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Comment Letter on Canadian Tax Exemption for U.S. Fund Investments, September 2000

By Federal Express

September 15, 2000

Mr. Len Farber
General Director, Legislation
Tax Legislation Division
Department of Finance Canada
17th Floor, East Tower, 140 O'Connor Street
Ottawa, Ontario
K1A 0G5

RE: Legislative Proposals on Taxation of Foreign Investment Entities

Dear Mr. Farber:

On behalf of the U.S. mutual fund industry, the Investment Company Institute[1] strongly supports the recent announcement by the Department of Finance that the legislative proposals[2] governing investments by Canadians in foreign investment entities ("FIEs") should be modified to exempt U.S. mutual funds treated as regulated investment companies ("RICs") from their application.[3] This modification to the FIE proposals effectively would preserve the exemption for RICs that exists under the current foreign investment fund rules.

We agree with the Department of Finance that the tax policy objectives of the FIE proposals—"that of annual recognition of the FIE's income or growth"[4] can be met without subjecting RICs to their provisions. In particular, RICs do not offer investors, including Canadian investors, tax deferral opportunities because RICs must distribute (1) at least 98 percent of their income and gains realized during the year to avoid paying a U.S. federal excise tax and (2) 100 percent of their realized income and gains on a fiscal year basis to eliminate U.S. federal income taxes at the fund level.[5]

We appreciate the opportunity to express our support for the Department of Finance's proposal to exempt RICs from the application of the pending FIE legislation. If we can provide additional information regarding this matter, please do not hesitate to contact me at 202/371-5436.

Sincerely,

Deanna J. Flores
Assistant Counsel

ENDNOTES

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,239 open-end investment companies ("mutual funds"), 489 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $7.047 trillion, accounting for approximately 95% of total industry assets, and over 83.5 million individual shareholders.

[2] Legislative Proposals and Explanatory Notes on Taxation of Non-Resident Trusts and Foreign Investment Entities, released June 22, 2000 (the "FIE proposals").

[3] Under the FIE proposals, a Canadian taxpayer who held an investment in a FIE generally would be taxed each year on the FIE's realized income, as well as the unrealized gains in the securities held by the FIE pursuant to a "mark-to-market" regime. Income

recognition would thereby be accelerated to the taxpayer and any includible amounts would be fully taxable on an ordinary income basis.

[4] Finance Canada News Release 2000-064 (September 7, 2000) (the "Release").

[5] In addition, as noted in the Release, U.S. mutual funds annually must distribute at least 90 percent of their "investment company taxable income" (which includes interest, dividends and realized short-term capital gains) in order to qualify as a RIC.
