HST & INVESTMENT PLANS

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A. INTRODUCTION[1]

1. A new regime for investment plans

From a tax perspective, on July 1, 2010 the world in which investment plans operated dramatically changed. This is the day that British Columbia and Ontario harmonized their respective retail sales taxes with the federal Goods and Services Tax ("GST") to form a single rate Harmonized Sales Tax ("HST") in each of those provinces and new proposed HST rules for investment plans came into effect. Most investment plans are now selected listed financial institutions ("SLFIs") per the proposed rules. This means that SLFIs must calculate their provincial component of HST or provincial value added tax ("PVAT") liability or refund using a formula called the special attribution method ("SAM").

SLFIs effectively operate in both a participating province and any other province.[2] In order to avoid paying the PVAT at all, or at a higher rate, SLFIs may have an incentive to acquire property and services in a non-participating province(s) for consumption or use in a participating province(s) or to acquire same in a participating province(s) with a lower PVAT rate than the participating province(s) in which the property and services will be consumed or used. The SAM formula is meant to ensure that such financial institutions pay an amount of PVAT that approximates the appropriate consumption or use in the participating provinces. From a policy perspective, tax should not influence buying decisions. Businesses in participating provinces should not have a competitive disadvantage relative to businesses in non-participating provinces.

The SAM formula looks to the following factors to determine a SLFI's PVAT liability or refund: the unrecoverable 5% GST paid or that became payable by the SLFI; an attribution percentage for each participating province; the PVAT rate for each participating province; and the PVAT actually paid or that became payable by the SLFI. The attribution percentage is a key component. These factors and the formula are discussed in detail later.

The formula is important because financial institutions generally are restricted in their ability to claim input tax credits ("ITCs") in order to recover the GST/HST paid on their input costs. Generally, financial institutions make exempt supplies of financial services and accordingly the GST/HST paid on input costs to supply such services is unrecoverable. For example, the sale of units in a mutual fund to investors resident in Canada is an exempt financial service. The fund would not be able to recover the GST/HST it pays on the management fees or other costs it pays in relation to these units. In limited situations investment plans can claim ITCs, e.g., relating to zero-rated supplies of financial services that may be made to investors that are not resident in Canada or in respect of taxable supplies made such as rentals of commercial or industrial real estate. It is expected that most investment plans though are not registered for GST/HST purposes.

At the time of writing, investment plans do not have the final complete and official set of rules to follow in order to do the SAM calculations and implement all of the necessary systems and operational changes to apply the new HST rules. The systems and operations changes required are significant. Industry has been relying on the proposed rules announced by the Department of Finance ("Finance") prior to July 1, 2010 and ongoing consultations with Finance. Additional rules and clarifications and modifications to the existing ones are expected in the near future. For this reason, readers are cautioned that there are still

[1] The authors acknowledge and thank Barbara Amsden of The Investment Funds Institute of Canada ("IFIC") and IFIC for their contribution to the paper and Mary Esteves and Karen Wong of Deloitte for their insights and comments. The authors also acknowledge and thank Lalith Kottachchi and Warren Light of the Department of Finance and Katherine Lairson of the Canada Revenue Agency ("CRA"). All views expressed herein and any errors are those of the authors alone.

[2] New Brunswick, Newfoundland, Nova Scotia, Ontario, and British Columbia are the current participating provinces.

some gaps in the rules. The purpose of this paper is to explain our understanding of how the proposed rules should apply in practice based on the releases by Finance to date among other things.[3]

The majority of the proposed rules are contained in the draft regulations. However, the starting point and what takes you to the draft regulations is section 225.2 of the *Excise Tax Act*[4] (Canada) ("ETA"). That section defines "who" is a SLFI and sets out the basic SAM formula. The draft regulations further define a SLFI, set out significant adaptations to the SAM formula, and contain many other "supplementary" rules. The "supplementary" rules include definitions that must be "strung" together and modifications to section 225.2 of the ETA and other sections of the ETA.

