**Brief to the House of Commons Standing Committee on Finance**

**Investment Counsel Association of Canada**
**August 2010**

Mr. Jean-François Pagé, Clerk
Standing Committee on Finance
6-14 131 Queen Street
House of Commons Ottawa, Ontario
K1A 0A6

August 13, 2010

Dear Mr. Pagé:

**Re: House of Commons Standing Committee on Finance – Pre-Budget Consultations**

The Investment Counsel Association of Canada (ICAC) is pleased to submit comments on recommended priorities for the **Federal 2011 Budget**.

As background, the Investment Counsel Association of Canada ("ICAC") represents investment management firms from across Canada. We invest the assets of individual Canadians who are saving for retirement and the assets of both traditional defined benefit pension plans and pooled funds set up for the purpose of providing defined contribution pension plans. Many of Canada's largest pension plans (e.g. CPPIB, OMERS, HOOP) and small employer pension plans hire our members to manage all or portions of their investment portfolios. In addition, individual Canadians who seek professional management of their savings, become clients of our members who set up custom portfolios for individuals based on their retirement goals, risk profile and financial objectives. Our members are from across Canada and manage retirement savings for Canadians in every province and territory. The ICAC was established in 1952 and its members manage in excess of $700 billion assets (excluding publicly offered mutual fund assets).

Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. This mission guides our advocacy objectives and focuses our government relations efforts on goals which ultimately benefit all Canadians.

We have 4 specific recommendations:

1) **Exempt discretionary investment management services provided to all retirement savings plans from the provincial portion of the HST.**

2) **Minimize Taxation Impact on Pensions & RRSPs due to 150 Unit Holder Rule for Mutual Fund Trust Status.**

3) **Non-Resident Trust/Foreign Investment Entity Rules (Former Bill C10) – Ensure Future Amendments to the Non-Resident Trust and Foreign Investment Entity Rules do not inadvertently tax pensions (i.e. both traditional pension plans and defined contribution pension plans) and RRSPs.**

4) **Expansion of Designated Stock Exchange List to Allow Canadians to Diversify their RRSP Investments.**

Each of the four issues below, if addressed, would greatly enhance Canadian's ability to save effectively for retirement.

**1) Exempt discretionary investment management services provided to all retirement savings plans from the provincial portion of the HST.**

We are very supportive of the broad analysis and variety of options that the Government is considering to improve Canadian's retirement income system. However, many of the options being contemplated are complex; costly to set up, operate and communicate; and may take several years to implement fully.

If the government is looking for a quick, simple solution to assist Canadians saving for retirement, we recommend that discretionary investment management services provided to retirement savings plans (both pension plans, RRSPs and RRIFs) be exempt from at least the provincial portion of the HST. The recent implementation of the HST in Ontario and British Columbia represents a 160% increase in the taxes payable by Ontario residents on investment management services and a 140% increase in BC. As the government is well aware, the implementation of HST in Ontario and BC on investment management services coincides with a period of extreme difficulty for firms and individuals saving for retirement. Pension funds are struggling with strict funding requirements and weak investment performance, and ordinary Canadians saving for retirement through RRSPs are still recovering from the financial meltdown of 2007 through 2009. While other areas of government are making good progress in alleviating the retirement funding challenges while financial markets recover, it is at best ironic that tax policy is, in effect, undermining those efforts. **The Federal government's HST policy is working at cross purposes to the policy objectives of the Department of Finance – to ensure the strength and adequacy of Canadian's retirement savings. HST is, pure and simple, a tax on retirement savings.** As such, it acts as a disincentive to the government's policy objectives of encouraging Canadians to take more responsibility for their retirement.

Although we are currently advocating that the government exempt investment management services from just the *provincial* portion of the HST, we recommend that, in the longer term, Canada take a broader policy view of how Value Added Taxes (VAT) are handled in other countries with a view to ultimately exempting investment management services from both the provincial *and* federal portions of the HST or GST (or making them zero-rated). In principle, VATs are meant to tax consumption of goods and services. If a Canadian hires a professional to manage their pool of savings, we would argue that there is no "consumption", within the definition of a consumption tax. Rather, the Canadian is growing his/her wealth to provide for greater consumption later in life. This is the policy position in Europe - investment management of retirement assets is not consumption. There is also no such added tax on managing retirement savings in the United States.

As a final note on this topic, we would point out the burden of the HST falls not just on Canadians living in BC and Ontario. As of July 1, residents of Alberta, Saskatchewan, Manitoba and the Territories whose retirement savings include mutual funds, are now in effect paying HST indirectly. Residents of such non-HST jurisdictions who invest in mutual funds together with Canadians in HST provinces will be paying HST indirectly on the investment management fees charged to the funds they own. Although the effective HST rate paid by mutual fund investors will be a "blended rate" that reflects the distribution of a fund's investors across Canada, given the populations of Ontario, BC and Atlantic Canada, the HST rate payable by many mutual fund investors will be much closer to the 13 % Ontario HST rate than the 5% GST rate that would otherwise apply in Manitoba, Saskatchewan and Alberta. Thus, the HST is doubly unfair. First it is being wrongly applied to tax Canadians' retirement savings. Secondly, the burden is being borne not just in HST provinces but by all those who are saving for retirement.

