VIA E-MAIL: Consultation-Legislation@fin.gc.ca

September 11, 2024

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

Re: Department of Finance consultation on draft tax proposals

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The Portfolio Management Association of Canada (**PMAC**) represents over 300 investment management firm members that collectively manage $3 trillion in assets for pension plans, endowments, individual and group RSPs, and other investments across Canada.

PMAC welcomes the additional clarity to the enhanced trust beneficiary reporting requirements provided by the Department of Finance's proposed amendments released on August 12, 2024 (the **Proposed Amendments**) and supports the Department's proposal to include certain specific exemptions from the enhanced trust reporting requirements. However, we believe that there are other items that require further clarification, and that certain additional types of trusts should be explicitly excluded from the enhanced reporting requirements, including pooled funds and certain accounts that cease to be TFSAs or FHSAs.

As set out in a submission dated April 5, 2022, we believe that pooled funds may have been unintentionally omitted from the list of excluded funds. The enhanced reporting requirements were not intended to impact commercial investment fund products, and these entities do not pose a risk of tax avoidance, tax evasion, money laundering or other criminal activities cited as the policy purposes for the proposals. The costs and burden of the reporting requirements are significant. We see no public policy benefit to requiring beneficial ownership reporting for pooled funds but not for mutual fund trusts and segregated funds.

PMAC also supports adjusting the proposed excessive interest and financing expense limitation (**EIFEL**) rules and believes further changes can be made to avoid what may be unintended consequences of those rules, without detracting from the base erosion and profit shifting concerns underlying the EIFEL regime.

PMAC'S REQUESTS

1. **Exclude pooled funds from the trust beneficiary reporting requirements**

   Pooled funds should be excluded from the beneficial owner reporting requirements. The enhanced reporting requirements were not intended to impact commercial investment fund products, and these entities do not pose a risk of tax avoidance, tax evasion, money laundering or other criminal activities cited as the policy purposes for the proposals. The costs and burden of the reporting requirements are significant. In the alternative and at minimum, pooled funds that are registered investments, and/or consist substantially of non-taxable entities should be exempt.

2. **Certain trusts that cease to be TFSAs and FHSAs should be exempt**

   Unlike RRSPs, TFSAs and FHSAs cease to continue as TFSAs or FHSAs after certain events, such as the death of the account holder. In those circumstances, these accounts would be subject to the trust reporting requirements, despite being previously expressly exempt. PMAC supports the proposal put forward by the Investment Institute of Canada (**IFIC**) in its submission to the Department of Finance on March 19, 2024, to exclude trusts that cease to be TFSAs or FHSAs following the death of the account holder from the trust reporting requirements.

3. **Amend the definition of "eligible group entity" to clarify that a majority interest beneficiary will not arise at fund creation**

   While PMAC appreciates that the Proposed Amendments contemplate changes to the EIFEL regime, the EIFEL rules as currently constructed potentially capture every new investment fund in its first year of existence as a technical consequence of the commercial realities of a fund's creation. PMAC shares some of the concerns expressed by IFIC in its submission to the Department of Finance on January 16, 2023, which are not addressed in the Proposed Amendments.

DISCUSSION

1. Pooled Funds Trust Beneficiary Reporting Exemption

Exemption for Pooled Funds

In our April 5, 2022 submission, PMAC asked that pooled funds be exempt from the trust beneficiary reporting requirements:

> …These entities do not pose a risk of aggressive tax avoidance, tax evasion, money laundering and other criminal activities, the prevention of which are cited as the policy purposes of the proposals.

Our understanding is that the beneficial owner reporting requirements were not intended from a tax policy perspective to impact commercial investment fund products. As it stands, pooled funds have not been carved out of the reporting requirements, and, as such, would be required to report the identity of all trustees, beneficiaries, and settlors of the trust, as well as the identity of each person who has the ability to exert control over trustee decisions regarding the appointment of income or capital of the trust.

We also ask the Department of Finance to confirm that when record keepers hold units of pooled funds on behalf of the ultimate beneficiaries, such pooled funds are not required to report the information of ultimate beneficiaries, but only the information of record keepers.

