



Le Comité mixte du droit fiscal de  
L'Association du Barreau canadien  
et

L'Institut canadien des comptables agréés

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Le 31 janvier 2007

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Monsieur,

**Avant-projet de loi du 21 décembre 2006 : Propositions législatives  
concernant les fiducies et sociétés de personnes intermédiaires de  
placement déterminées**

Dans le mémoire ci-joint, le comité mixte énonce des préoccupations et ses suggestions en ce qui concerne les aspects techniques de l'avant-projet de loi susmentionné. Un grand nombre de membres du comité mixte ont participé à la rédaction du présent mémoire. Cet exercice illustre l'intérêt considérable que les fiscalistes et leurs clients portent à ces propositions.

Nous espérons que nos observations et nos suggestions vous seront utiles et qu'elles permettront d'améliorer l'avant-projet de loi. Si vous et vos collègues le jugez opportun, le comité mixte serait heureux de vous rencontrer pour discuter du présent mémoire. Nous sommes, comme toujours, très reconnaissants d'avoir eu l'occasion de formuler des observations pendant que des avant-projets de loi sont à l'étude.

Nous avons entrepris la rédaction d'un autre mémoire qui portera sur les questions soulevées par les précisions sur la « croissance normale » des EIPD contenues dans le communiqué de presse que le ministère des Finances a publié le 15 décembre 2006. Dans ce second mémoire, nous formulerons également des observations sur la conversion de fiducies en sociétés. Nous prévoyons vous transmettre le mémoire durant les deux prochaines semaines.

Veillez agréer, Monsieur, l'expression de nos sentiments les meilleurs.



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c. c. : Brian Ernewein – ministère des Finances  
Lawrence Purdy – ministère des Finances

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#### Avant-projet de loi du 21 décembre 2006 : Propositions législatives concernant les fiducies et sociétés de personnes intermédiaires de placement déterminées

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**[Disponible en anglais seulement]**

**Submission of the  
CICA-CBA Joint Committee on Taxation**

**December 21, 2006 Draft Legislative Proposals Concerning Specified  
Investment Flow-Through Trusts and Partnerships**

**A. INTRODUCTION**

This submission addresses technical issues with respect to the Draft Legislative Proposals Concerning Specified Investment Flow-Through Trusts and Partnerships released by the Minister of Finance on December 21, 2006 (“Draft Legislation”).

The following abbreviations are used throughout this submission:

Act	Income Tax Act (Canada)
NPE	non-portfolio earnings
NPP	non-portfolio property
REIT	real estate investment trust

References to subsections, paragraphs, etc., are to provisions of the Act, as amended by the Draft Legislation.

**B. TAXATION OF SIFT TRUSTS AND THEIR BENEFICIARIES**

**1. Timing of Receipt of Deemed Dividend from a SIFT Trust**

Subsection 104(13) provides that income payable by a trust to a beneficiary during a taxation year of the trust is included in the income of the beneficiary in the beneficiary’s taxation year in which the trust’s taxation year ends. Subsection 104(19) contains similar timing for dividends received by the trust and flowed through to the beneficiary.

Under paragraph 104(16)(a), however, the beneficiary is deemed to have received a dividend *at each time* at which an amount became payable by the trust. This means, for example, that if the beneficiary’s taxation year ends on January 31 and the trust’s taxation year ends on December 31, a trust distribution on January 15, 2011 would, if subsection 104(16) is applicable, result in a deemed dividend in the beneficiary’s taxation year ending January 31, 2011. This creates compliance problems for the beneficiary because the trust might not be able to determine the amount of the distribution that is deemed to be a dividend until after the end of 2011. Furthermore, the beneficiary would be in the anomalous position that distributions of income other than NPE in January 2011 (such as the flow-through of dividends received by the trust) would be included in the beneficiary’s income for the taxation year ending January 31, 2012.

### **Recommendation**

We recommend that subsection 104(16) be revised to provide that the deemed dividend provided for in that subsection is deemed to be received by each beneficiary in the taxation year of the beneficiary in which the SIFT trust's taxation year ends.

