000	4,870,000	4,740,000	-	
Units outstanding before redemption	526,000	526,000	527,000	537,000	522,665		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-		(500,000)			
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	11,179	13,084	11,833	(2,165)		**33,931**	
Unrealized gain/loss before redemptions $	490,000	458,821	415,737	(81,096)	(78,931)		
Unrealized gain/loss after redemption $	478,821	445,737	403,904	(78,931)			
Investor gain/loss (if held from beginning)	11,538	14,423	14,423	436		**40,821**	
Net capital gain/loss for the year $ (C)	21,179	33,084	41,833	(17,165)		**78,931**	
Point in time ATR	483	943	1,191	-	-	**2,617**	*Point in time before limitation*
Capital gains refund mechanism - short cut formula $						-	*NIL*
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady							
Redemptions $ at the end of period	120,000	140,000	150,000	140,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.19	10.21	10.28			
NAV per unit for the redemption	10.19	10.21	10.28	10.38			
Units redeemed (A)	11,776	13,713	14,585	13,490		**53,564**	
NAV before redemptions	5,360,000	5,370,000	5,430,000	5,580,000	5,440,000	-	
Units outstanding before redemption	526,000	526,000	527,959	537,682	524,192		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	100,000	10,000	40,000	50,000		**200,000**	
Trading gain for the period $	20,000	20,000	20,000	-		**60,000**	
Net capital gain/loss from redemption $	12,985	30,000	15,111	14,600		**72,696**	
Unrealized gain/loss before redemptions $	580,000	557,015	547,015	581,904	567,304		
Unrealized gain/loss after redemption $	567,015	527,015	531,904	567,304			
Investor gain/loss (if held from beginning)	13,562	16,054	18,179	18,069		**65,863**	
Net capital gain/loss for the year $ (C)	32,985	50,000	35,111	14,600	-	**132,696**	
Point in time ATR = A/B*C	738	1,304	970	366	-	**3,378**	*Point in time < Average*
Capital gains refund mechanism - short cut formula $						**57,356**	*>ATR*

APPENDIX A

Alternative 4: # of Redeemed Units in the Year /Weighted Daily Average # units outstanding x Net Realized Gains for the Year

Assumptions:		**Investor initial cost**
NAV at start of the year	5,200,000	
Unrealized gain at start of the year	500,000	
Units outstanding at start of the year	520,000	**9.04**
Unrealized gain is constant except where indicated otherwise in the scenarios below.		
Quarterly redemptions occurring mid-quarter, so there is a quarterly calculation		

	15-Mar	15-Jun	15-Sep	15-Dec	31-Dec	Total	*Observations*
Scenario A: Trading gains before redemption and market is down at the year-end							
Redemptions $ at the end of period	100,000	130,000	150,000	170,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	9.91			
NAV per unit for the redemption	10.00	10.00	9.91	8.98			
Units redeemed (A)	10,000	13,000	15,143	18,927		**57,070**	
NAV before redemptions $	5,260,000	5,280,000	5,260,000	4,860,000	4,690,000		
Units outstanding before redemption	526,000	528,000	531,000	541,095	522,168		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	(50,000)	(500,000)	-		
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	9,316	11,343	10,533	(4,414)		**26,777**	
Unrealized gain/loss before redemptions $	490,000	460,684	369,342	(126,191)	(121,777)		
Unrealized gain/loss after redemption $	480,684	449,342	358,809	(121,777)			
Investor gain/loss (if held from beginning)	9,615	12,500	13,134	(1,073)		**34,177**	
Net capital gain/loss for the year (C)	19,316	31,343	40,533	(19,414)		**71,777**	
Weighted average # units outstanding (B)						**531,365**	
Gross limitation on ATR = A / B * C						**7,709**	
Point in time ATR = A/B*C	367	772	1,156	-	-	2,295	***Point in time < Average***
Capital gains refund mechanism - short cut formula						-	***NIL***
Scenario B: More redemption during periods when the market is steady							
Redemptions $ at the end of period	120,000	150,000	150,000	130,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	10.00			
NAV per unit for the redemption	10.00	10.00	10.00	9.07			
Units redeemed (A)	12,000	15,000	15,000	14,335		**56,335**	
NAV before redemptions $	5,260,000	5,260,000	5,270,000	4,870,000	4,740,000	-	
Units outstanding before redemption	526,000	526,000	527,000	537,000	522,665		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	-	(500,000)			
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	11,179	13,084	11,833	(2,165)		**33,931**	
Unrealized gain/loss before redemptions $	490,000	458,821	415,737	(81,096)	(78,931)		
Unrealized gain/loss after redemption $	478,821	445,737	403,904	(78,931)			
Investor gain/loss (if held from beginning)	11,538	14,423	14,423	436		**40,821**	
Net capital gain/loss for the year $ (C)	21,179	33,084	41,833	(17,165)		**78,931**	
Weighted average # units outstanding (B)						**528,848**	
Gross limitation on ATR = A / B * C						**8,408**	
Point in time ATR	483	943	1,191	-	-	2,617	
Capital gains refund mechanism - short cut formula $						-	***NIL***
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady							
Redemptions $ at the end of period	120,000	140,000	150,000	140,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.19	10.21	10.28			
NAV per unit for the redemption	10.19	10.21	10.28	10.38			
Units redeemed (A)	11,776	13,713	14,585	13,490		**53,564**	
NAV before redemptions	5,360,000	5,370,000	5,430,000	5,580,000	5,440,000	-	
Units outstanding before redemption	526,000	526,000	527,959	537,682	524,192		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	100,000	10,000	40,000	50,000		**200,000**	
Trading gain for the period $	20,000	20,000	20,000	-		**60,000**	
Net capital gain/loss from redemption $	12,985	30,000	15,111	14,600		**72,696**	
Unrealized gain/loss before redemptions $	580,000	557,015	547,015	581,904	567,304		
Unrealized gain/loss after redemption $	567,015	527,015	531,904	567,304			
Investor gain/loss (if held from beginning)	13,562	16,054	18,179	18,069		**65,863**	
Net capital gain/loss for the year $ (C)	**32,985**	**50,000**	**35,111**	**14,600**	**-**	**132,696**	
Weighted average # units outstanding (B)						**529,327**	
Gross limitation on ATR = A / B * C						**13,428**	
Point in time ATR = A/B*C	738	1,304	970	366	-	3,378	
Capital gains refund mechanism - short cut formula $						**57,356**	***>ATR***

