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

September 8, 2023

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

Department of Finance Canada
90 Elgin Street
Ottawa, Ontario
K1A 0G5

Dear Sirs and Mesdames:

RE: Proposed Excessive Interest and Financing Expenses Limitation (EIFEL)

We are grateful for the opportunity to provide you with comments on the proposed EIFEL rules contained in the draft legislation to amend the *Income Tax Act* (Canada) (the "**ITA**") released on August 4th, 2023 ("**Proposed Rules**"). Our comments are directed to the application of the Proposed Rules to retail mutual funds structured as "unit trusts', "mutual fund trusts" and "mutual fund corporations" as defined in the ITA (collectively "**Funds**"). The Funds discussed herein are all Canadian resident trusts or corporations and their respective investment fund manager would be resident in Canada. Unless otherwise noted, all references to sections and components thereof are to the ITA as it is proposed to be amended by the Proposed Rules.

IFIC is the voice of Canada's investment funds industry. IFIC brings together 150 organizations, including fund managers, distributors and industry service organizations, to foster a strong, stable investment sector where investors can realize their financial goals. IFIC operates on a governance framework that gathers member input through working committees. The recommendations of the working committees are submitted to the IFIC Board or board-level committees for direction and approval. This process results in a submission that reflects the input and direction of a broad range of IFIC members.

Background

We appreciate the consideration that you gave to our submission dated April 25, 2022, and another dated January 16, 2023, regarding the proposed EIFEL rules previously released. We have attached a copy of these submissions as an Appendix so as to not repeat the information therein.

We want to thank you for the changes that we believe were made, at least in part, in response to our earlier submissions. In particular, we appreciate the addition of "if any" under subparagraph (c)(i) of the "excluded entity" definition and the modification made to (c) and (d) of the definition of "eligible group entity" as it provided more clarity.

Our comments today stem from two aspects of the operation of Funds by our members in which they have connections outside Canada.

Firstly, Funds typically invest some or all of their assets in foreign securities. Where they do, ownership of those securities will be in the custody of a financial intermediary (a "Custodian") in the local jurisdiction (i.e., in the US for US securities) and where they transact in such securities, they will employ a local broker (i.e., an entity licensed to trade securities in the local jurisdiction). Custodian and brokers are independent contractors to the Fund.

Secondly, in respect of foreign securities held by a Fund, many Canadian managers employ non-Canadian sub-advisors to perform the investment management function over all or a portion of the Fund's securities. A sub-advisor typically will manage a fund's investment portfolio (or portions of it), by providing investment analysis to the investment manager and the Fund, make securities selections (buy, sell, hold decisions) and oversee trades made by brokers in the securities over which they are sub-advisor). The Canadian manager remains wholly responsible for the management of each of the funds, including the management of their investment portfolios and the investment advice provided by the sub-advisors. Sub-advisors are independent contractors to the Fund.

Excluded Entity

We are seeking clarification that the excluded entity requirement that all or substantially all of the undertakings and activities of the tested entity not include the ownership of foreign securities, including trading of such securities and that the use of independent contractors as custodians, brokers or sub-advisors relating to those securities is not an activity or undertaking that is attributed to the Fund.

Under the "excluded entity" section of the Explanatory Notes, we note that the Department added language indicating that the ownership of foreign affiliate shares is not an "activity". We appreciate this change, but since it only refers to foreign affiliate with no clear mention of other types of connection outside of Canada (e.g., foreign custodians) we are concerned that the specific mention of foreign affiliate could be read to suggest that other holding of securities could be an activity that could cause a fund not to qualify for relief. In addition, even if ownership of foreign securities and related custody are not considered as not being an "undertaking or activity" or not being substantially all, we are still concern about how foreign sub-advisors would be considered under the Proposed Rules.

In our previous submission we recommended a further exclusion from the "activities or undertakings" language for the provision of designated investment services (within the meaning of section 115.2) to a taxpayer or an eligible group entity in respect of the taxpayer. That would permit a Canadian Fund to acquire the type of activity described herein regarding its investments.

An alternative to the above would be to clarify the Explanatory Notes to the definition of "excluded entity" as follows: " A "mutual fund corporation", "mutual fund trust" or trust that would be a "mutual fund trust" if it satisfied the condition in paragraph 4801(b) of the Regulations is not considered to engage in an activity or undertaking outside Canada for these purposes by reason of any or all of the following: engaging a foreign custodian or sub-custodian to hold some or all of its assets, engaging a foreign broker to execute transactions in foreign securities or engaging a foreign investment adviser with or without discretionary authority to trade in foreign securities.