### **2. Further Deeming Rules Required re Dividends**

Since a SIFT trust is not a corporation, deeming rules in addition to the rule in paragraph 104(16)(a) are required so that deemed dividends under that paragraph receive appropriate treatment under other provisions of the Act and under Canada's income tax conventions. We note that paragraph 104(16)(d) contains one such additional deeming rule, for the purposes of Part XIII. Other provisions for which we think further deeming rules are required include the following (this list is not intended to be comprehensive):

- Part IV tax. In order to apply the "connected corporation" aspect of Part IV, a SIFT trust must be deemed to be a corporation, and rules are required for determining when a beneficiary is connected with the trust.
- Dividend articles in tax conventions. Under many of Canada's income tax conventions, the rate of withholding tax on dividends depends on the level of the shareholder's beneficial ownership of the voting stock of the company paying the dividends.
- Securities lending arrangement rules (section 260). Deeming rules are required so that, inter alia, the deemed dividend is considered to be the "underlying payment" for a compensation payment, and the deemed dividend is considered to be paid on a share of the capital stock of a public corporation.

### **Recommendation**

We recommend that additional deeming rules be added to address the above issues, and any other issues of a similar nature which are identified.

### **3. Portion of Every Amount Payable Deemed to be a Dividend**

Where subsection 104(16) applies with respect to a taxation year of a SIFT trust, a portion of *every* amount that became payable by the trust in the year to a beneficiary is treated as a dividend. As a result, a portion of an amount that would otherwise be a return of capital or the redemption price of trust units could be recharacterized as a dividend. For example, if a SIFT trust has \$100 of NPE which is payable as a distribution to beneficiaries in the year and also \$900 is payable to beneficiaries in the year as the redemption price of units, \$10 of the \$100 distribution and \$90 of the \$900 redemption payment would be deemed to be a dividend. The recharacterization of the redemption proceeds seems inappropriate.

### **Recommendation**

We recommend that subsection 104(16) be revised so that it applies only with respect to amounts of trust income that become payable in a year to each beneficiary.

#### **4. Amount of Deemed Dividends**

The aggregate amount of deemed dividends under subsection 104(16) for a year is equal to the SIFT trust's non-deductible distributions amount for the year. This amount could be greater than the amount of the non-deductible distributions amount that is actually subject to tax under section 122.

This inconsistency can arise where a SIFT trust deducts a loss carryover. The following example illustrates this, and also the different consequences of the deduction of a current year loss and a carried forward loss:

A SIFT trust has income of \$100 (all of which is NPE) and also has current year losses of \$100. In that case, there would be no SIFT tax payable by the trust. Furthermore, since the trust would have no income payable to its beneficiaries in the year for the purposes of subsection 104(6), the trust's "non-deductible distributions amount" under subsection 104(16) would be nil and no deemed dividend could arise under subsection 104(16). Accordingly, any amount distributed to beneficiaries in the year would be treated as a return of capital.

On the other hand, if the same trust had \$100 of NPE in the current year and a non-capital loss of \$100 from a prior year, the trust would also have no SIFT tax payable for the year as a result of the application of the loss carry forward. In that case, however, the \$100 of trust income could nevertheless be payable to the beneficiaries in the current year. If so, the trust's non-deductible distributions amount would be \$100. As a result, the \$100 distribution would be deemed by subsection 104(16) to be a dividend to the beneficiaries.

In the second case, therefore, there would be a deemed dividend, whereas there would have been no deemed dividend if the same amount of income had been offset by current year losses. We submit that this distinction should not be made. At present, subsection 104(6) permits a trust to deduct less than the full amount of its income payable to beneficiaries and subsection 104(13.1) provides a mechanism whereby the undeducted amount will not be taxable in the hands of the beneficiaries. Under the Draft Legislation, designations made under subsection 104(13.1) would not affect the amount of the deemed dividends under subsection 104(16).