APPENDIX A

Alternative 5: Finance Proposal

Assumptions: **Investor initial cost**

NAV at start of the year (Ca)	5,200,000	
Unrealized gain at start of the year	500,000	
Units outstanding at start of the year	520,000	**9.04**
Unrealized gain is constant except where indicated otherwise in the scenarios below.		
Quarterly redemptions occurring mid-quarter, so there is a quarterly calculation		

	15-Mar	15-Jun	15-Sep	15-Dec	31-Dec	Total	*Observations*
Scenario A: Trading gains before redemption and market is down at the year-end							
Redemptions $ at the end of period	100,000	130,000	150,000	170,000		**550,000**	B
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	9.91			
NAV per unit for the redemption	10.00	10.00	9.91	8.98			
Units redeemed	10,000	13,000	15,143	18,927		**57,070**	
NAV before redemptions $	5,260,000	5,280,000	5,260,000	4,860,000	4,690,000	**4,690,000**	Cb
Units outstanding before redemption	526,000	528,000	531,000	541,095	522,168		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	(50,000)	(500,000)	-		
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	9,316	11,343	10,533	(4,414)		**26,777**	
Unrealized gain/loss before redemptions $	490,000	460,684	369,342	(126,191)	(121,777)		
Unrealized gain/loss after redemption $	480,684	449,342	358,809	(121,777)			
Investor gain/loss (if held from beginning)	9,615	12,500	13,134	(1,073)		**34,177**	
Net capital gain/loss for the year	19,316	31,343	40,533	(19,414)		**71,777**	D
Greater of current year-end NAV and prior year-end NAV (C)						**5,200,000**	
Gross limitation on ATR = B / (B + C) x D						**6,866**	
Capital gains refund mechanism - short cut formula						-	**NIL**
Scenario B: More redemption during periods when the market is steady							
Redemptions $ at the end of period	120,000	150,000	150,000	130,000		**550,000**	B
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	10.00			
NAV per unit for the redemption	10.00	10.00	10.00	9.07			
Units redeemed (A)	12,000	15,000	15,000	14,335		**56,335**	
NAV before redemptions $	5,260,000	5,260,000	5,270,000	4,870,000	4,740,000	-	Cb
Units outstanding before redemption	526,000	526,000	527,000	537,000	522,665		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	-	(500,000)			
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	11,179	13,084	11,833	(2,165)		**33,931**	
Unrealized gain/loss before redemptions $	490,000	458,821	415,737	(81,096)	(78,931)		
Unrealized gain/loss after redemption $	478,821	445,737	403,904	(78,931)			
Investor gain/loss (if held from beginning)	11,538	14,423	14,423	436		**40,821**	
Net capital gain/loss for the year $ (C)	21,179	33,084	41,833	(17,165)		**78,931**	D
Greater of current year-end NAV and prior year-end NAV (C)						**5,200,000**	
Gross limitation on ATR = B / (B + C) x D						**7,550**	
Capital gains refund mechanism - short cut formula						-	**NIL**
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady							
Redemptions $ at the end of period	120,000	140,000	150,000	140,000		**550,000**	B
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.19	10.21	10.28			
NAV per unit for the redemption	10.19	10.21	10.28	10.38			
Units redeemed (A)	11,776	13,713	14,585	13,490		**53,564**	
NAV before redemptions	5,360,000	5,370,000	5,430,000	5,580,000	5,440,000	**5,440,000**	Cb
Units outstanding before redemption	526,000	526,000	527,959	537,682	524,192		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	100,000	10,000	40,000	50,000		**200,000**	
Trading gain for the period $	20,000	20,000	20,000	-		**60,000**	
Net capital gain/loss from redemption $	12,985	30,000	15,111	14,600		**72,696**	
Unrealized gain/loss before redemptions $	580,000	557,015	547,015	581,904	567,304		
Unrealized gain/loss after redemption $	567,015	527,015	531,904	567,304			
Investor gain/loss (if held from beginning)	13,562	16,054	18,179	18,069		**65,863**	
Net capital gain/loss for the year $ (C)	**32,985**	**50,000**	**35,111**	**14,600**	-	**132,696**	D
Greater of current year-end NAV and prior year-end NAV (C)						**5,440,000**	
Gross limitation on ATR = B / (B + C) x D						**12,184**	
Capital gains refund mechanism - short cut formula						**57,356**	

APPENDIX B
(Sent July 29, 2020)

ATR SUBMISSION

Contents

A. Introduction

This memorandum contains a revised submission for an allocation of capital gains to redeemers ("ATR") proposal for exchange-traded funds ("ETFs") from the Joint IFIC/CEFTA ATR Working Group. It responds to input provided to the Working Group by the federal Department of Finance and the Ontario Ministry of Finance (collectively, "Finance") on a May 27, 2020 telephone call. We understand, based on that call, that Finance's preferences include the following:

I. a single, formulaic test for the maximum amount of net realized capital gains that can be allocated to redeemers;

II. a formula that is easy to administer and that uses variables that are relatively easily referenced in public data and/or auditable by the Canada Revenue Agency ("CRA");

III. that the formula —

(a) not follow a "point in time" approach to measuring the amount of gains that can be allocated, but a preference for an averaging method to "smooth" over the amount of gains that can be allocated to particular redeemers, and

(b) be more reflective of secondary market gains than a test that looks only to the net unrealized capital gains of the particular ETF;

IV. that the Working Group demonstrate the connection between the ATR model and secondary market activity; and

V. that the Working Group articulate the philosophy and policy rationale for the proposal and explain why the proposal is "fair" and "right".

This memorandum addresses the preferences in I, II, IV and V. The Working Group made good faith efforts to accommodate preference III. We considered alternative averaging formulas in order to determine philosophically, whether any of them would be in the best interest of investors and also would not disadvantage ETFs competitively relative to other mutual fund trusts. Our analysis has shown, and the IFIC/CETFA membership concluded, that an averaging approach which disregards the unrealized net gain position of the ETF prior to a redemption would create a risk of double taxation. It would also

competitively disadvantage Canadian ETFs relative to conventional mutual fund trusts domestically and relative to foreign ETFs.

A major limitation of the CGRM (an averaging based mechanism) is that it provides no relief from double taxation to a fund that ends up in a net loss position at year's end. A workable ATR mechanism needs to provide ETFs in that scenario with the ability to allocate redemption-related gains realized earlier in the year when the ETF was in a net gain position. Otherwise, double taxation will occur and Canadian ETFs will be competitively disadvantaged relative to mutual funds and foreign ETFs.