We thank the Department for considering our submission and we are available to meet with you at your convenience should you wish to discuss any aspect of the above further.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Josée Baillargeon
Senior Policy Advisor, Taxation

cc: Trevor McGowan, Associate Assistant Deputy Minister, Finance Canada
(Trevor.McGowan@fin.gc.ca)

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

January 16, 2023

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

Department of Finance Canada
90 Elgin Street
Ottawa, Ontario
K1A 0G5

Dear Sirs and Mesdames:

RE: Proposed Excessive Interest and Financing Expenses Limitation (EIFEL)

Thank you for the helpful discussions we had with Department of Finance officials regarding this proposal and its policy objectives. We are grateful for the opportunity to provide you with comments on the proposed EIFEL rules contained in draft legislation to amend the *Income Tax Act* (Canada) (the "**ITA**") released on November 3, 2022 ("**Proposed Rules**"). Our comments are directed to the application of the Proposed Rules to mutual funds structured as "unit trusts", "mutual fund trusts" and "mutual fund corporations" as defined in the ITA (collectively "**Funds**"). Unless otherwise noted, all references to sections and components thereof are to the ITA as it is proposed to be amended by the Proposed Rules.

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We made a submission dated April 25, 2022, in regard to the proposed EIFEL rules released on February 4, 2022. We have attached a copy of that submission as an Appendix so as to not repeat the background information therein.

Amendments included in November Proposed Rules

We want to thank you for the changes that we believe were made, at least in part, in response to our earlier submission. In particular:

a) We appreciate the introduction of proposed paragraph 18.2(16)(a), which addresses the concern that a trust might be embodied in its trustee for purposes of determining whether entities are eligible group entities by reason of being related. We further appreciate the statement in the Explanatory Notes that this rule is provided for greater certainty, as we believe an adverse inference should not be made in other contexts.

b) We appreciate the amendment to subparagraph (c)(i) of the definition of excluded entity to add undertakings and activities, as opposed to referring solely to businesses carried on. We do have a concern with the textual drafting of this subparagraph, as noted below.

Specific Issues Identified

We have identified the following specific issues regarding the application of the Proposed Rules to Funds:

a) Subparagraph (c)(i) of the definition of "excluded entity" – textual requirements:

Subparagraph (c)(i) of the definition of "excluded entity" requires that "all or substantially all of the businesses, undertakings and activities" of the taxpayer be carried on in Canada. We understand that it is not necessary for a taxpayer to have a business to satisfy this test and suggest that the phrase "if any" be added to make this clear.

b) Subparagraph (c)(i) of the definition of "excluded entity" – activities undertaken on behalf of a Fund:

We have identified examples in which it seems unclear whether the "all of the businesses, undertakings and activities" test is met:

i. Example 1: A Canadian resident mutual fund trust or corporation (or its manager) engages a foreign subadvisor that has full discretionary authority to make all or a portion of the investment decisions on behalf of the fund. Can Finance please confirm that the activities of the foreign subadvisor are not intended to be considered to be activities of the fund for purposes of the test in subparagraph (c)(i)?

ii. Example 2: A Canadian resident mutual fund trust or corporation uses a foreign custodian or prime broker to deal with securities that trade on exchanges outside Canada. Can Finance please confirm that the mere holding of securities by a foreign custodian or prime broker is not considered a business, undertaking or activity of the Fund for purposes of paragraph (c)(i)?

In order to address these potential problems, we recommend the following:

Change the wording to in (c)(i) to "all or substantially all of the businesses, and if there are undertakings and activities that are not part of a business, such undertakings and activities…"

Add an additional interpretative rule to the end of 18.2(16) as follows:

In determining whether all or substantially all of the businesses, and if there are undertakings and activities that are not part of a business, such undertakings and activities, of a taxpayer or an eligible group entity in respect of the taxpayer are carried on in Canada,

(a) the issuance of shares or debt of the taxpayer or the eligible group entity, as the case may be, to non-residents shall be excluded.

(b) the provision of designated investment services to a taxpayer or an eligible group entity in respect of the taxpayer shall be excluded.

We suggest that this approach could address the above concerns without having to create a carve out for specific types of funds.

c) Paragraph (b) of the definition of "eligible group entity" – majority interest beneficiary

We have identified examples where a financial institution/manager could be a majority-interest beneficiary of a trust temporarily, such that the financial institution/manager would be an eligible group entity and would preclude the trust from qualifying as an excluded entity (for example, because a group entity has material foreign affiliates). This seems inappropriate from a policy perspective where the purpose of the holding is expected to be temporary:

i. Example 3: An asset management company, that is a subsidiary of a bank, provides seed capital when launching a new mutual fund. When the seed capital is invested, during the first year of the fund, the manager holds for a short period of time more than 50% of the interests in the fund such that it is a "majority interest beneficiary" of the fund as defined in subsection 251.1(3).

ii. Example 4: A designated broker that makes a market for a Canadian "exchange-traded fund" ("**ETF**") that is a trust that invests in shares of Canadian companies in proportion to a recognized stock index, and borrows to fund a portion of its investments. In the first year of the ETF, the designated broker holds for a short period of time more than 50% of the interests in the ETF such that it is a "majority interest beneficiary" of the ETF as defined in subsection 251.1(3).