Another reason why the deemed dividends may be excessive in some situations is that the tax payable by a SIFT trust on its non-deductible distributions amount is not taken into account. Assume that a trust has income of \$100 in 2011, all of which is NPE, and that the full \$100 is payable to beneficiaries. Assume also that the tax rate applicable to NPE is 31.5%. We submit that only \$68.50 of the amount payable to beneficiaries should be deemed to be dividends, and the remaining \$31.50 should be treated as a return of capital. This would not be the case under the Draft Legislation, however, because the full \$100 payable to beneficiaries is included in the trust's non-deductible distributions amount and would be deemed by subsection 104(16) to be paid to the beneficiaries as dividends.

From a tax policy perspective, there does not appear to be any reason to treat distributions of NPE in excess of the after-tax amount of NPE as dividends, rather than returns of capital.

We note that the proposed rules for SIFT partnerships do not have the same problem – a deemed dividend arises under subsection 96(1.11) only to the extent that the SIFT partnership has paid tax, and the deemed dividend is net of the tax paid. There does not appear to be any policy reason to treat SIFT trusts and SIFT partnerships differently in this regard.

### **Recommendation**

We recommend that a mechanism be included in subsection 104(16) whereby the amount of each distribution that is deemed to be a dividend is determined net of the SIFT tax that applies to the related NPE and net of any NPE that is sheltered by available non-capital losses and net capital losses.

## **5. Amount Deemed Paid as Tax**

Subsection 122(1) establishes how much tax is payable by an *inter vivos* trust under Part I of the Act. Subsection 122(1.01) treats a negative amount determined under subsection 122(1) as a payment of tax by the trust. However, there do not appear to be any circumstances in which a negative amount could arise. The amount under paragraph 122(1)(a) is 29% times the “amount taxable” for the year. The amount determined under paragraph 122(1)(b) is the decimal fraction A times the “taxable SIFT trust distributions” for a taxation year. By definition, taxable SIFT trust distributions cannot exceed the trust’s “amount taxable” for the year. Accordingly, the amount determined under subsection 122(1) would be negative only if the decimal fraction A is less than -0.29, which appears to be impossible.

### **Recommendation**

We recommend that subsection 122(1.01) be deleted.

## **C. TAXATION OF SIFT PARTNERSHIPS AND THEIR PARTNERS**

### **1. Attribution of Deemed Dividends to Partners**

According to the Explanatory Notes to the Draft Legislation, a deemed dividend under subsection 96(1.11) is to be allocated to the partners in proportion to their share of taxable NPE. The intention appears to be to rely on paragraph 96(1)(f) to produce this result. However, since the dividend is a notional dividend rather than an actual dividend, it is not possible to rely on paragraph 96(1)(f) (as read with subsection 96(1.11)) without a further rule indicating how each partner’s share of the dividend is to be determined. As a related point, we note that subsection 126(8) refers to an amount that is “deemed by subsection 96(1.11) to be a taxable dividend received by a person in a taxation year of the person in respect of a partnership”. That is not an accurate description of what subsection 96(1.11) does at present.

## **Recommendations**

We recommend that a rule be added to provide the basis of attribution of a paragraph 96(1.11)(b) deemed dividend to partners. Also, subsection 126(8) needs to be revised so that it refers correctly to the mechanism for attributing deemed dividends to partners.

### **2. Further Deeming Rules Required re Dividends**

As in the case of deemed dividends from SIFT trusts, further rules are required so that deemed dividends received by partners are given appropriate treatment under other provisions of the Act and under Canada's income tax conventions. In particular, rules are required for purposes of the "connected corporations" aspect of Part IV and also for the dividend articles in tax conventions

#### **Recommendation**

We recommend that additional rules be added to ensure that deemed dividends receive appropriate treatment under the provisions mentioned above and under other provisions applicable to dividends.

### **3. Partnership Losses**

Subsection 96(1.11) does not deal with partnership losses. If a partnership has a loss from a source, all or part of the loss may serve to reduce the amount subject to the tax under Part IX.1. Presumably, to the extent that a loss has this effect, it should not also be allocated to partners under paragraph 96(1)(g).