We cover various types of SLFI investment plans including mutual fund trusts, mutual fund corporations, mortgage investment corporations, segregated funds of insurers, exchange traded funds, and other plans (e.g., registered plans, retirement compensation arrangements, deferred profits sharing plans, and health and welfare trusts).[5] We briefly address the rebate available to non-SFLIs and certain SFLIs in respect of the PVAT payable on management or administrative services and the self-assessment of PVAT where the SAM is not applicable. Also, we provide an update on the industry consultations including areas of uncertainty and challenge.

This is not a paper on tax policy for investment plans. However, it is difficult not to think about the underlying policy, particularly in light of the significant systems, process and operational changes required and the technical complexity of the rules themselves. For context and perspective in this regard, we provide a high level comparison of the application of GST/HST between investment plans and other investment products, and insight as to how other jurisdictions apply VAT, if applicable, to comparable investment plans.

As is seen from the summary below, investment plans appear to bear a greater burden of GST relative to other comparable investment products and relative to similar products offered in other jurisdictions. With the introduction of HST in Ontario and British Columbia, the burden is accentuated and multiplied. This does not change how the current rules for HST will apply to investment plans; however, it appears that this has lead to greater awareness in industry and the Government to consider a broader policy review as to the application of GST/HST to financial services products in general. Such a policy review, if undertaken, likely will need to consider the importance of neutrality in the application of GST/HST to financial services as well as the impact that any policy changes will have on economic behavior and government revenues. Stay tuned as HST may be the stimulus for such a review.

2. Comparison to other investment products

Generally and based on certain factors, there are differences in the GST burden borne by investment plans compared to other competing investment products. If we focus on mutual funds and segregated funds for example under investment plans and say guaranteed investment certificates (GICs), stocks and bonds under competing investment products, the differences are easily highlighted. The outcome generally is that investment plans bear a higher GST burden compared to the competing investment products. Of course, with HST, this added burden on investment plans is exacerbated.

The two main factors lending to the added burden on investment plans are: (i) the structure of investment plans; and (ii) the GST rules applicable to investment plans. In this regard, mutual funds are structured within trusts or corporations. Both trusts and corporations are treated as persons for GST purposes and when taxable supplies are made to them, GST must be collected accordingly. In the case of segregated

[3] For ease of reading and to avoid numerous references to the term "proposed", we generally describe the proposed rules as if they were enacted except in cases where there is uncertainty as to a particular rule.

[4] RSC, 1985, c. E-15, as amended.

[5] We will not cover pension plans. They will be covered by Line Arseneau, KPMG LLP on September 28, 2010.

funds, notwithstanding the funds are assets held within the insurance companies themselves, the GST legislation through section 131 of the ETA creates a fiction to treat them as separate persons from the insurance companies and to be dealing with them at arm's length. Further, with some exceptions, monies removed from the segregated funds are deemed to be consideration for taxable supplies.[6] In the end, for both mutual funds and segregated funds, GST applies to investment and administrative management services since they are provided by third parties, either through fact or legal fiction. Further, given the way the rules work in the ETA and how costs are recovered from investment plans, otherwise exempt intermediation (i.e., "arranging for" services) are taxable to them. Given the significance of the cost of intermediation, this factor leads to much of the added burden of GST to investment plans compared to other investment products. Unfortunately, generally there is no way to take advantage of the relieving election under section 150 of the ETA to treat any of the services as exempt financial services.

With respect to GICs, these are generally managed and sold within a single legal entity (i.e., a deposit-taking financial institution). As such, investment and administrative management services are provided in-house and therefore do not attract GST on the key elements of self-supplied labour and profit. Comparatively speaking, an investor could incur a management expense ratio (MER) for a mutual fund through the management fees and other expenses charged by a mutual fund manager and other suppliers. That same investor could invest in a GIC and essentially incur a similar MER that is built in the margin between lending and deposit rates. In each case the investor is paying for similar services, as follows:

GIC **Built in the Margin Spread**	**Mutual Fund** **Part of Management Fees and Other Expenses Charged to the Fund**
Time value of money/risk premium/profit	Time value of money/risk premium/profit
Treasury/cash management	Portfolio investment management
Branch costs to initiate and provide loans/deposits to customers	Distribution costs of mutual fund dealers/financial advisors
Administration: client interaction/account statements/tax reporting/etc.	Administration: client interaction/account statements/tax reporting/custody/etc.