In order to address these potential problems, we recommend adding an additional interpretive rule to the end of (b) of the definition of "eligible group entity" (or as a new rule that is similar to 18.2(16)) that reads as follows: "and the following paragraph (e) were added at the end of subsection 251.1(4)

"(e) in determining whether a person is affiliated with a trust, the person shall be deemed not to hold a particular interest in the trust if

(i) either

(A) the particular interest derives all or substantially all its value from one or more mutual funds that are subject to, and substantially comply with, the requirements of National Instrument 81-102 Mutual Funds, as amended from time to time, of the Canadian Securities Administrators, or

(B) the trust follows a reasonable policy of investment diversification, and

(ii) either

(A) the time is

I. during the 24-month period that begins on the day on which the first taxation year of the trust begins, or

II. during the 24-month period that ends on the day on which the last taxation year of the trust ends; or

(B) the interest is a unit of a class of units of the trust if all of the units of such class are listed on a designated stock exchange in Canada and in continuous distribution.

This recommendation is based on a similar exclusion to the prohibited investment rules for investment funds, which is included in paragraph (b) of the definition of "excluded property" in subsection 207.01(1), incorporating the concept of an "exchange traded fund" from subsection 132(5.31).

d) Can Finance please confirm that, for purposes of paragraphs (c) and (d) of the definition of "eligible group entity", a person's share of the income or capital of a trust does not depend on the exercise of, or the failure to exercise, a discretionary power solely as a result of the manager or trustee of the trust having the power to determine the timing of distributions of the trust? The reference to a person's share of the income or capital of the trust suggests a discretion that could result in an amount being distributed to one or more beneficiaries of the trust to the exclusion of the other beneficiaries of a trust, and not simply the power to determine the timing of distributions; however, the explanatory notes accompanying the definition of "fixed interest" in subsection 94(1) could be read to suggest that a trustee's ability to determine the timing of distributions is acceptable under that definition only because of the exclusion in paragraphs (a) to (c) of that definition, and paragraphs (c) and (d) of the definition of "eligible group entity" do not include an analogous exclusion.

We recommend that Finance build the concept of a "fixed interest" into paragraphs (c) and (d) of the definition of "eligible group entity", along the following lines:

> (c) that is a trust in respect of which the taxpayer's interest [in the trust] is not a "fixed interest" (as defined in subsection 94(1)); or
>
> (d) that is a beneficiary of the taxpayer, if the taxpayer is a trust, whose interest in the taxpayer is not a "fixed interest" (as defined in subsection 94(1)) (other than a beneficiary that is a registered charity, or a non-profit organization, with whom the taxpayer deals at arm's length).

An alternative to the above would be to include in the explanatory notes to the definition of "eligible group entity" a note along the lines of the following, which is similar to a paragraph in the explanatory notes to the definition of "fixed interest" in subsection 94(1)

> For purposes of paragraphs (c) and (d) of the definition of "eligible group entity", in the context of a commercial trust, the ability of a trustee to determine the timing of distributions does not affect a taxpayer's share of income and capital in respect the trust. This is so even if a beneficiary (the "seller") were to sell their interest to another beneficiary (the "purchaser"), such that an amount that would have been payable to the seller is instead paid to purchaser (the seller would presumably have been compensated for this in determining the proceeds of disposition of the interest). However, if a trustee may choose which beneficiary would be entitled to a particular distribution (i.e., where payments made before a specific date would be payable to one beneficiary and payments made after that date would be payable to another beneficiary), a taxpayer's share of income and capital in respect the trust may depend on the exercise by the trustee of such discretion.

e) Paragraph (a) of the definition of "eligible group entity" – mutual fund corporation with voting shares held by manager

   i. Example 6: A mutual fund corporation has two classes of shares: voting shares that carry nominal economic interest and non-voting shares that have a significant economic entitlement. The non-voting shares are held by members of the public. The voting shares are held by the manager of the mutual fund corporation, such that the mutual fund corporation is controlled by the manager and therefore related to the manager. The manager, or Canadian resident corporations affiliated with the manager, hold material foreign affiliates. Therefore, the mutual fund corporation would appear to be precluded from qualifying as an "excluded entity" under subparagraph (c)(ii) as a result of the foreign affiliates of the manager or its affiliates, which seems inappropriate from a policy perspective given that the economic interests in the mutual fund corporation are held by members of the public. The reason that the public hold non-voting shares is so that it is not necessary to have public shareholders attend annual meetings at which directors are elected which means that the mutual fund corporation can save the significant costs of holding such a meeting (including preparing, printing and mailing meeting materials).