**We recommend that the Federal Government agree with the provincial governments to remove the provincial portion of HST immediately and undertake a review of the application of VATs around the world, with a view to ultimately removing the HST or GST from investment management services entirely.**

### 2) Minimize Taxation Impact on Pensions & RRSPs Due to 150 Unit Holder Rule to Qualify for Mutual Fund Trust Status

Some individual Canadians and pension plans invest part of their investments with investment managers who offer "pooled funds" that are very similar to mutual funds but are offered pursuant to exemptions from the prospectus requirements under provincial securities legislation. The *Income Tax Act (ITA)* was revised in the 1990s to attempt to provide similar tax treatment to pooled funds and mutual funds, as long as the pooled fund has at least 150 unit holders (the "150 unit holder rule"). This limit was set to avoid potential tax avoidance by setting up small family trusts. Currently, if a pooled fund has more than 150 unit holders, it qualifies for treatment as a "mutual fund trust" and is subject to beneficial tax treatment. However, if a fund drops below 150 unit holders, the fund may be subject to a variety of different tax treatments.

There are two main problems with the 150 unit holder rule. First, although many pooled funds have investors who are pension plans, the ITA currently considers each pension plan to be 1 unit holder, regardless of the number of participants in the plan. Second, since most pooled funds are redeemable by a unit holder on demand, managers of pooled funds have little or no control over the number of unit holders in the fund at any given time: in other words, if the number of unitholders is dropping to near or below 150, a pooled fund manager cannot compel new investors to come into the fund and it cannot prohibit existing investors from redeeming out of the fund. **As a result, Canadians who believe that investments held in their RRSP or pension are tax-exempt are actually subject to tax indirectly at the fund level, simply because the number of investors in the fund has dropped below 150.** We feel that the 150 unit holder rule results in an unfair and an unintended tax consequence on retirement savings that should be corrected.

There would be minimal tax loss from a change to the 150 unit holder rule that restores tax fairness. In fact, a change would create a better environment for investment that would enable Canadians to optimize their savings.

In addition, it would encourage new smaller entrants into the investment industry, further competition in the successful management of assets and increase overall asset management efficiency. A modification in the rule is also necessary to cover defined contribution plan annuitants and/or Group RRSP holders whose investment into a pooled fund is through an insurance company's segregated fund.

**Negative effects of the 150 unit holder rule**

1. It restricts Canadians from being able to optimize their savings. While a fund that has less than 150 unit holders may offer the best group of investments, the unfair tax implications may rule it out as an option altogether.

2. If an MFT drops below 150 unit holders, the impact could be significantly detrimental on the remaining investors. For example, once an MFT drops below 150 unit holders, it could lose its

qualification as an investment for an RRIF, RRSP, DPSP, or RESP. This would immediately trigger a 1% penalty tax per month on an RRSP or RRIF holder that continues to hold the units.

**We recommend that the 150 unit holder rule to qualify for "mutual fund trust" status be modified to (a) only require 50 unit holders, and (b) provide a "look through" for pension plans and group RRSPs such that each participant in the pension/group RRSP is counted as 1 unit holder, regardless if they invest in fund directly or via an insurance segregated fund.**

**3) Non-Resident Trust/Foreign Investment Entity Rules (Former Bill C10) – Ensure Future Amendments to the Non-Resident Trust and Foreign Investment Entity Rules do not inadvertently tax pensions (i.e. both traditional pension plans and defined contribution pension plans) and RRSPs.**

We attach for your information recent correspondence with the Department of Finance on 2010 Budget Proposals Relating to Foreign Investment Entities ("FIEs") and Non-Resident Trusts ("NRTs"). ICAC endorsed the proposal not to proceed with the FIE rules and much of the inclusion in the 2010 Budget. There remain however, some outstanding issues which we wish to bring to your attention which impact retirement savings.

In principal, since the first introduction of Former Bill C10, ICAC has been advocating that defined benefit and defined contribution pension plans and RRSPs should not be subject to tax in the event they invest internationally in anything deemed to be a trust by definition of the *Income Tax Act. (ITA*) In the Budget paper, it was clear that pension plans were to be exempt, however, it was less clear whether certain pooling arrangements, and the arrangements themselves, would be exempt. (i.e. would not be a "resident contributor" or a "resident beneficiary".)

**We recommend that changes to the NRT rules be worded broadly enough to ensure that all Canadians' retirement savings, whether in an RRSP, defined contribution pension plan or a traditional defined benefit pension plan, be exempt from tax.**

**4) Expansion of Designated Stock Exchange List to Allow Canadians to Diversify Their RRSP Investments**

The 2005 Federal budget took the important step of eliminating the foreign content limit for RRSPs and other tax-deferred plans. However, seniors and Canadians saving for retirement are still unable to optimize the foreign content portion of their investment portfolio due to the fact that certain countries exchanges are not on the designated stock exchange list maintained by the Department of Finance.

Given the recent economic downturn, diversification of capital is even more critical. The current list of approximately 38 exchanges primarily consists of exchanges in North America ( 40%) and Europe (40%). Accordingly, Canadians are effectively prohibited from investing their retirement savings in companies listed on many respected, well regulated and established exchanges in other parts of the world.

**We recommend the current list of designated stock exchanges be expanded and updated to allow Canadians to adequately diversify their savings in different economies around the world.**

We would be happy to present our submission to the House of Commons Standing Committee on Finance.

Sincerely,

Katie Walmsley, President
ICAC

Mark Pratt, Chair
ICAC, Industry Regulation & Tax Committee
AVP, Legal, Mackenzie Investments