There is a significant burden associated with compliance with the enhanced reporting, which would adversely impact the ease of doing business in Canada, and increase costs, to the detriment of the many Canadian savers that are invested pooled funds. Pooled fund managers will be required to build and implement systems to collect and report beneficial ownership information; they would also be subject to the proposed monetary penalties for the late filing of T3 returns.

Exemption for Non-taxable entities

In the alternative to excluding all pooled funds, we suggest that pooled funds that are registered investments, and/or consist substantially of non-taxable entities, as set out in section 149(1) of the *Income Tax Act* (the **Act**), (e.g., registered pension plans, foundations, and charities) be excluded from the reporting requirements. We appreciate the exemption for trusts holding property for the non-taxable entities set out in section 149(1) of the Act included in the Proposed Amendments. However, that exemption only extends to property that "consists solely of funds received from the Crown". Given that these entities are tax-exempt, they do not present a risk of tax avoidance or tax evasion, nor do they pose a risk of money laundering and other criminal activities.

In some cases, the beneficiaries themselves may be exempt from the additional reporting (such as a trust whose beneficiaries are registered pension plans or registered charities). Many non-taxable entities already provide significant information regarding their beneficiaries, and in some cases some of the specific additional information required by the proposals would not be available. In the case of funds established by employers to provide benefits to employees, the trusts may have thousands of beneficiaries. Collecting and reporting this information represents a tremendous burden for these entities and would not serve the proposals' policy goals cited above.

Exemption for Designated Plan Trusts

PMAC has been engaged in on-going discussions with Department of Finance staff with respect to the tax treatment of certain pooled funds. We provided a proposed solution in a submission dated December 7, 2023, in the form of a draft amendment to the Act, to introduce the concept of a "designated plan trust" (**DPT**).

Should the Department of Finance decline to exempt all pooled funds from the trust beneficiary reporting requirements but accept PMAC's proposed draft amendment with respect to DPTs, it is PMAC's position that these DPTs be exempt from the trust beneficiary reporting requirements as they are similar to mutual fund trusts (**MFTs**), which are already expressly exempt. That change could be easily implemented with a minor amendment to subsection 150(1.2) of the Act, indicated in underline below:

> **(1.2)** Subsection (1.1) does not apply to a taxation year of a trust if the trust is resident in Canada and is an express trust, or for civil law purposes a trust other than a trust that is established by law or by judgement, unless the trust
>
> […]
>
> **(f)** is a mutual fund trust;
>
> <u>**(f.1)** is a designated plan trust;</u>

2. Exemption for former TFSAs and FHSAs

In its submission dated March 19, 2024, IFIC proposed that the Act be amended to exempt trusts that ceased to be TFSAs or FHSAs from the trust reporting requirements following the death of the account holder:

> While we appreciate the policy objectives of the legislation, we do not believe that the additional trust reporting requirements in section 204.2(1) of the [*Income Tax Regulations*] should apply to [TFSAs and FHSAs] that cease to be TFSAs and FHSAs, as these are not the types of trusts targeted by this proposal, and we do not believe that the Department of Finance intended to include them, since TFSAs and FHSAs are already excluded.
>
> It is worth noting, that in most cases, the reason why these [TFSAs and FHSAs] become *inter vivos* trusts beyond the exempt period (and subject to the additional trust reporting requirements) is because the financial service provider or the issuer does not have the relevant contact information or has tried and failed to obtain the beneficiary information necessary to settle the account within the exempt period. The additional reporting requirements would only add an unnecessary

> administrative burden on the issuer while not targeting the individuals that the policy is intended to identify.
>
> For the reasons outlined above, and taking into account the Government's policy objectives, we propose that additional language be added to subsection 150(1.2)(n) to exclude trusts that cease to be TFSAs or FHSAs by virtue of the application of subsections 146.2(9) and of 146.6(a)(ii) of the [Act], respectively.[1]

PMAC supports IFIC's position and endorses its proposal to include additional language to subsection 150(1.2)(n) of the Act to exclude trusts that cease to be TFSAs or FHSAs following the death of the account holder.