      To address the foregoing, we submit that it would be appropriate to have a rule that ascribes voting rights to all shareholders of a mutual fund corporation based on the fair market value of their shares. For example, the rule could provide

      > "For the purposes of determining whether a trust or corporation is an eligible group entity in respect of a mutual fund corporation, the mutual fund corporation shall be deemed to have issued one class of shares, each carrying one vote in all circumstances, that are owned by each shareholder of the mutual fund corporation in the same proportion that the fair market value of the shares of the mutual fund corporation owned by the shareholder is of the fair market value of all shares of the mutual fund corporation."

f) Subparagraph (c)(iii) of the definition of "excluded entity" – identifying unitholders of ETFs

   i. Example 7: Investment funds whose units are traded on a stock exchange, like an ETF, may not be able to determine whether any particular unitholder is a non-resident that is a "specified

beneficiary" or is a partnership that owns more than 25% of interests in the trust and of which more than 50% of the interests in the partnership are held by non-residents.

In general, the early warning reporting system under Canadian securities laws requires a report if a person or company acquires securities of a reporting issuer such that it owns or controls 10% or more of the outstanding securities of a class of voting or equity securities of the issuer. The early warning system does not apply in connection with the ownership or control of securities issued by an ETF. In addition, ETF's typically obtain exemptive relief allowing a unitholder to acquire more than 20% of the units of the ETF without regard to the takeover requirements of Canadian securities laws. Therefore, as a practical matter, unlike other issuers of securities listed on a stock exchange, an ETF is unlikely to know who holds a substantial number of its units.

To address the foregoing, we submit that it would be appropriate to provide that, in the absence of reason to know otherwise, an ETF should be presumed not to have a specified beneficiary or specified shareholder. Clause (c)(iii)(A) of the definition of "excluded entity" could provide:

> "a ***specified shareholder*** or a ***specified beneficiary*** (both as defined in subsection 18(5)) of the taxpayer, or of any eligible group entity in respect of the taxpayer, that is not resident in Canada, and for the purposes of this clause, where the taxpayer is a mutual fund corporation or mutual fund trust and the outstanding shares of the corporation or units of the trust include shares or units listed on a designated stock exchange and are in continuous distribution, the taxpayer shall be deemed not to have a specified shareholder or specified beneficiary unless it has reason to know that it has a specified shareholder or specified beneficiary."

g) Definition of "Adjusted Taxable Income"

i. As set out in our letter dated April 25th, 2022, we continue to believe that the determination of "adjusted taxable income" may not address tiered trust structures.

Consider the following example:

Trust 1 owns 100% of the units of Trust 2

Trust 2 has $100 of income, all of which is made payable to Trust 1, and deducted under subsection 104(6).

Trust 1 has no other income except the $100 payable to it by Trust 2 that is included in income under subsection 104(13). Trust 1 has interest and financing expenses of $30.

Trust 1 makes $70 payable to its beneficiaries.

The adjusted taxable income of Trust 2 will be $100 (i.e., its taxable income (nil)) plus the amount deducted under subsection 104(6), $100, which is added back by paragraph (g) of the description of B).

The adjusted taxable income of Trust 1 will be nil (i.e., its taxable income (nil), plus the amount of its interest and financing expenses ($30) added back by paragraph (a) of the description of B, plus the amount deducted under subsection 104(6), $70, which is added back by paragraph (g) of the description of B, less $100, which is deducted by paragraph (h) of the description of C).

Thus, it appears that some part of the $30 interest and financing expenses will not be deductible which seems to be inappropriate. In this example, the solution would be for Trust 2 to transfer "cumulative unused excess capacity" to Trust 1. That is possible in this example

since Trust 1 and Trust 2 are affiliated. However, if Trust 1 owned less than 50% of the units of Trust 2, that would not be possible.