After running detailed calculations and discussing the results internally and with the business units of IFIC/CETFA members, we unanimously concluded and feel strongly that an averaging approach that disregards the unrealized gain position of the ETF prior to redemptions does not yield appropriate results.

We respect and appreciate Finance's objective of developing an ATR formula that is easily auditable by the CRA. All but one of the variables in our proposed formula are publicly available. To require that every component of the formula be derived from published data, we submit, holds ETFs to an unreasonably higher standard not required of non-ETF mutual fund trusts: none of the numerical data used in the mutual fund ATR in proposed paragraph 132(5.3)(b) is publicly available, so it is not clear why the opposite should be required of ETFs.

In summary, while the Working Group, in the interests of reaching a mutually acceptable ATR for ETFs as soon as reasonably possible, would have liked to subscribe to and propose an averaging formula based solely on NAV and other published amounts, we respectfully submit for consideration by Finance a different type of formula, buttressed by an anti-avoidance rule, as well as the rationale for the proposed formula.

B. Proposed Amendments

We propose that new defined terms be added to subsection 132(4) and that a paragraph be added to subsection 132(5.3). The numerical formula limiting ATR for ETFs would be contained in new paragraph 132(5.3)(c), and it would be subject to an anti-avoidance rule contained in one of the new defined terms.

132(4) Definitions — In this section,

…

"ETF units" means units of a mutual fund trust that are listed on a designated stock exchange in Canada and that are in continuous distribution;

"unrealized gain position" in respect of a redemption of ETF units of a particular class or series of ETF units of a trust means the amount, if any, by which the fair market value of the properties of the trust attributable to the particular class or series exceeds the cost amount to the trust of such properties, determined at the beginning of the day that the ETF units are redeemed;

"proportionate unrealized gain position" in respect of a redemption of ETF units by a particular beneficiary (the "redeemer") means an amount equal to the product of (a) the unrealized gain

position of the particular class or series of ETF units the units of which are redeemed, and (b) the quotient obtained by dividing the number of ETF units of the particular class or series redeemed by the total number of ETF units of the class or series, as the case may be, issued and outstanding immediately before the redemption, provided however that the proportionate unrealized gain position in respect of a redemption of ETF units shall be deemed to be nil if it may reasonably be concluded, having regard to all the circumstances, including

(a) whether it can reasonably be considered that the redeemer requested the redemption as a result of being solicited to make the request by the trustee or manager of the trust, and[1]

(b) whether either (a) the units redeemed were identical to units previously issued on that same day to that redeemer, or (b) if prior to the redemption the redeemer already held at least the same number of ETF units as were redeemed, the acquisition of such units by the redeemer was part of the same series of transactions as the redemption,

that one of the main reasons for the issuance of units to the redeemer, the disposition of securities by the trust either as an in-kind redemption or to obtain cash to pay cash redemption proceeds on the redemption, and the redemption was that the taxes, if any, under this Part paid by any person or persons on the capital gains realized on such disposition are significantly less than the tax that would have been applicable under this Part if such capital gains had instead been realized by the trust and distributed to the other holders of ETF units who are allocated capital gains of the trust;

132(5.3) Allocation to redeemers — If a trust that is a mutual fund trust throughout a taxation year paid or made payable, at any time in the taxation year, to a beneficiary an amount on a redemption by that beneficiary of a unit of the trust (in this subsection referred to as the "allocated amount"), and the beneficiary's proceeds from the disposition of that unit do not include the allocated amount, in computing its income for the taxation year no deduction may be made by the trust in respect of

(a) the portion of the allocated amount that would be, without reference to subsection 104(6), an amount paid out of the income (other than taxable capital gains) of the trust; ~~and~~

(b) in the case of a redemption of units other than ETF units, the portion of the allocated amount determined by the formula [in paragraph (b)] …; and

(c) in the case of a redemption of ETF units, the portion of the allocated amount determined by the formula

$$A - (½ \times B)$$

[1] The "and" here is not meant to indicate that both hallmarks (a) and (b) must be present; it was simply meant to indicate that these are two potentially relevant factual circumstances to be taken into account in determining whether the anti-avoidance rule applies. If Finance prefers an "or", we would not object.

where

A is the portion of the allocated amount that would be, without reference to subsection 104(6), an amount paid out of the taxable capital gains of the trust, and

B is the proportionate unrealized gain position amount in respect of the redemption.

C. Rationale for the Proposed Amendments

Our ATR proposal involves a calculation of the unrealized gain or loss position of a particular class or series of ETF units of a mutual fund trust. Such a calculation is made immediately prior to a redemption of units of the particular class or series. If the class or series is in an unrealized gain position on the day of the redemption, then a proportion of the overall unrealized gain is allocated to the redeemer. No gains are allocated to a redeemer if the class or series is in an unrealized loss position. The following statements are explicit or implicit in this proposal:

- The unrealized gain/loss position of the property of an ETF is an acceptable proxy for the secondary market position of an ETF's unitholders as a whole (i.e., unrealized gain position on units and realized gains or losses from selling on the exchange).

- The redemption of units by an AP is correlated with sales of ETF units on the exchange. The redemption of units will not necessarily coincide in time with the sales on the market. However, a redemption of units by an AP ultimately reflects a net sale of units by the public because the sole reason for such redemptions should relate to its role as an intermediary market maker. Therefore, redemptions by APs are a proxy for sales on the market.

- It is reasonable to treat each holder of ETF units of a particular class or series (including the APs) as being in the same position. They are all in either an unrealized gain position or an unrealized loss positon, both in absolute terms and on a per unit basis.

- Our proposed ATR formula for a particular taxation year does not take into account transactions or data from preceding taxation years (e.g., cost of units, income/gain allocations etc.)

We provide some comments below regarding why we believe that the above attributes of our ATR formula are reasonable. We acknowledge that someone may be able to come up with a more theoretically pure ATR formula. However, we submit that the factual data needed for the purpose of such a formula is either not available or not practical to use. We submit that some compromise must be made in arriving at a formula that is practical and administrable.

At any given time, the unrealized gain/loss position of an ETF class or series should approximate the realized and unrealized gains and losses of its units in the secondary market in aggregate. Since transactions can take place in the secondary market without any impact on the ETF (and can be direct between investors, not always involving activity on the part of a market maker or designated broker), some of the unrealized gains in the market can be crystalized well before any redemption, or well after.