We recommend below that a partnership be entitled to carry certain losses forward to be deducted in computing taxable NPE for future years. If this recommendation is accepted then, to the extent that a loss is permitted to be carried forward, it should not be allocated under paragraph 96(1)(g).

#### **Recommendation**

We recommend that the allocation of losses to partners be limited as described above.

### **4. Coordination with Resource Rules**

The rules applicable with respect to SIFT partnerships have not been coordinated with the resource rules. Consequently, where a SIFT partnership owns resource properties or carries on a resource-related business, there can be anomalous and inequitable tax consequences.

Resource expenditures are not deducted in computing the income of a partnership, but instead are considered to be incurred directly by the partners by virtue of the various resource expenditure definitions and paragraph 96(1)(d). Under the current regime, therefore, each partner makes the appropriate deductions from their resource pools which accumulate from, *inter alia*, their proportionate share of partnership resource expenditures.

One inequity is that a SIFT partnership is not given opening pool balances for any of the resource expenditures incurred in the past by the partnership before it becomes a SIFT partnership. Also, it is unclear whether there is an accumulation of current expenditures into pools while it is a SIFT. The new rules can, therefore, result in income being taxed in the partnership under Part IX.1, without all related expenses being deductible by the partnership in computing its taxable NPE.

Currently, when a Canadian resource property is sold by a partnership, proceeds from the sale of the property are included in computing the income of the partners and not the partnership. Under the proposed rules, a SIFT partnership will be required to recognize the proceeds. The results can be harsh, as in the following example:

A SIFT partnership sells Canadian resource properties for \$1,000 and has no other resource expenditures in the year. Each partner has at least its proportionate share of \$1,000 in its cumulative Canadian oil and gas property expense pool (“CCOGPE”). Assume further that the only investment that any partner has ever made in Canadian resource properties is through what is now a SIFT partnership. The sale proceeds of \$1,000 would form part of the taxable NPE of the SIFT partnership under both paragraphs in the definition of taxable NPE. The SIFT partnership would pay tax on \$1,000 and the partners of the partnership would be deemed to have received their proportionate share of the balance of the \$1,000 remaining after-tax as a dividend, upon which they would be taxed at the appropriate rate if they are individuals. In addition, the partners are deemed under the definition of “cumulative Canadian oil and gas property expense” to have their proportionate charge to their CCOGPE balance.

Similar concerns arise with respect to the rules applicable to foreign resource properties and expenditures.

### **Recommendations**

We recommend that the rules applicable to SIFT partnerships and the resource rules be revised so that the two sets of rules fit together in an appropriate way. Also, there need to be suitable start-up rules for SIFT partnerships so that expenditures that have flowed out to partners are properly taken into account.

Other special regimes in the Act should also be reviewed to ensure that there is coordination between those regimes and the SIFT partnership rules.

### **5. Partnership Rollover Rules**

The amount in paragraph (b) of the definition of taxable NPE of a partnership in subsection 197(1) is determined as if the partnership were a SIFT trust. Thus it would seem that the partnership rollover rules in subsections 85(2), 85(3) and 97(2) and section 98 cannot be applied in computing this amount. This issue does not appear to exist with paragraph (a) of the definition of taxable NPE. While that paragraph requires income to be determined as if the partnership

were a “taxpayer”, it does not deem the partnership not to be a partnership for this purpose, and hence all the partnership rules should be applicable.

### **Recommendation**

We recommend that effect be given to the partnership rollover rules for the purposes of the calculation of a partnership’s taxable NPE.

## **6. Dividends Received by a SIFT Partnership**

Paragraph (a) of the definition of taxable NPE in Part IX.1 refers to income as determined under section 3. As a result, dividends received by a SIFT partnership from a taxable Canadian corporation will be included in this amount. We submit that such dividends should not be included in taxable NPE, but should flow through to partners under paragraph 96(1)(f).

### **Recommendation**

We recommend that the definition of taxable NPE be revised to exclude taxable dividends received by a SIFT partnership.