Assuming all of the services in the case of the GICs are supplied by in-house staff of the deposit-taking institution, very little GST will be incurred in the management and administration of GICs compared to mutual funds.[7] Even if some of the management and administration is performed by entities related to the originating deposit-taking institution, there may be the possibility to utilize the benefits of the election under section 150 of the ETA to exempt the inter-company supplies. Using a 2% MER, GST adds 10 basis points (bps) to the cost of management and administration for mutual funds. Depending on the residency of investors, HST further adds 0 to 20 bps to this cost.

In the case of direct ownership of stocks and bonds as comparable investment products to investment plans, the significant difference in the GST cost is with respect to the intermediation or "arranging for" services, which, for the most part, will be exempt for stocks and bonds. Investors generally pay for these services directly and do not pay GST thereon. In contrast, since these services are bundled with the management and administration charges by the mutual fund manager or insurance company and given the operation of the rules in the ETA affecting these investment plans, these otherwise exempt services are taxable for investment plans. It should be noted that unlike in the case of GICs, the management and administration of a portfolio of stocks and bonds generally is taxable. That said, since the intermediation or "arranging for" services are a significant component of the costs incurred by investors with respect to

[6] These rules for segregated funds exist to put them on a level playing field with mutual funds from a GST perspective.

[7] There will be some GST cost (i.e., denial of ITCs) relating to external costs incurred by the deposit-taking institution in providing the management and administrative support relating to the GICs.

stocks and bonds, there still is a GST benefit generally for stocks and bonds compared to investment plans.

3. Comparison to other jurisdictions

From a GST/HST perspective, it seems fair to generalize that investment plans in Canada are disadvantaged compared to investment plans in certain other jurisdictions.

a. United States (US)

First off, Canada's most significant neighbor, the US, does not impose a value added tax (VAT) and, thus, comparable investment plans there do not incur a VAT component in the MER.

b. European Union (EU)

Looking at the EU, broadly speaking, investment management supplies are taxable but there are exemptions in certain countries (Member States). Exemptions in the EU are codified in the ***VAT Directive***. Article 135(1)(g) in the ***VAT Directive*** provides for the exemption of "the management of special investment funds as defined by Member States". Following this directive, in the United Kingdom (UK), retail fund management is generally exempt. As well, the exemption for investment management services (and fund administration services) has developed and expanded due to recent European case law and UK legislative changes. The type of fund covered by the exemption is largely governed by how it is regulated and marketed - exemption now includes investment management services provided to UK and non-UK "special investment funds" including many closed-ended and open–ended fund vehicles. As well, segregated fund management is not taxable when provided by the insurance provider. There is also a case due to be heard next year at the UK Tribunal on whether the exemption should apply to pension fund management.

With respect to other EU countries, exemption applies in Luxembourg and Spain. As well, Portugal applies the exemption broadly, covering the "administration and management" of "investment funds" (i.e. any type of investment fund). Ireland does not apply the exemption to pension funds but it is otherwise applied widely, including investment companies, unit trusts, pension pooling vehicles, investment limited partnerships, securitization vehicles, life assurance companies and collective investment undertakings. In certain other EU countries, only funds of a specific legal form will qualify for exemption as "special investment funds".

It should be noted that where exemption applies to investment management services to investment plans, service providers supplying such services will be denied the recovery of VAT incurred on costs related to supplying those services. Overall, the impacted investment plans are much better off with having the exemption apply.

c. Australia

Investment management services and financial intermediary services are generally taxable in Australia and hence suppliers of financial services may suffer a restriction in the recovery of GST incurred. However, for certain costs, suppliers of financial services are entitled to special input tax relief (referred to as a "reduced input tax") equal to 75% of the GST paid on such costs that are associated with the provision of input taxed (i.e. exempt) financial services.[8] This relief applies to investment plans since they make supplies of input taxed (i.e. exempt) financial services (i.e., earning of interest, dividends, buying and selling of financial instruments, etc.).