Similarly, some gains or losses may be realized by an ETF (corporate actions, rebalancing) without any corresponding impact on the secondary market gain or loss. There is no publicly available empirical proxy of the secondary market position of the ETF unitholders and it is impracticable to compare the outside basis with the inside basis even if that information was available. Therefore, we think it is reasonable that if an ETF is in an unrealized gain (loss) position in respect of its assets, the unitholders as a group should be considered to be in an overall net unrealized gain (loss) position on their units.

The industry does not know which groups of ETF investors have the unrealized gain (loss) position reflected in their units. The possibilities include investors who redeemed before the beginning of the year, investors who redeemed at any time during the year and investors that hold units at the end of the year (with this latter group including those who have held their units for years and those who subscribed for the first time during the year). Of those groups, only two are candidates for an allocation out of the fund's realized capital gains for the year: those who were unitholders at any time in the year but redeemed before year-end and those who were or became unitholders during the year and were still unitholders at year end (and a person could be a member of both groups – i.e., someone who did a partial redemption during the year).

In the absence of empirical data regarding which unitholders are in an unrealized gain or loss position, the fairest position is to treat them alike. All unitholders on average will be in either an unrealized gain or unrealized loss position commensurate with that of the ETF. We also consider it fair to only allocate capital gains to redeemers when the ETF is in an unrealized gain position. This is consistent with our position that the fund level tax position is a good proxy for the investor's tax position. Finally, it is fair to allocate the unrealized gain position on a pro rata basis among the two groups of unitholders using data as of, and on, the date of redemption (i.e., a point in time test).

D. Data Availability

We acknowledge Finance's desire for market data on the relationship of primary market to secondary market activity. Industry currently does not maintain data tracking the correlation of those variables, and the Working Group determined that simply comparing raw numbers regarding creation/redemption activity and market activity would not lead to reliable conclusions on which to base policy decisions. For instance, a market maker might be redeeming excess supply from three days prior to the trade date and so looking at a one-day snapshot of how that redemption volume relates to secondary market activity would be misleading; similarly, even within a single day.

We also acknowledge Finance's desire for the ATR formula to be based on data readily available to the CRA. As noted elsewhere, it is not a requirement in the design of rules in the Act that they utilize only publicly available data – in fact, the norm is quite the reverse.

The ATR formula we have proposed uses some data that is, and some that is not, publicly available. It contains three data points: number of units redeemed on a day; the number of units outstanding at the beginning of the day and the unrealized gain/loss position of the ETF. The first two should be publicly available. The third item is calculated every day by funds (including by retail MFTs) and thus should be easily auditable.

While the anti-avoidance rule is not as easily auditable, we submit it is no less auditable than a wide range of "main purpose" tests in the Act, which require for their application questions as to whether there is a series of transactions, what the purpose of an arrangement was, etc. Again, we are asking that the ETF ATR be held to no lower and no higher a standard than other rules in the Act.

E. Timing of Relief

This is an extraordinary time for tax policymakers and tax administrators, as well as for taxpayers and their advisors. Both activity levels and economic uncertainty are high and there are new and evolving priorities. It is in this environment that ETFs and their investors are facing a rule proposed during the relative calm of 2019 that – if enacted as proposed – already applies to ETFs launched after March 19 of this year and will apply to other ETFs beginning January 1, 2021.

Under these circumstances, and given the complexities of the issues and the stage that our discussions are at, we would like to discuss with you what the realistically available relief options are at this time.

From: James Carman
Sent: Friday, August 28, 2020 6:16 PM
To: 'Darmo, Marc (FIN)' ; 'Jillian.Welch'
Cc: 'Bergeron, Olivier (FIN)'; 'Picard, Josianne (FIN)'; 'Phil.Kohnen'
Subject: Alternative ATR Formulas - Comparison

Good evening,

Attached are two documents – an Excel titled "Alternative ATR Formulas – Comparison" (the "Charts") and our analysis of four alternative ATR methodologies.

The Charts illustrate the application of four alternative ATR formulas, the first of which is the current CETFA/IFIC proposal:

- Alternative 1 – ATR is based on the fund's net **unrealized gains** as at each relevant **point in time** (i.e. time of each redemption) and the percentage of the fund's units redeemed at that time

- Alternative 2 – The starting point for this ATR is the amount of net **unrealized gains** of the fund at the end of regular intervals (e.g. month-end or quarter-end)[1]. An average net unrealized gain position for the year is calculated by a weighted average of the individual amounts at each such period end. The allocation of this average net unrealized gain amount among redeemers and non-redeemers is based upon the **average** number of units outstanding during the year)

- Alternative 3 – ATR is based on net **realized gains** existing at each relevant **point in time**

- Alternative 4 – ATR is based on net **realized gains** for the year and the **average** number of units outstanding during the year.

Detailed calculations are provided in the spreadsheet for each alternative ATR formula so that you can review our calculations. All four are summarized and compared in the "Summary" tab of the spreadsheet.

In the Charts, the four alternative approaches are applied to three scenarios. Two of the three scenarios involve markets declining toward year-end, since this is the situation that results in suboptimal results under the CGRM and where it is most

important therefore that ETFs have access like mutual funds to a workable ATR.

The analysis also includes our concerns regarding an averaging approach which disregards the unrealized net gain position of the ETF prior to a redemption and the associated risk of double taxation

After you have had sufficient time to review these materials, we would like to arrange a conference call to get your feedback.