## **7. Loss Carryforwards / Tax Credits**

If a SIFT partnership has a non-capital loss from a business or from NPP or an allowable capital loss from the disposition of NPP, we submit that the partnership should be entitled to carry forward such amounts to reduce taxable NPE in a future year.

Furthermore, we submit that a SIFT partnership should be entitled to deduct investment tax credits and foreign tax credits related to the earning of NPE, in the same manner as a corporation. Currently, such deductions may be available to the partners. However, this does not produce an appropriate result where the related income is taxed at the partnership level.

### **Recommendations**

We recommend that a mechanism be introduced to allow a SIFT partnership to deduct non-capital and net capital losses, investment tax credits and foreign tax credits in respect of activities related to the earning of NPE.

## **D. DEFINITION OF “INVESTMENT”**

The definition of “investment” in section 122.1 is used only to determine whether a trust or a partnership is a SIFT trust or partnership. Paragraph (a) of the definition refers to a security of a trust or partnership, which includes debt of the trust or partnership. Accordingly, a trust or partnership could be a SIFT solely because debt of the trust or partnership is listed on a public market. It is not clear why such a broad definition is required. This is particularly a concern because of the broad definition of “public market” (discussed below) whereby securities (including debt) could be said to be “listed” without the consent or knowledge of the issuer.

The definition of “security” includes “any right, whether absolute or contingent, conferred by the particular entity or by an entity that is affiliated with the particular entity, to receive, either immediately or in the future, an amount that can reasonably be regarded as all or any part of the capital, of the revenue or of the income of the particular entity...” As a result, for example, if a corporation, trust or partnership (“parent entity”) holds an interest in an underlying partnership or trust that is affiliated with the parent entity, any publicly-listed interests or rights issued by the parent entity could be considered to be listed “securities” of the underlying trust or partnership, thereby causing the underlying partnership or trust to be a SIFT. We assume that this was not intended. This result could occur even where the parent entity is itself a SIFT trust or partnership.

Paragraph (b) of the definition of “investment” refers to “a right which may reasonably be considered to replicate a return on, or the value of, a security of the trust or partnership.” This wording seems aimed at derivatives or linked instruments. Such instruments may in fact be issued by an unrelated third party and listed on a public market (such as an alternative trading system) without the involvement of the relevant trust or partnership.

### **Recommendation**

We recommend that the definition of “investment” be changed to refer only to

- (a) an income or capital interest in a trust,
- (b) an interest as a member of a partnership, and
- (c) a right issued by a trust or partnership to acquire an interest referred to above in that trust or partnership.

If the Department of Finance is concerned that other instruments could be used to avoid the application of the SIFT provisions to a trust or partnership, a specific anti-avoidance provision should be included to address the concern.

### **E. INVESTMENT “BUSINESS” AND DEFINITIONS OF NPE AND NPP**

Paragraph (c) of the definition of NPP in section 122.1 includes property used in the course of carrying on business in Canada. Consequently, even though all property held by a trust or partnership is regarded as portfolio investments in the ordinary sense of this term, the property would be NPP if the investment activity of the trust or partnership constituted a business. Therefore, a trust that meets the first two conditions in the definition of a SIFT trust and whose only activity is investing in portfolio investments would be a SIFT trust if its investment activity is considered to be a business. A similar observation applies with respect to a partnership. We submit that it is not appropriate to include property in NPP of a trust or partnership under paragraph (c) of the definition of NPP where the business carried on by the trust or partnership is an investment business and the principal purpose of that business is to earn income from properties that are not otherwise included in the definition.

Similarly, the definition of NPE includes income from a business carried on in Canada. We submit that there should also be an exclusion for income of a SIFT trust or partnership from a

Canadian investment business the principal purpose of which is to earn income from properties that are not included in NPE.

### **Recommendation**

We recommend that, for the purposes of the definitions of NPP and NPE, a business not include an investment business, the principal purpose of which is to earn income from property not referred to in paragraphs (a) or (b) of the definition of NPP.