Exclusion of Funds

While we understand that Finance is reluctant to provide broad exemptions from the Proposed Rules for categories of taxpayers, we submit that Funds should nonetheless be excluded from the Proposed Rules because they do not present the base erosion and profit shifting risks targeted by the Proposed Rules. The exclusion of Funds will eliminate the compliance burden on Funds whose interest and financing expenses will, in most circumstances, not be limited by the Proposed Rules if they were to apply

In particular:

a) Most Funds are held by individuals and deferred plans. The Proposed Rules do not apply to individuals so applying them to Funds may create inequities between investors that invest directly compared to those that invest in Funds.

b) As noted in our April submission, the exclusion of Funds would be consistent with the approach that a number of countries have taken with respect to the implementation of BEPS Action 4.

c) We prefer not to rely on the "fund of one" exception because it is not clear whether a Fund and its manager (including sub-advisors with discretionary asset management power) deal at arm's length (this is a recurring audit issue with the Canada Revenue Agency). Where a Fund is not a member of a consolidated group, proposed subsection 18.21(7) will allow the group ratio rules in section 18.21 to apply, such that the deduction of interest and financing expenses is not constrained by the 30% fixed ratio. This also requires an election. Where this is the case, it appears appropriate to exclude the Fund from the compliance burden of computing the ratio, allocations, and other amounts relevant under section 18.21 where an entity is a member of an actual consolidated group.

d) With respect to mutual fund corporations, we submit it is inappropriate from the perspective of both the mutual fund corporation and from the perspective of a corporation that holds its voting shares (e.g., a manager corporation), and any corporation to which that corporation is related, for the mutual fund corporation to be considered an eligible group entity in applying the Proposed Rules either to the mutual fund corporation or to those other corporations. We submit that it is inappropriate for the mutual fund corporation's tax attributes under the Proposed rules (e.g., excess capacity) to be shared with those of the other corporations.

We thank the Department of Finance for considering our submission and we are available to meet with you at your convenience should you wish to discuss any aspect of the above further.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Josée Baillargeon
Senior Policy Advisor, Taxation

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

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

April 25, 2022

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

Department of Finance Canada
90 Elgin Street
Ottawa, Ontario
K1A 0G5

Dear Sirs and Mesdames:

RE: Proposed Excessive Interest and Financing Expenses Limitation (EIFEL)

We are writing to provide comments on the proposed EIFEL rules contained in draft legislation to amend the *Income Tax Act* (Canada) (the **ITA**) released on February 4, 2022 (**Proposed Rules**). Our comments are directed to the application of the Proposed Rules to mutual funds structured as "unit trusts", "mutual fund trusts" and "mutual fund corporations" as defined in the ITA (collectively **Funds**). Unless otherwise noted, all references to sections and components thereof are to the ITA as it is proposed to be amended by the Proposed Rules.

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Background

Before providing specific comments on the Proposed Rules, it is important to note certain relevant considerations applicable to Funds:

a. Funds permit the collective investment of assets by investors.

b. Securities of a Fund may be distributed to the public pursuant to a prospectus (widely-held Funds) or pursuant to exemptions from the prospectus requirements. Securities are generally offered on a continuous basis and are redeemable on demand. Most securityholders have their securities redeemed by the Fund.

c. Securities of exchange-traded mutual funds (ETFs) are listed on a stock exchange. Securityholders may redeem securities of an ETF but, except for "designated brokers" and other dealers, most securityholders sell their units on the stock exchange. "Designated brokers" and dealers engage in transactions to adjust the supply of ETF securities up or down as needed.

d. The provisions of the ITA are generally intended to apply so that an investor in a Fund is not disadvantaged from a tax perspective by investing through a Fund rather than investing directly.

e. Mutual fund corporations may have a number of classes of shares, each of which is recognized under securities legislation as, or as part of, a separate investment fund.[1] We refer to such investment funds as "**Class Funds**". Except where the context requires, reference to a Fund includes a Class Fund.

f. The manager of a Fund has a fiduciary obligation to the Fund.

g. A manager may manage numerous Funds with different investment objectives and different strategies. A manager usually does not have a material economic interest in the Funds that it manages.

h. A manager may control a mutual fund corporation.

i. A single corporation, which may be a manager or trust company, can be the trustee of a large number of unit trusts and mutual fund trusts.

j. The trustee or manager of a Fund may be related to or affiliated with many other corporations. Such other corporations may carry on business outside Canada or have foreign affiliates.