Best regards,

James

JAMES CARMAN | Senior Policy Advisor, Taxation | Conseiler principal en politiques, Fiscalite
The Investment Funds Institute of Canada
jcarman@ific.ca | 416-309-2323

Connect with Us: IFIC.CA | @ific | https://www.facebook.com/ific.ca/ | http://ca.linkedin.com

APPENDIX B

Summary of Alternative ATR Formulas Comparison by IFIC/CETFA

	Current Proposal (Alternative 1)- Point in time & URG		Alternative 2-Avg & URG	Alternative 3 -Point in time & RG	Alternative 4-Avg & RG
	- # units redeemed in the year / total units before redemptions x unrealized gains before redemptions;		***- # units redeemed in the year / average units x average unrealized gains for the year***	***- # units redeemed in the year / total units before redemptions x net realized gains;***	***- # units redeemed in the year / average units x net realized gains for the year***
	Point in time calculation and aggregate annually		***- data to be collected periodically (e.g. daily), computed annually***	***Point in time calculation and aggregate annually***	***- data to be collected periodically (e.g. daily), computed annually***
Scenario A: Trading gains before redemption and market is down at the year-end					
Net capital gains for the year	71,777		71,777	71,777	71,777
Net capital gain/loss from redemptions	26,777		26,777	26,777	26,777
Trading capital gain/(loss)	45,000		45,000	45,000	45,000
Investor gain/loss (if held from beginning) on redemption	34,177		34,177	34,177	34,177
ATR (realized capital loss on redemption cannot be allocated out)	31,191	<	33,131	2,295	7,709
Capital gains retained with CGRM only	*NIL*		*NIL*	*NIL*	*NIL*
Scenario B: More redemption during periods when the market is steady					
Net capital gain for the year	78,931		78,931	78,931	78,931
Net capital gain/loss from redemptions	33,931		33,931	33,931	33,931
Trading capital gain/(loss)	45,000		45,000	45,000	45,000
Investor gain/loss (if held from beginning) on redemption	40,821		40,821	40,821	40,821
ATR (realized capital loss on redemption cannot be allocated out)	36,096	>	34,055	2,617	8,408
Capital gains retained with CGRM only	*NIL*		*NIL*	*NIL*	*NIL*
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady					
Net capital gain for the year	132,696		132,696	132,696	132,696
Net capital gain/loss from redemptions	72,696		72,696	72,696	72,696
Trading capital gain/(loss)	60,000		60,000	60,000	60,000
Investor gain/loss (if held from beginning) on redemption	65,863		65,863	65,863	65,863
ATR	57,218	<	57,250	3,378	13,428
Capital gains retained with CGRM only	57,356		57,356	57,356	57,356

APPENDIX B

Current Proposal/Alternative 1: Annual aggregate of (Redeemed units at point in time / units outstanding before redemption x unrealized gains before redemption)

Assumptions:		**Investor initial cost**
NAV at start of the year	5,200,000	
Unrealized gain at start of the year	500,000	
Units outstanding at start of the year	520,000	**9.04**
Unrealized gain is constant except where indicated otherwise in the scenarios below		
Quarterly redemptions occurring mid-quarter, so there is a quarterly calculation		

	15-Mar	15-Jun	15-Sep	15-Dec	31-Dec	Total	*Observations*
Scenario A: Trading gains before redemption and market is down at the year-end							
Redemptions $ at the end of period	100,000	130,000	150,000	170,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	9.91			
NAV per unit for the redemption	10.00	10.00	9.91	8.98			
Units redeemed (A)	10,000	13,000	15,143	18,927		**57,070**	
NAV before redemption $	5,260,000	5,280,000	5,260,000	4,860,000	4,690,000		
Units outstanding before redemption	526,000	528,000	531,000	541,095	522,168		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	(50,000)	(500,000)	-		
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	9,316	11,343	10,533	(4,414)		**26,777**	
Unrealized gain/loss before redemptions $ (C)	490,000	460,684	369,342	(126,191)	(121,777)		
Unrealized gain/loss after redemption $	480,684	449,342	358,809	(121,777)			
Investor gain/loss (if held from beginning)	9,615	12,500	13,134	(1,073)		34,177	
Net capital gain/loss for the year						**71,777**	
Gross limitation on ATR = A / B * C	9,316	11,343	10,533	-	-	**31,191**	
Capital gains refund mechanism - short cut formula						-	*NIL*
Scenario B: More redemption during periods when the market is steady							
Redemptions $ at the end of period	120,000	150,000	150,000	130,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	10.00			
NAV per unit for the redemption	10.00	10.00	10.00	9.07			
Units redeemed (A)	12,000	15,000	15,000	14,335		**56,335**	
NAV before redemption $	5,260,000	5,260,000	5,270,000	4,870,000	4,740,000	-	
Units outstanding before redemption (B)	526,000	526,000	527,000	537,000	522,665		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	-	(500,000)			
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	11,179	13,084	11,833	(2,165)		**33,931**	
Unrealized gain/loss before redemptions $ (C)	490,000	458,821	415,737	(81,096)	(78,931)		
Unrealized gain/loss after redemption $	478,821	445,737	403,904	(78,931)			
Investor gain/loss (if held from beginning)	**11,538**	**14,423**	**14,423**	**436**	**-**	**40,821**	
Net capital gain/loss for the year $						**78,931**	
Gross limitation on ATR = A / B * C	11,179	13,084	11,833	-	-	**36,096**	
ATR adjusted by s.104(21)(d) - not to exceed net capital gains for the year						**36,096**	
Capital gains refund mechanism - short cut formula $						-	*NIL*
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady							
Redemptions $ at the end of period	120,000	140,000	150,000	140,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.19	10.21	10.28			
NAV per unit for the redemption	10.19	10.21	10.28	10.38			
Units redeemed (A)	11,776	13,713	14,585	13,490		**53,564**	
NAV before redemption	5,360,000	5,370,000	5,430,000	5,580,000	5,440,000	-	
Units outstanding before redemption	526,000	526,000	527,959	537,682	524,192		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	100,000	10,000	40,000	50,000		**200,000**	
Trading gain for the period $	20,000	20,000	20,000			**60,000**	
Net capital gain/loss from redemption $	12,985	30,000	15,111	14,600		**72,696**	
Unrealized gain/loss before redemptions $ (C)	580,000	557,015	547,015	581,904	567,304		
Unrealized gain/loss after redemption $	567,015	527,015	531,904	567,304			
Investor gain/loss (if held from beginning)	**13,562**	**16,054**	**18,179**	**18,069**		**65,863**	
Net capital gain/loss for the year $						**132,696**	
Gross limitation on ATR = A / B * C	12,985	14,522	15,111	14,600	-	**57,218**	
Capital gains refund mechanism - short cut formula $						**57,356**	*>ATR*

APPENDIX B

Alternative 2: # of Redeemed Units in the year/Weighted Daily Average # units outstandingx Weighted Average Unrealized Gains

Assumptions:		**Investor initial cost**
NAV at start of the year	5,200,000	
Unrealized gain at start of the year	500,000	
Units outstanding at start of the year	520,000	**9.04**
Unrealized gain is constant except where indicated otherwise in the scenarios below.		
Quarterly redemptions occurring mid-quarter, so there is a quarterly calculation		