## **F. DEFINITION OF “NON-PORTFOLIO EARNINGS”**

The only losses taken into account in the definition of NPE are losses from a business carried on in Canada or from NPP and allowable capital losses from the disposition of NPP. Thus, there is no recognition of a loss that a SIFT may realize under a hedging arrangement (such as a currency swap), where the hedging arrangement is regarded as a separate source that is not NPP. Furthermore, there is no recognition of a capital loss that a SIFT may realize under subsection 39(2) or (3) on money borrowed to acquire NPP.

### **Recommendation**

We recommend that the definition of NPE be revised to take into account losses in respect of hedging arrangements and indebtedness relating to a business carried on in Canada or to NPP.

## **G. DEFINITION OF “NON-PORTFOLIO PROPERTY”**

### **1. 10% of Equity Value of Subject Entity Test**

Subparagraph (a)(i) of the definition of NPP in section 122.1 includes a security of a subject entity, if the trust or partnership holds securities of the subject entity that have a total fair market value that is greater than 10% of the equity value of the subject entity. The term “security” is very broadly defined, whereas “equity value” is determined by reference only to equity interests in the subject entity. As a result, for example, debt of a corporation could be NPP if the amount of the debt exceeds 10% of the fair market value of the corporation’s issued shares. This could cause even a small amount of debt or other non-equity securities of an entity to be NPP, if the entity is thinly-capitalized. We submit that the portfolio property test for debt and other non-equity investments should not be the same as for equity investments. For example, most arm’s length debt that arises in the ordinary course of a trust’s or partnership’s activities would ordinarily be considered to be portfolio investments without regard to the amount of the issuer’s equity.

Some trusts and partnerships will face compliance difficulties with the condition in subparagraph (a)(i) of the definition of NPP. One source of difficulty arises from the fact that the condition applies on a continuous basis. Since the condition is based on fair market values, which are not stable amounts, trusts and partnerships that may be close to the 10% threshold with particular investments will have to monitor the condition on a continuous basis. A trust or partnership may also face valuation difficulties, if any securities required to be taken into account in applying the 10% condition are not traded on a public market, or are thinly traded. Furthermore, all the information required to apply the condition may not be available in some situations—for

example a trust or partnership investing in debt of an unrelated private corporation may not have information on the shares that have been issued by the corporation and are outstanding from time to time.

### **Recommendations**

We recommend that, except in the case of true equity investments, the 10% equity value test in subparagraph (a)(i) of the definition of NPP be replaced by a 10% test that is based on all of the issued and outstanding securities of the subject entity.

In addition, we recommend that the definition of NPP exclude any debt or other non-equity security held by a trust or partnership in circumstances where the holder and the issuer deal at arm's length, the holder has no equity interest in the issuer (or an equity interest which is not itself NPP) and the security has no conversion or participation feature.

While we do not have a solution to the compliance difficulties that are identified above, we wanted to ensure that they are not disregarded.

## **2. 50% of Equity Value of SIFT Tests**

Subparagraph (a)(ii) of the definition of NPP in section 122.1 includes securities of a subject entity if the trust or partnership holds securities of the subject entity having a total fair market value that is greater than 50% of the equity value of the trust or partnership. There is a similar inclusion condition in paragraph (b) for Canadian real, immovable or resource property.

The equity value of a trust or partnership is equal to the fair market value of the issued equity interests in the trust or partnership. Accordingly, it does not take into account the value of any issued debt or other securities of the trust or partnership. As a result, particular investments held by a partnership or trust may be included as NPP even though the investments constitute less than 50% of all the trust or partnership's property.

Also, the 50% conditions give rise to some of the compliance difficulties identified above in respect of the 10% condition. In particular, in some cases continuous monitoring may be required.

### **Recommendations**

We recommend that the 50% of equity value conditions in subparagraph (a)(ii) and paragraph (b) of the definition of NPP be based on a measure of all the assets of the trust or partnership, rather than interests in the trust or partnership.