k. National Instrument 81-102 of the Canadian Securities Administrators (**NI 81-102**) generally applies to (i) a "mutual fund"[2] that offers or has offered securities under a prospectus for so long as the mutual fund remains a reporting issuer, and (ii) a non-redeemable investment fund[3] that is a reporting issuer[4]. A sub-category of "mutual fund" is an "alternative mutual fund", which is a mutual fund, other than a precious metals fund, that has adopted fundamental investment objectives that permit it to invest in physical commodities or specified derivatives, to borrow cash or engage in short selling in a manner not permitted for other mutual funds under NI 81-102. NI 81-102 imposes restrictions on the ability of an investment fund to borrow, to enter into derivative instruments for non-hedging purposes and to enter into repurchase agreements, including:

   i. An investment fund may not borrow cash or provide a security interest over any of its portfolio assets unless the transaction is a temporary measure to accommodate requests for the redemption of securities of the investment fund while the investment fund effects an orderly liquidation of portfolio assets, or to permit the investment fund to settle portfolio transactions and, after giving effect to all such transactions, the outstanding amount of all borrowings of the investment fund does not exceed 5% of its net asset value at the time of the borrowing; notwithstanding the above, an alternative mutual fund and a non-redeemable investment fund may borrow cash subject to certain conditions, including that the value of the cash borrowed cannot exceed 50% of the fund's net asset value;

   ii. In the case of a derivative position entered into for purposes other than for hedging, a mutual fund, other than an alternative mutual fund, is required to hold certain portfolio assets to cover the obligations under the derivative; and

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1 This is acknowledged in the definition of "qualifying exchange" in subsection 132.2(1).

2 "Mutual fund" is defined in the *Securities Act* (Ontario) as "an issuer whose primary purpose is to invest money provided by its security holders and whose securities entitle the holder to receive on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest in the whole or in part of the net assets, including a separate fund or trust account, of the issuer"

3 A "non-redeemable investment fund" is defined in National Instrument 81-106 as an issuer,

(a) whose primary purpose is to invest money provided by its securityholders,

(b) that does not invest,

(i) for the purpose of exercising or seeking to exercise control of an issuer, other than an issuer that is a mutual fund or a non-redeemable investment fund, or

(ii) for the purpose of being actively involved in the management of any issuer in which it invests, other than an issuer that is a mutual fund or a non-redeemable investment fund, and

(c) that is not a mutual fund;

4 A "reporting issuer" is defined in the *Securities Act* (Ontario) and includes an issuer that has filed a prospectus under that Act and has received a receipt.

iii. In the case of repurchase agreements, the aggregate market value of all securities loaned by an investment fund in securities lending transactions and not yet returned to it or sold by the investment fund in repurchase transactions and not yet repurchased may not exceed 50% of the net asset value of the investment fund.

l. The restrictions in NI 81-102 apply to Canadian ETFs, which are considered to be mutual funds under NI 81-102.

Submissions

Exclusion of Funds

As stated, Funds permit the collective investment of assets by investors. The provisions of the ITA are generally intended to apply so that an investor in a Fund is not disadvantaged from a tax perspective by investing through a Fund rather than investing directly. The vast majority of investors in widely-held funds, the securities of which are distributed to the public pursuant to a prospectus, are individuals (including their RRSPs, RRIFs and TFSAs) or "excluded entities" to which the Proposed Rules do not apply.

In general, those Funds to which NI 81-102 applies will not have substantial borrowings or other interest and financing expenses. Having regard to the technical issues addressed below with respect to the definition of "excluded entity", many Funds will be unable to establish they are "excluded entities" and it is possible that their status may change from year to year. As a practical matter, this will require such Funds to introduce measures to track all interest and financing expenses and then test that amount against interest and financing income and adjusted taxable income. These amounts are not currently calculated.

A mutual fund trust generally distributes all of its income and net realized capital gains (after taking into account the capital gains refund) for a taxation year to its unitholders before the end of the taxation year (or between December 15 and December 31 if it has elected to have a December 15 tax year end). The calculations required by the Proposed Rules will have to be completed before the end of the taxation year (or between December 15 and December 31 if it has elected to have a December 15 tax year end) in order to determine if there is additional income caused by a denial of interest and financing expenses that must be made payable to unitholders. Mutual fund trusts will need to incur this administrative burden even though the Proposed Rules would not apply to deny any interest and financing expense in almost all cases. A bright line exclusion for them as described below would alleviate this burden without material risk of base erosion.

Accordingly, from a policy perspective we submit that it is appropriate to exclude the following from the application of the Proposed Rules:

a. A mutual fund trust (or a trust that would be a mutual fund trust if it satisfied the condition in paragraph (c) of subsection 132(6)) that is a mutual fund that is subject to, and substantially complies with, the requirements of NI 81-102 as amended;

b. A mutual fund corporation that is a mutual fund that is subject to, and substantially complies with, the requirements of NI 81-102 as amended; and

c. A mutual fund corporation comprised of a number of Class Funds, each of which is a mutual fund that is subject to, and substantially complies with, the requirements of NI 81-102 as amended.

We would also note that from a policy perspective and for the reasons discussed below under the International Competitiveness sub-heading, consideration should also be given to excluding all investment funds, including those that are not subject to the requirements of NI 81-102.

