



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

BY EMAIL

March 7, 2011

Mr. Gérard Lalonde
Director, Tax Legislation Division
Finance Canada
140 O'Connor Street
Ottawa, ON K1A 0G5
Tel: 613-995-0405
Email: Gerard.Lalonde@fin.gc.ca

Dear Mr. Lalonde:

Re: Capital Gains Redemptions Formula

I am writing further to the meeting held on June 2, 2010 and as follow-up to IFIC's request for a technical amendment to the definition of "capital gains redemptions" in subsection 132(4) of the *Income Tax Act* (Canada) (ITA) to correct an element in the formula that results in double-counting. This issue was identified some years ago in a letter to Brian Ernewein dated March 8, 2002 (copy attached).

Several years ago a number of mutual fund trusts adopted a distribution policy whereby capital gains realized by the trust during a year may be distributed to unitholders who redeem their units during the year. The units of a mutual fund trust are redeemed for a price equal to their net asset value (NAV). A portion of that redemption price may be paid as a capital gain (if the trust has net realized capital gains for the year) and the remainder as proceeds of disposition. This distribution policy has been the subject of several CRA Rulings, for example: 981758; 2000-004136; 2000-0041363; 2001-009107A; 2003-000348D; 2007-0224201R3 and 2007-025755R3.

In recognition of this distribution policy, the "capital gains redemptions" formula in subsection 132(4) of the ITA was amended as part of the 2000 Federal Budget amendments (S.C. 2001, c. 17, subsections. 129(2) and (3)). Element "A" of the formula was modified. Element "E" was added. Both "A" and "E" carve out any capital gains distributed by the trust to redeeming unitholders. In our view, this is double counting and results in an undue reduction of the capital gains refund available to mutual fund trusts under subsection 132(1) of the ITA. We believe that the carve-out in "E" alone is sufficient.

Previously, "A" was defined as "the total of all amounts paid by the trust in the year on the redemption of units of the trust". "A" was modified so that it only includes the portion of the redemption price that is paid as proceeds of redemption. Thus, "A" excludes the "capital gains redemptions", i.e., the portion of the redemption price that is paid as a capital gains distribution. "E" is defined as "twice the total of all amounts each of which is an amount designated under subsection 104(21) for the year by the trust in respect of a unit of the trust redeemed by the trust at any time in the year and after December 21, 2000". As a result of "E", the "capital gains redemptions" is further reduced by any capital gains distributed to redeeming unitholders.

Mr. Gérard Lalonde

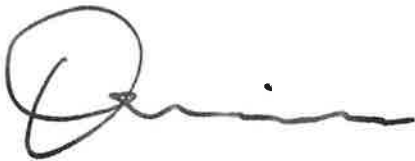
Re: *Capital Gains Redemptions Formula*

As we believe that "E" alone is sufficient to reduce "capital gains redemptions" by the amount of any capital gains paid by a mutual fund trust to redeeming unitholders, we therefore recommend that the description of "A" be amended to read as it did before the 2000 Federal Budget amendment:

"A is the total of all amounts paid by the trust in the year on the redemption of units of the trust".

I would be pleased to discuss this with you at your convenience.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jon Cockerline', with a large circular flourish at the beginning and a horizontal line extending to the right.

Jon Cockerline

Director, Policy and Research - THE INVESTMENT FUNDS INSTITUTE OF CANADA

Tel: 416-309-2327

Email: jcockerline@ific.ca

Cc: Mr. Brian Ernewein, General Director, Tax Policy Branch (brian.ernewein@fin.gc.ca)

Mr. Grant Nash, Acting Chief, Tax Policy Branch (grant.nash@fin.gc.ca)

Attachment



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151 YONGE ST., 5TH FLOOR, TORONTO, ONTARIO, M5C 2W7 TEL 416 363-2158 FAX 416 861-9937

BY FACSIMILE: 1-613-992-4450

March 8, 2002

Mr. Brian Ernewein
Director
Tax Legislation Division
Tax Policy Branch
Department of Finance
17th Floor E. L'Esplanade Laurier
140 O'Connor Street
Ottawa, ON K1A 0G5

Dear Mr. Ernewein:

Re: Capital Gains Redemptions

We are writing to request a technical amendment to the Income Tax Act (Canada) (the "ITA") relating to mutual fund trusts which we believe should be considered independently of the project to harmonize the taxation of various investment fund vehicles. As you are aware, a number of mutual fund trusts have adopted a capital gains distribution policy that, on redemption of a unit for an amount equal to net asset value ("NAV"), a portion of the redemption price may constitute the payment of a portion of the capital gains realized by the trust for the year in which the redemption occurs. The efficacy of such allocations was recognized in an advance income tax ruling issued by the Canada Customs and Revenue Agency and by recent amendments to the ITA made by Bill C-22, particularly those to the definition of "capital gains redemptions" ("CGR") in subsection 132(4) of the ITA.

The amendments to the definition of CGR contemplate two effects as a result of the redemption of a unit of a mutual fund trust in a year where a portion of the redemption price is treated as a distribution of realized capital gains of the trust:

1. the value for "A" includes only that part of the amount paid on the redemption as is included in the unitholder's proceeds of disposition. Consequently, the portion of the NAV that is a distribution of capital gains will be excluded from "A" which reduces the trust's CGR; and

2. the CGR otherwise determined is further reduced by “E” which is twice the total of all amounts designated under subsection 104(21) of the ITA for the year in respect of a unit of the trust that is redeemed in the year.

It is the view of our Tax Steering Committee that the variable “E” alone is sufficient to exclude from CGR the portion of the NAV that is treated as a payment of capital gains by the trust to a redeeming unitholder. Accordingly, we respectfully request that the description of “A” be amended so that it is simply the amount paid to the unitholder on redemption (i.e., NAV), which is the same as it was before Bill C-22’s amendments.

We also respectfully submit that a further amendment is required to the description of “E” since it literally includes all capital gains distributed on a unit that is redeemed in the year and not just the capital gains distributed on redemption as part of NAV.

Members of our Tax Steering Committee would be pleased to discuss the foregoing recommended amendments with you at your convenience.

Yours very truly,

“ORIGINAL SIGNED BY JOHN MOUNTAIN”

John Mountain
Vice-President
Regulation