We also recommend that cost be used for the purpose of the 50% conditions, rather than fair market value. For example, subparagraph (a)(ii) of the definition of NPP would apply to securities that have a cost to the trust or partnership that exceeds 50% of the cost of all its property.

### **3. Exclusions from Non-Portfolio Property for Investments in REITs and Entities Holding only Portfolio Investments**

Since REITs are excluded from the application of the SIFT provisions, an investment in a REIT should be excluded from the definition of NPP. Similarly, a publicly-listed trust or partnership should be able to invest without limitation in another investment vehicle which itself does not carry on business in Canada or hold NPP. For example, an investment by one mutual fund trust in another mutual fund trust should not be NPP where the second mutual fund trust does not hold any NPP.

#### **Recommendation**

We recommend that the definition of NPP be revised to exclude a security (or any right or interest in a security) of a REIT or of another investment vehicle (such as a mutual fund trust, mutual fund corporation or a public limited partnership) that does not hold any NPP.

### **4. Canadian Real, Immovable or Resource Property**

The definition of “Canadian real, immovable or resource property” in subsection 248(1) includes a share of the capital stock of a corporation or an interest in a trust or partnership if more than 50% of the fair market value of the share or interest is derived directly or indirectly from Canadian real or immovable property, Canadian resource property or timber resource property. As a result, if a trust or partnership has investments in one or more of such entities which exceed in aggregate 50% of the equity value of the trust or partnership, all of such investments will be NPP. For example, if a listed closed-end mutual fund trust is established to hold a diversified portfolio of investments concentrated in securities issued by entities in the Canadian real property or resource property sectors, the mutual fund trust may be a SIFT even if none of its investments represents more than 10% of the equity value of the issuer or more than 50% of the equity value of the fund.

#### **Recommendation**

We recommend that paragraph (b) of the definition of NPP be revised to exclude “portfolio investments” (which term would need to be suitably defined) in listed securities.

### **5. Other**

It appears to us that the commas in paragraph (c) of the definition of NPP are in the wrong place and that the paragraph is intended to read:

a property that the trust or partnership, or a person or a partnership with whom the trust or partnership does not deal at arm’s length, uses at that time in the course of carrying on business in Canada.

## **H. “LISTED” ON A “PUBLIC MARKET”**

The definition of a SIFT trust or partnership refers to investments that are listed on a stock exchange “or other public market.” A “public market” is broadly defined in section 122.1 to include “any trading system or other organized facility through which securities that are qualified for public distribution may be exchanged...” This definition could be broad enough to include privately-operated “alternative trading systems” or “interdealer bond brokerage systems” that are operated to trade in a wide variety of securities, including debt. Securities can be traded on such systems without the knowledge or involvement of the issuer. Since the definition of “public market” is an inclusive one, it is also not clear what other arrangements are intended to be included by the ordinary meaning of the term.

The meaning of the word “listed” is also not clear. A security could be said to be “listed” on a trading system simply because it appears on a list of securities that are traded on the system. As indicated above, this could be the case without the knowledge or involvement of the issuer.

### **Recommendation**

We recommend that the term “public market” be more specifically defined to indicate what arrangements are intended to be covered and that the term “listed” be defined to refer only to arrangements where the issuer of a security has applied to have the security listed.

## **I. REAL ESTATE INVESTMENT TRUSTS**

### **1. Real Estate Business**

A trust cannot qualify as a REIT as defined in section 122.1 if it holds any NPP other than “real or immovable properties” situated in Canada. NPP is defined in subsection 122.1 to include property used in the course of carrying on business in Canada. This creates uncertainty where a trust that owns real estate could be considered to be carrying on a business of earning income from real estate. In that case, if the trust holds any property in the course of that business (such as cleaning equipment) which does not come within the definition of “real or immovable property,” it would be disqualified from being a REIT.

Furthermore, one of the requirements for a trust to qualify as a REIT is that the total of the trust’s incomes for a taxation year from properties and its taxable capital gains from dispositions of real or immovable properties in the taxation year must be not less than 95% of its income for the taxation year. There is a concern that the reference to “incomes... from properties” does not include income from a real estate business.