[8] Included in the list of items subject to the reduced input tax credit relief are the "arrangement, by a financial supply facilitator, of the provision, acquisition or disposal of an interest in a security…", certain "investment portfolio management functions", "administrative functions in relation to investment funds" and "trustee and custodial services". (Ref. *Goods and Services Tax Ruling 2004/1)*

The policy behind Australia's approach is to eliminate the bias that would otherwise exist as between outsourcing versus insourcing. Outsourcing will carry a GST cost with it, but the 75% input tax relief would bring it back to comparable GST costs under insourcing (i.e., recognizing the non-taxable inputs such as salary and wages).

d. New Zealand

New Zealand generally taxes investment management services and exempts financial intermediary/"arranging for" services. However, a protocol exists whereby management fees charged to unit trusts and collective investment funds are only taxable to the extent of 10% of the fees. This protocol generally exists to recognize that a significant component of the management fees charged to those investment vehicles would qualify for exemption as financial services.

B. GOVERNMENT RELEASES TO DATE

The Government has released a number of documents to date relevant to investment plans and HST implementation. Most of the substantive rules including the adaptations to the SAM formula, are set out in three documents: a backgrounder released May 19, 2010 followed by draft regulations and a backgrounder both released June 30, 2010. This later background clarifies and modifies certain of the proposed rules set out in the May 19, 2010 backgrounder. The draft regulations do not include all of the rules and do not include all of the proposed changes indicated in the June 30, 2010 backgrounder.

We understand from discussions with Finance that additional announcements will be made in the form of backgrounders, draft legislation, and draft regulations. Also, we understand from these discussions that Finance is currently reviewing arrangements involving partnerships, insurance, and pensions. Readers should watch for these new releases. Readers are cautioned that the information presented here could change as a result of such releases.

GOVERNMENT RELEASES	LINK
July 2010, CRA, GST/HST Notice 255, "Elections for Certain Selected Listed Financial Institutions under the HST" ("Notice 255").	http://www.cra-arc.gc.ca/E/pub/gi/notice255/notice255-e.pdf
June 30 2010, Finance, Backgrounder, "Harmonized Sales Tax Rules for Financial Institutions, Interment Rights and Streamlined Accounting Methods" ("June 30, 2010 Backgrounder").	http://www.fin.gc.ca/n10/10-062-eng.asp
June 30, 2010, Draft Regulations Amending Various GST/HST Regulations, No. 2. ("Draft Regulations"). Proposed amendments to rules for SLFI and modifications to net tax in section 225.2 of the ETA.	http://www.fin.gc.ca/n10/10-062-eng.asp
June 17, 2010, SOR/2010-150, *Electronic Filing and Provision of Information (GST/HST) Regulations*.	http://canadagazette.gc.ca/rp-pr/p2/index-eng.html
May 31, 2010, SOR/2010-117, *New Harmonized Value-added Tax System Regulations*. Place of supply and transitional rules.	http://canadagazette.gc.ca/rp-pr/p2/index-eng.html
May 19, 2010, Finance, Backgrounder, "Financial Institution Rules for the Harmonized Sales Tax (HST)" ("May 19, 2010 Backgrounder").	http://www.fin.gc.ca/n10/data/10-050_1-eng.asp

GOVERNMENT RELEASES	LINK
December 15, 2009, HST framework legislation, *An Act to Amend the Excise Tax Act*, SC 2009, c. 32 ("c. 32"). Assented to December 15, 2009. Establishes the framework, including regulation making authority, for the new HST rules including the proposed rules for investment plans.	http://laws.justice.gc.ca/PDF/Annual/2/2009_32.pdf

C. KEY CONCEPTS

1. What the proposed rules set out to accomplish

The proposed rules determine for each participating province, the PVAT liability for an investment plan that has a permanent establishment in a participating province and any other province. The PVAT liability is based on a proxy to allocate consumption or use by the plan in each respective participating province. The Draft Regulations use the residency of investors/members in an investment plan as a proxy to determine the PVAT liability for the plan. No PVAT liability in connection with the expenses incurred by the plan (e.g., management fees) is imposed on the investors/members by virtue of the proxy, i.e., the PVAT liability is that of the plan and not the investors/members.