	15-Mar	15-Jun	15-Sep	15-Dec	31-Dec	Total	*Observations*
Scenario A: Trading gains before redemption and market is down at the year-end							
Redemptions $ at the end of period	100,000	130,000	150,000	170,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	9.91			
NAV per unit for the redemption	10.00	10.00	9.91	8.98			
Units redeemed (A)	10,000	13,000	15,143	18,927		**57,070**	
NAV before redemptions $	5,260,000	5,280,000	5,260,000	4,860,000	4,690,000		
Units outstanding before redemption	526,000	528,000	531,000	541,095	522,168		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	(50,000)	(500,000)	-		
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	9,316	11,343	10,533	(4,414)		**26,777**	
Unrealized gain/loss before redemptions $	490,000	460,684	369,342	(126,191)	(121,777)		
Unrealized gain/loss after redemption $	480,684	449,342	358,809	(121,777)			
Investor gain/loss (if held from beginning)	9,615	12,500	13,134	(1,073)	-	**34,177**	
Net capital gain/loss for the year						**71,777**	
Weighted average # units outstanding (B)						**531,365**	
Weighted average unrealized gains (C)						**308,474**	
Gross limitation on ATR = A / B * C						**33,131**	
Point in time ATR = A/B*C	9,316	11,343	10,533	-	-	31,191	***Point in time < Average***
Capital gains refund mechanism - short cut formula						-	***NIL***
Scenario B: More redemption during periods when the market is steady							
Redemptions $ at the end of period	120,000	150,000	150,000	130,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	10.00			
NAV per unit for the redemption	10.00	10.00	10.00	9.07			
Units redeemed (A)	12,000	15,000	15,000	14,335		**56,335**	
NAV before redemptions $	5,260,000	5,260,000	5,270,000	4,870,000	4,740,000	-	
Units outstanding before redemption	526,000	526,000	527,000	537,000	522,665		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $				(500,000)			
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	11,179	13,084	11,833	(2,165)		**33,931**	
Unrealized gain/loss before redemptions $	490,000	458,821	415,737	(81,096)	(78,931)		
Unrealized gain/loss after redemption $	478,821	445,737	403,904	(78,931)			
Investor gain/loss (if held from beginning)	11,538	14,423	14,423	436		**40,821**	
Net capital gain/loss for the year $						**78,931**	
Weighted average # units outstanding (B)						**528,848**	
Weighted average unrealized gains (C) $						**319,694**	
Gross limitation on ATR = A / B * C						**34,055**	
ATR adjusted by s.104(21)(d) - not to exceed net capital gains for the year						**34,055**	
Point in time ATR subject to *s.104(21)(d)*	11,179	13,084	11,833	-	-	36,096	***Point in time before limitation > Average ATR***
Capital gains refund mechanism - short cut formula $						-	***NIL***
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady							
Redemptions $ at the end of period	120,000	140,000	150,000	140,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.19	10.21	10.28			
NAV per unit for the redemption	10.19	10.21	10.28	10.38			
Units redeemed (A)	11,776	13,713	14,585	13,490		**53,564**	
NAV before redemptions	5,360,000	5,370,000	5,430,000	5,580,000	5,440,000	-	
Units outstanding before redemption	526,000	526,000	527,959	537,682	524,192		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	100,000	10,000	40,000	50,000		**200,000**	
Trading gain for the period $	20,000	20,000	20,000	-		**60,000**	
Net capital gain/loss from redemption $	12,985	30,000	15,111	14,600		**72,696**	
Unrealized gain/loss before redemptions $	580,000	557,015	547,015	581,904	567,304		
Unrealized gain/loss after redemption $	567,015	527,015	531,904	567,304			
Investor gain/loss (if held from beginning)	13,562	16,054	18,179	18,069	-	**65,863**	
Net capital gain/loss for the year $						**132,696**	
Weighted average # units outstanding (B)						**529,327**	
Weighted average unrealized gains (C)						**565,748**	
Gross limitation on ATR = A / B * C						**57,250**	
Point in time ATR = A/B*C	12,985	14,522	15,111	14,600	-	57,218	***Point in time < Average***
Capital gains refund mechanism - short cut formula $						**57,356**	***>ATR***

APPENDIX B

Alternative 3 '- Annual aggregate of (# units redeemed at the point in time/ total units before redemption x net realized gains)

Assumptions:		**Investor initial cost**
NAV at start of the year	5,200,000	
Unrealized gain at start of the year	500,000	
Units outstanding at start of the year	520,000	**9.04**
Unrealized gain is constant except where indicated otherwise in the scenarios below.		
Quarterly redemptions occurring mid-quarter, so there is a quarterly calculation		