### **Recommendations**

In section E of this submission, we recommended that certain investment businesses not be regarded as businesses for purposes of the definitions of NPE and NPP. We recommend that this exclusion specifically apply to an investment business the principal purpose of which is to earn income from real or immovable property.

We also recommend that the definition of REIT be changed to clarify that a trust may qualify as a REIT even if its income from real or immovable property is also income from an investment business.

## **2. Ancillary Investments**

Since a trust is excluded from the definition of a REIT if it owns any NPP other than real or immovable property, it follows that ancillary investments such as shares of a management subsidiary or nominee title holding company would prevent a trust from qualifying as a REIT.

### **Recommendation**

We recommend that paragraph (a) of the definition of REIT be revised to permit a trust to hold ancillary investments in securities that are NPP, including shares of a management subsidiary or a nominee title holding company.

## **J. DEFINITION OF “REAL OR IMMOVABLE PROPERTY”**

### **1. Right or Interest in Real or Immovable Property**

The definition of “real or immovable property” in section 122.1 does not expressly include a *right or interest* in real or immovable property. There is uncertainty as to whether such rights and interests are included by the ordinary meaning of the term, particularly because of the specific inclusion of such rights and interests in the definition of “Canadian real, immovable or resource property.”

### **Recommendation**

We recommend that the definition of “real or immovable property” be expanded to include a right or interest in real or immovable property.

### **2. Exclusions from Real or Immovable Property**

Paragraph (b) of the definition of real or immovable property excludes depreciable property with a capital cost allowance rate of more than 5%. This exclusion is too broad.

The capital cost allowance that may be claimed in respect of a leasehold interest is not set at a rate; rather, it is computed based in part on the term of the relevant lease. Accordingly, where a leasehold interest relates to a lease with a term of less than 20 years, the effective “rate” of capital cost allowance that may be claimed in respect of the leasehold interest may be greater than 5%. It is not clear whether it is intended for such a leasehold interest to be real or immovable property.

The exclusion would also cover property which is incidental to the ownership of real property, such as parking lots included in Class 17 (which has a capital cost allowance rate of 8%).

### **Recommendation**

We recommend that the definition of real or immovable property be revised to specifically include leasehold interests in real or immovable property and also depreciable property that is incidental to the ownership of real or immovable property.

### **K. PART XII.2 TAX**

The NPE of a SIFT trust will generally also be “designated income” as defined in Part XII.2. It seems inappropriate for Part XII.2 tax to apply to NPE, since it is taxed under the SIFT rules at a corporate rate of tax.

### **Recommendation**

We recommend that the NPE of a SIFT trust be excluded from designated income for purposes of Part XII.2.

### **L. APPLICATION PROVISIONS**

The Draft Legislation generally provides that the amendments to the Act are applicable to a trust or partnership for taxation years that end after 2010 if units, interests in, or other securities of the trust or partnership were, before November 1, 2006, listed on a stock exchange or other public market. The terms “securities” and “public market” used in the application provisions are not defined in the draft enacting legislation, i.e., they are not defined for the operative provisions of that legislation. While the enacting legislation would add definitions of the terms to the Act, it is not clear that the definitions would be applied for purposes of the application provisions, which are not provisions of the Act but of the enacting legislation. There is also a temporal problem, in that the definitions are not supposed to apply to a grandfathered trust or partnership until the end of the grandfathering period, so even if they could otherwise be referred to for purposes of interpreting the application provisions, they would not be in force for the grandfathered entities.

A further problem with the application provisions is that they are not consistent with the definitions of a SIFT trust and partnership. Those definitions refer to “investments” that are listed. The term “investment” has a broader meaning than “security”. To be consistent, the application provisions should refer to “investments”.

### **Recommendations**

We recommend that it be clarified that the terms used in the application provisions of the Draft Legislation have the same meanings as they have for purposes of the SIFT rules in the Act. Also, the application provisions should refer to “investments” in a trust or partnership, rather than “securities” of a trust or partnership.