International Competitiveness

The exclusions we are requesting to the Proposed Rules would be consistent with the approach that a number of countries have taken with respect to the implementation of BEPS Action 4. In particular, we would note that several European countries have exempted certain "financial undertakings" from the scope

of their interest deduction limitation rules. Such exclusions are consistent with recital 9 to the EU Anti-Tax Avoidance Directive 2016/1164 (the "ATAD") that states:

> Although it is generally accepted that financial undertakings, i.e. financial institutions and insurance undertakings, should also be subject to limitations to the deductibility of interest, it is equally acknowledged that these two sectors present special features which call for a more customised approach. As the discussions in this field were not sufficiently conclusive in the international and the Union context, it is not possible to provide specific rules in the financial and insurance sectors and Member States should therefore be able to exclude them from the scope of interest limitation rules.

Article 4(7) of the ATAD provides that member states may exempt certain "financial undertakings" within the meaning of Article 2(1) of the ATDA.[5] Finland, for example, has chosen to exempt the following financial undertakings:

- Credit institutions;
- Investment firms;
- Alternative investment funds and their managers;
- Undertakings for a collective investment in transferable securities and their management companies; and
- Insurance companies.[6]

We would also note there is a carve out in the UK for Authorised Investment Funds ("AIFs") and Investment Trust Companies.[7]

Technical Comments

We have a number of technical comments with respect to the definitions of "eligible group entity", "excluded entity" and "adjusted taxable income".

"Eligible Group Entity"

With respect to paragraph (a) of the definition of "eligible group entity", we are concerned that the CRA may take the view that two mutual fund trusts with the same trustee are an "eligible group entity" in respect of each other merely because they have the same trustee even though they would not be affiliated with each other.

Two trusts would not be affiliated with each other merely because they have the same trustee. In the context of the definition of "affiliated persons", paragraph 251.1(4)(c) provides that, notwithstanding subsection 104(1), a reference to a trust does not include a reference to the trustee or other persons who own or control the trust property. The provision was added to address the concern that subsection 104(1) may embody a trust in its trustee for the purposes of the affiliation rules such that every trust with the same trustee would be affiliated for the purposes of the suspended loss rules. The Explanatory Notes to the amendment (and other amendments addressing trusts) state that the effects of this rule are that two trusts are not affiliated simply because they share the same trustee, and a person is not affiliated with a trust simply because that person is affiliated with the trustee of the trust.

However, there is no rule comparable to paragraph 251.1(4)(c) that applies for the purpose of the definition of "related persons". Subsection 104 (1) provides that a reference to a trust or estate in the ITA shall, unless

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5 See Annex "A" attached hereto for full text of that definition.

6 Antti Lehtimaja and Sanna Lindqvist, "2019 Welcomes New Finnish Interest Deduction Limitations" (2019): http://publications.ruchelaw.com/news/2019-01/Finnish-Interest-Deduction.pdf

7 See https://www.gov.uk/hmrc-internal-manuals/corporate-finance-manual/cfm95697

the context otherwise requires, be read to include a reference to the trustee, executor, administrator, liquidator of a succession, heir, or other legal representative having ownership or control of the trust property. The CRA has taken the position that a trust is related to each person related to the trustee of the trust.[8] The only relevant case is *Wright Estate v. The Queen*[9] in which the Court stated that the relevant provisions of the ITA "created a new person, a trust, which is related to no one."

Thus, even though two mutual fund trusts with the same trustee are not affiliated merely because they have the same trustee, we are concerned that CRA may take the view that they are related. Although we contend that this is not appropriate, the uncertainty in this area may create additional uncertainty under the Proposed Rules.

"Excluded Entity"

With respect to paragraph (c) of the definition of "excluded entity", we have the following comments:

a. Clause (c)(i)(A) requires that all or substantially all of each business of the taxpayer be carried on in Canada. Most Funds take the position that they do not carry on a business. In this regard, we note that the ITA requires that the undertaking of a mutual fund trust or mutual fund corporation be limited to the investing of its funds in property (other than real property) and certain permitted activities in relation to real property. We assume that it is intended that, if the taxpayer does not carry on any business, the requirement in clause (c)(i)(A) is satisfied. **We request that the opening language of subparagraph (c)(i) be modified to read "all or substantially all of each business, *if any*, of…" to make this clear.**

b. In respect of mutual fund corporations, it is common for the investment manager to control a mutual fund corporation through the ownership of voting shares that have nominal economic entitlement. The investment manager would be related to the mutual fund corporation and therefore would be an "eligible group entity" in respect of the mutual fund corporation. Each corporation related to the investment fund manager would be related to the mutual fund corporation and would also be an eligible group entity in respect of the mutual fund corporation. If any corporation related to the investment manager were to carry on a business, all or substantially all of which was not carried on in Canada, the test in clause (c)(i)(B) would not be satisfied. **We submit that, in applying clause (c)(i)(B) to a mutual fund corporation, the activities of eligible group entities should be disregarded.**