	15-Mar	15-Jun	15-Sep	15-Dec	31-Dec	Total	*Observations*
Scenario A: Trading gains before redemption and market is down at the year-end							
Redemptions $ at the end of period	100,000	130,000	150,000	170,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	9.91			
NAV per unit for the redemption	10.00	10.00	9.91	8.98			
Units redeemed (A)	10,000	13,000	15,143	18,927		**57,070**	
NAV before redemptions $	5,260,000	5,280,000	5,260,000	4,860,000	4,690,000		
Units outstanding before redemption	526,000	528,000	531,000	541,095	522,168		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	(50,000)	(500,000)	-		
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	9,316	11,343	10,533	(4,414)		**26,777**	
Unrealized gain/loss before redemptions $	490,000	460,684	369,342	(126,191)	(121,777)		
Unrealized gain/loss after redemption $	480,684	449,342	358,809	(121,777)			
Investor gain/loss (if held from beginning)	9,615	12,500	13,134	(1,073)		**34,177**	
Net capital gain/loss for the year (C)	19,316	31,343	40,533	(19,414)		**71,777**	
Point in time ATR = A/B*C	367	772	1,156	-		**2,295**	*Point in time < Average*
Capital gains refund mechanism - short cut formula						-	*NIL*
Scenario B: More redemption during periods when the market is steady							
Redemptions $ at the end of period	120,000	150,000	150,000	130,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	10.00			
NAV per unit for the redemption	10.00	10.00	10.00	9.07			
Units redeemed (A)	12,000	15,000	15,000	14,335		**56,335**	
NAV before redemptions $	5,260,000	5,260,000	5,270,000	4,870,000	4,740,000	-	
Units outstanding before redemption	526,000	526,000	527,000	537,000	522,665		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-		(500,000)			
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	11,179	13,084	11,833	(2,165)		**33,931**	
Unrealized gain/loss before redemptions $	490,000	458,821	415,737	(81,096)	(78,931)		
Unrealized gain/loss after redemption $	478,821	445,737	403,904	(78,931)			
Investor gain/loss (if held from beginning)	11,538	14,423	14,423	436		**40,821**	
Net capital gain/loss for the year $ (C)	21,179	33,084	41,833	(17,165)		**78,931**	
Point in time ATR	483	943	1,191	-	-	**2,617**	*Point in time before limitation*
Capital gains refund mechanism - short cut formula $						-	*NIL*
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady							
Redemptions $ at the end of period	120,000	140,000	150,000	140,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.19	10.21	10.28			
NAV per unit for the redemption	10.19	10.21	10.28	10.38			
Units redeemed (A)	11,776	13,713	14,585	13,490		**53,564**	
NAV before redemptions	5,360,000	5,370,000	5,430,000	5,580,000	5,440,000	-	
Units outstanding before redemption	526,000	526,000	527,959	537,682	524,192		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	100,000	10,000	40,000	50,000		**200,000**	
Trading gain for the period $	20,000	20,000	20,000	-		**60,000**	
Net capital gain/loss from redemption $	12,985	30,000	15,111	14,600		**72,696**	
Unrealized gain/loss before redemptions $	580,000	557,015	547,015	581,904	567,304		
Unrealized gain/loss after redemption $	567,015	527,015	531,904	567,304			
Investor gain/loss (if held from beginning)	13,562	16,054	18,179	18,069		**65,863**	
Net capital gain/loss for the year $ (C)	32,985	50,000	35,111	14,600	-	**132,696**	
Point in time ATR = A/B*C	738	1,304	970	366	-	**3,378**	*Point in time < Average*
Capital gains refund mechanism - short cut formula $						**57,356**	*>ATR*

APPENDIX B

Alternative 4: # of Redeemed Units in the Year /Weighted Daily Average # units outstanding x Net Realized Gains for the Year

Assumptions:		**Investor initial cost**
NAV at start of the year	5,200,000	
Unrealized gain at start of the year	500,000	
Units outstanding at start of the year	520,000	**9.04**
Unrealized gain is constant except where indicated otherwise in the scenarios below.		
Quarterly redemptions occurring mid-quarter, so there is a quarterly calculation		

	15-Mar	15-Jun	15-Sep	15-Dec	31-Dec	Total	*Observations*
Scenario A: Trading gains before redemption and market is down at the year-end							
Redemptions $ at the end of period	100,000	130,000	150,000	170,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	9.91			
NAV per unit for the redemption	10.00	10.00	9.91	8.98			
Units redeemed (A)	10,000	13,000	15,143	18,927		**57,070**	
NAV before redemptions $	5,260,000	5,280,000	5,260,000	4,860,000	4,690,000		
Units outstanding before redemption	526,000	528,000	531,000	541,095	522,168		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	(50,000)	(500,000)	-		
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	9,316	11,343	10,533	(4,414)		**26,777**	
Unrealized gain/loss before redemptions $	490,000	460,684	369,342	(126,191)	(121,777)		
Unrealized gain/loss after redemption $	480,684	449,342	358,809	(121,777)			
Investor gain/loss (if held from beginning)	9,615	12,500	13,134	(1,073)		**34,177**	
Net capital gain/loss for the year (C)	19,316	31,343	40,533	(19,414)		**71,777**	
Weighted average # units outstanding (B)						**531,365**	
Gross limitation on ATR = A / B * C						**7,709**	
Point in time ATR = A/B*C	367	772	1,156	-	-	2,295	***Point in time < Average***
Capital gains refund mechanism - short cut formula						-	***NIL***
Scenario B: More redemption during periods when the market is steady							
Redemptions $ at the end of period	120,000	150,000	150,000	130,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.00	10.00	10.00			
NAV per unit for the redemption	10.00	10.00	10.00	9.07			
Units redeemed (A)	12,000	15,000	15,000	14,335		**56,335**	
NAV before redemptions $	5,260,000	5,260,000	5,270,000	4,870,000	4,740,000	-	
Units outstanding before redemption	526,000	526,000	527,000	537,000	522,665		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	-	-	-	(500,000)			
Trading gain for the period $	10,000	20,000	30,000	(15,000)		**45,000**	
Net capital gain/loss from redemption $	11,179	13,084	11,833	(2,165)		**33,931**	
Unrealized gain/loss before redemptions $	490,000	458,821	415,737	(81,096)	(78,931)		
Unrealized gain/loss after redemption $	478,821	445,737	403,904	(78,931)			
Investor gain/loss (if held from beginning)	11,538	14,423	14,423	436		**40,821**	
Net capital gain/loss for the year $ (C)	21,179	33,084	41,833	(17,165)		**78,931**	
Weighted average # units outstanding (B)						**528,848**	
Gross limitation on ATR = A / B * C						**8,408**	
Point in time ATR	483	943	1,191	-	-	2,617	
Capital gains refund mechanism - short cut formula $						-	***NIL***
Scenario C: Gain on redemption exceeds redeemer's proportion of unrealized gains and market has been steady							
Redemptions $ at the end of period	120,000	140,000	150,000	140,000		**550,000**	
Subscriptions $ at the beginning of period	60,000	120,000	160,000	250,000		**590,000**	
NAV per unit for the subscription	10.00	10.19	10.21	10.28			
NAV per unit for the redemption	10.19	10.21	10.28	10.38			
Units redeemed (A)	11,776	13,713	14,585	13,490		**53,564**	
NAV before redemptions	5,360,000	5,370,000	5,430,000	5,580,000	5,440,000	-	
Units outstanding before redemption	526,000	526,000	527,959	537,682	524,192		
# days in period	73	93	92	91	16	**365**	
Market movement before the redemption by $	100,000	10,000	40,000	50,000		**200,000**	
Trading gain for the period $	20,000	20,000	20,000	-		**60,000**	
Net capital gain/loss from redemption $	12,985	30,000	15,111	14,600		**72,696**	
Unrealized gain/loss before redemptions $	580,000	557,015	547,015	581,904	567,304		
Unrealized gain/loss after redemption $	567,015	527,015	531,904	567,304			
Investor gain/loss (if held from beginning)	13,562	16,054	18,179	18,069		**65,863**	
Net capital gain/loss for the year $ (C)	**32,985**	**50,000**	**35,111**	**14,600**	**-**	**132,696**	
Weighted average # units outstanding (B)						**529,327**	
Gross limitation on ATR = A / B * C						**13,428**	
Point in time ATR = A/B*C	738	1,304	970	366	-	3,378	
Capital gains refund mechanism - short cut formula $						**57,356**	***>ATR***