3. Amendment to EIFEL Rules to clarify that a majority interest beneficiary will not arise at fund creation

The proposed rules have the potential to cause a negative outcome for investment funds and ETFs in their first year. When an investment fund is created, it is common for an asset manager to provide the seed capital required to start the fund to comply with the manager's obligations under securities law. Under National Instrument 81-102, a manager is prohibited from filing a prospectus for a newly established mutual fund unless: (a) the manager or its related entities contribute at least $150,000 in seed capital to the fund; or (b) the prospectus states that the mutual fund will issue no securities until at least $500,000 has been contributed by persons other than the manager or its related entities.[2] Asset managers typically comply with this obligation by contributing the required seed capital; the manager's position is gradually diluted as further capital is raised. For ETFs, an investment dealer may act as the designated broker or market maker in the early stages of an ETF. In both situations, the asset manager or investment dealer may own more than 50% of the fair market value of units of the fund or ETF and will likely be a majority-interest beneficiary for a brief period as part of the commercial reality of launching these products. In PMAC's view, neither of these scenarios are related to the base erosion and profit shifting concerns that the EIFEL rules were designed to target.

The proposed EIFEL rules contemplate that the main operative provision, subsection 18.2(2), would deny a deduction for a proportion of a taxpayer's "interest and financing expenses" (**IFEs**). However, subsection 18.2(2) would not apply to a taxpayer that is an "excluded entity". This term, defined in proposed subsection 18.2(1), includes a taxpayer that, together with each eligible group entity in respect of the taxpayer, has less than $1 million of IFEs net of interest and financing revenues (**IFRs**), excluding IFRs of any financial institution group entity (proposed paragraph 18.2(1)(b)).

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[1] Letter to Department of Finance of Canada, dated March 19, 2024, The Investment Funds Institute of Canada, online at: https://www.ific.ca/wp-content/themes/ific-new/util/downloads_new.php?id=29328&lang=en_CA.

[2] National Instrument 81-102 *Investment Funds*, s. 3.1, online at: https://www.osc.ca/sites/default/files/2023-10/ni_20230913_81-102_unofficial-consolidation.pdf.

Two entities might form a group entity for the purposes of proposed paragraph 18.2(1)(b) where one becomes the "majority-interest beneficiary" of the other, through the operation of subsection 251.1(3) and subparagraph 251.1(1)(g)(i) of the Act. In circumstances where the group entity formed after a majority-interest beneficiary arises has more than $1 million of IFEs, it is not an excluded entity and therefore subject to a denial of a deduction for a proportion of its IFEs pursuant to subsection 18.2(2). The proposed EIFEL rules result in the asset manager's or investment dealer's IFEs being combined with those of the nascent fund or ETF, and those entities will be denied a deduction for a portion of their IFEs should the combined amount exceed the $1 million threshold. Practically, this will almost always be the case.

In its submission dated January 16, 2023, IFIC proposed draft legislation that would resolve this issue (among others).[3] PMAC supports IFIC's proposed draft legislation and endorses its adoption.

CONCLUSION

Pooled funds should be excluded from the trust reporting requirements. The additional burden and cost of reporting for these investment funds is not commensurate with any stated policy objective and will result in costs being passed on to investors.

TFSAs and FHSAs that cease to be registered following the death of their account holder should be exempt from the trust reporting requirements, as they would have continued to be exempt but for the death of the account holder.

Mutual funds and ETFs should not be considered together with their asset managers or broker-dealers for purposes of the EIFEL exclusions, as this will often lead to a denial of deduction of IFEs as a consequence of a practical commercial reality.

Thank you for the opportunity to participate in this Consultation. We would be pleased to continue the dialogue on this important issue and discuss the recommendations included in this submission in more detail.

If you have any questions regarding this submission, please do not hesitate to contact Katie Walmsley (kwalmsley@pmac.org) at (416) 560-9419 or Thomas Lee (thomas.c.y.lee@rbc.com) at (416) 955-2505.

[3] Letter to Department of Finance of Canada, dated January 16, 2023, The Investment Funds Institute of Canada, online at: https://www.ific.ca/wp-content/themes/ific-new/util/downloads_new.php?id=28018&lang=en_CA.

Yours truly,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

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