c. Subparagraph (c)(ii) requires that no corporation be a foreign affiliate of the taxpayer or an eligible group entity. In the situation described in paragraph (b) above, if the investment manager or any corporation related to the investment manager were to own shares of a foreign affiliate, the test in subparagraph (c)(ii) would not be satisfied. **We submit that, in applying subparagraph (c)(ii) to a mutual fund corporation, the ownership of foreign affiliates by eligible group entities should be disregarded.**

d. Subparagraph (c)(iv) requires that all or substantially all of the interest and financing expenses of the taxpayer, and of each eligible group entity, are paid or payable to persons or partnerships that are not at any time in the year tax-indifferent investors (which includes non-residents and tax-exempts). For many Funds, the interest and financing expense of the Fund will consist primarily of spread under repurchase agreements and the cost of leverage on equity swaps. To comply with the requirement in subparagraph (c)(iv), Funds would have to limit the counterparties to their transactions in derivatives and repurchase agreements to taxable Canadian entities. This is not practical for many reasons including that securities lending (including repurchase agreements) by Funds is often outsourced. **We submit that subparagraph (c)(iv) be deleted.**

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8 See, for example, CRA doc. 2001-0019525.

9 96 DTC 1509 (TCC).

"Adjusted Taxable Income"

We believe that, in the determination of adjusted taxable income, paragraph (e) of the description of C is not appropriate.

Consider the following example:

> Trust 1 owns 100% of the units of Trust 2
>
> Trust 2 has $100 of income, all of which is made payable to Trust 1, and deducted under subsection 104(6).
>
> Trust 1 has no other income except the $100 payable to it by Trust 2 that is included in income under subsection 104(13). Trust 1 has interest and financing expenses of $30.
>
> Trust 1 makes $70 payable to its beneficiaries.

The adjusted taxable income of Trust 2 will be $100 (i.e., its taxable income (nil) plus the amount deducted under subsection 104(6), $100, which is added back by paragraph (f) of the description of B).

The adjusted taxable income of Trust 1 will be nil (i.e., its taxable income (nil), plus the amount of its interest and financing expenses ($30) added back by paragraph (a) of the description of B, plus the amount deducted under subsection 104(6), $70, which is added back by paragraph (f) of the description of B, less $100, which is deducted by paragraph (e) of the description of C).

Thus, it appears that some part of the $30 interest and financing expenses will not be deductible which seems to be inappropriate.

Members of our Taxation Working Group would be pleased to discuss our submissions with you.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

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ANNEX A

'financial undertaking' means any of the following entities:

(a) a credit institution or an investment firm as defined in point (1) of Article 4(1) of Directive 2004/39/EC of the European Parliament and of the Council or an alternative investment fund manager (AIFM) as defined in point (b) of Article 4(1) of Directive 2011/61/EU of the European Parliament and of the Council or an undertaking for collective investment in transferable securities (UCITS) management company as defined in point (b) of Article 2(1) of Directive 2009/65/EC of the European Parliament and of the Council;

(b) an insurance undertaking as defined in point (1) of Article 13 of Directive 2009/138/EC of the European Parliament and of the Council;

(c) a reinsurance undertaking as defined in point (4) of Article 13 of Directive 2009/138/EC;

(d) an institution for occupational retirement provision falling within the scope of Directive 2003/41/EC of the European Parliament and of the Council, unless a Member State has chosen not to apply that Directive in whole or in part to that institution in accordance with Article 5 of that Directive or the delegate of an institution for occupational retirement provision as referred to in Article 19(1) of that Directive;

(e) pension institutions operating pension schemes which are considered to be social security schemes covered by Regulation (EC) No 883/2004 of the European Parliament and of the Council and Regulation (EC) No 987/2009 of the European Parliament and of the Council as well as any legal entity set up for the purpose of investment of such schemes;

(f) an alternative investment fund (AIF) managed by an AIFM as defined in point (b) of Article 4(1) of Directive 2011/61/EU or an AIF supervised under the applicable national law;

(g) UCITS in the meaning of Article 1(2) of Directive 2009/65/EC;

(h) a central counterparty as defined in point (1) of Article 2 of Regulation (EU) No 648/2012 of the European Parliament and of the Council;

(i) a central securities depository as defined in point (1) of Article 2(1) of Regulation (EU) No 909/2014 of the European Parliament and of the Council.