APPENDIX B

Averaging Alternatives Considered
Supplement to July 29, 2020 CETFA/IFIC ATR Working Group Submission

This memorandum elaborates upon, and provides further detail in support of, statements on pages 1-2 of our July 29, 2020 submission:

> *We considered alternative averaging formulas in order to determine philosophically, whether any of them would be in the best interest of investors and also would not disadvantage ETFs competitively relative to other mutual fund trusts. Our analysis has shown, and the IFIC/CETFA membership concluded, that an averaging approach which disregards the unrealized net gain position of the ETF prior to a redemption would create a risk of double taxation. It would also competitively disadvantage Canadian ETFs relative to conventional mutual fund trusts domestically and relative to foreign ETFs*.
>
> [Emphasis added]

We attach hereto spreadsheets in an Excel document titled "Alternative ATR Formulas – Comparison" (the "Charts"). The Charts illustrate the application of four alternative ATR formulas, the first of which is the current CETFA/IFIC proposal:

- Alternative 1 – ATR is based on the fund's net **unrealized gains** as at each relevant **point in time** (i.e. time of each redemption) and the percentage of the fund's units redeemed at that time

- Alternative 2 – The starting point for this ATR is the amount of net **unrealized gains** of the fund at the end of regular intervals (e.g. month-end or quarter-end)[1]. An average net unrealized gain position for the year is calculated by a weighted average of the individual amounts at each such period end. The allocation of this average net unrealized gain amount among redeemers and non-redeemers is based upon the **average** number of units outstanding during the year)

- Alternative 3 – ATR is based on net **realized gains** existing at each relevant **point in time**

- Alternative 4 – ATR is based on net **realized gains** for the year and the **average** number of units outstanding during the year.

Detailed calculations are provided in a separate spreadsheet for each alternative ATR formula so that you can review our calculations. All four are summarized and compared in the "Summary" spreadsheet.

In the Charts, the four alternative approaches are applied to three scenarios. Two of the three scenarios involve markets declining toward year-end, since this is the situation that results in suboptimal results under the CGRM and where it is most important therefore that ETFs have access like mutual funds to a workable ATR.

In the above excerpt from our submission, we referred to two aspects of alternative formulas that we found would lead to inappropriate results:

(a) disregarding unrealized gains (i.e., focusing only on realized gains), and

(b) if unrealized gains are to be taken into account, averaging annual net unrealized gains (losses) as opposed to taking into account only those unrealized gains immediately before the time of redemption.

The submission did not spell out which of these two aspects we found most likely to result in double taxation.

---

[1] Daily measurement could also be considered in such an alternative.

As shown in the "Summary" spreadsheet, taking into account **only realized gains** would by far be the most problematic feature of a possible ETF ATR formula. The scenarios that only take into account realized gains (Alternatives 3 and 4) – permit an allocation to redeemers of a small fraction (ranging from 5% to 29%) of the annual gains realized by the ETF on redemptions.

This would put Canadian ETFs at a competitive disadvantage compared to US ETFs and Canadian mutual funds, which are able to allocate to redeemers a much higher proportion of gains realized by the fund on redemptions.

When comparing our ETF ATR proposal (Alternative 1) with the current mutual fund ATR, we believe our proposal would bring the two products into reasonable alignment in terms of fairness and competitiveness. Our proposal for ETFs allocates gains pro rata among redeemers and non-redeemers where the fund is in a net unrealized gain position at the time of redemption - which is a more restrictive condition than the ATR for mutual funds: under proposed paragraph 132(5.3)(b), there is no limit on the amount of a mutual fund's capital gains that can be allocated to redeemers. If there are sufficient unitholder-level gains, all of a mutual fund's gains can be allocated to redeemers without regard to the unrealized gain (loss) position of the fund. An ATR that considers only realized gains would make ETFs even less competitive with mutual funds.

Overall, Alternative 1 should serve to make ETFs reasonably competitive with mutual funds, rather than to put mutual funds at a competitive disadvantage.

Another issue with using only realized gains is that it facilitates so-called cherry picking. When using unrealized gains, redemptions trigger a gain allocation based on a slice of all the ETF's holdings. With a realized gains methodology, an ETF could sell a security/securities with large(r) capital gains to allocate a disproportionate amount of gains, including trading gains, to a redeemer. This kind of manipulation could be caught by an anti-abuse rule, but we note that an ETF heartbeat trade, in which a subscriber-redeemer is allocated a large portion of the ETF's unrealized gains, is not the only scenario in which an ATR rule could be abused.

Our objection to averaging is not so much economic as philosophical. Averaging of unrealized gains (Alternative 2) often – and perhaps more often than not[2] – leads to a larger amount that can be allocated to redeemers than under a point in time approach (Alternative 1).

However, we feel strongly that (absent abusive situations, discussed below) the intent of an ETF ATR should be to allocate to redeemers those gains that are "triggered by" the redemption – and that the best measure of such gains is the proportionate amount of unrealized gains of the ETF immediately before the redemption.

If an ETF has fewer redemptions volume-wise during a period when the ETF is in an unrealized loss position (such as at year-end in a down market), Alternative 1 (the CETFA/IFIC proposal) will lead to more gains being allocable to redeemers than an averaging method (see Scenario B in the Charts).

Reducing the amount that can be allocated to redeemers by using averaging in this situation would, we feel, lead to undue double taxation of some portion of the gains realized by the ETF on redemptions - as it seems fair to us for gains being realized from redemptions to be allocated to redeemers rather than year-end unitholders.

We understand that Finance is, however, concerned with a potential for manipulation (heartbeat trades) if a point in time approach were adopted. The proposed anti-abuse rule in our submission addresses such tax avoidance in a manner consistent with other provisions in the Act.

[2] We did not model enough scenarios to determine with any degree of certainty which approach will most often yield a higher ATR amount. However, what we can say is that the scenarios we did run tended to produce a higher ATR amount under Alternative 2 (averaging) than Alternative 1 (point in time).