An investment plan is a **person** for HST purposes and therefore can be a **recipient** of a supply for HST purposes liable to pay HST, e.g., on management fees charged to it, on third-party expenses charged to it. Subsection 123(1) of the ETA defines **person** to mean:

> …an individual, a partnership, a corporation, the estate of a deceased individual, a trust, or a body that is a society, union, club, association, commission or other organization of any kind;

Subsection 123(1) of the ETA defines **recipient**, as follows:

> "recipient" of a supply of property or a service means
>
> (a) where consideration for the supply is payable under an agreement for the supply, the person who is liable under the agreement to pay that consideration,
>
> (b) where paragraph (a) does not apply and consideration is payable for the supply, the person who is liable to pay that consideration, and…

The person liable and responsible to pay the PVAT (and GST) in respect of expenses charged to the investment plan (or its trustee on behalf of the plan) is the plan. It is not the investors/members.

The current PVAT rates for the five participating (harmonized) provinces used by investment plans to calculate their PVAT liability are: British Columbia (7%); Newfoundland (8%); New Brunswick (8%); Nova Scotia (10%); and Ontario (8%).

The proposed changes for investment plans generally apply in respect of any reporting period of a SLFI that ends after June 2010.

2. Interaction with HST place of supply rules

HST place of supply rules are used to determine whether a supply made in Canada is made in a participating province and hence to determine the applicable PVAT rate.[9] Investment plan managers and other persons who make supplies to the plans are, notwithstanding the Draft Regulations, required to charge the plans and to account for and report the applicable PVAT on their returns. The Draft Regulations do not change the place of supply rules and the manager's and other supplier's obligations to properly account for and report the applicable PVAT based on the place of supply rules.

As discussed later, if a manager and investment plan elect to use the proposed tax adjustment transfer election set out in section 56 of the Draft Regulations, the PVAT amount that the manager actually collects from the plans will likely be different than the amount that it is required to collect and report per the HST place of supply rules. The difference is shown as an adjustment on both the managers' and plans' returns.

> **Example – HST place of supply:**
>
> A mutual fund manager charges a management fee to a fund. The address of the fund that the manager obtains in the ordinary course of its business is in Ontario and this Ontario address is indicated in the management agreement between the manager and the fund. This would likely be the address of the trustee. Based on the HST place of the rule for general services, the applicable rate that the manager is required to charge the fund on the management fee is 13%. (See: *New Harmonized Value-added Tax Systems Regulations,* subsection 13(1)).

3. Who is a SLFI?

The starting point is subsection 225.2(1) of the ETA. Essentially, that section tells you that for a financial institution to qualify as a SLFI it must be: (i) a listed financial institution; and (ii) a corporation, trust/individual, partnership, or prescribed financial institution that satisfies a permanent establishment test. These requirements are described below.

a. <u>Listed financial institution</u>

A listed financial institution is a financial institution listed in paragraph 149(1)(a) of the ETA. An investment plan is one such listed financial institution per ETA subparagraph 149(1)(a)(ix). The term investment plan is defined in subsection 149(5) as follows:

> In this section, "investment plan" means
>
> (a) a trust governed by
>
> (i) a registered pension plan,
>
> (ii) an employee's profit sharing plan,
>
> (iii) a registered supplementary unemployment benefit plan,
>
> (iv) a registered retirement savings plan,
>
> (v) a deferred profit sharing plan,

[9] Note that a number of recent amendments were made to the place of supply rules which determine whether a supply made in Canada is made in a participating province or outside a participating province. The rules determine the applicable rate for taxable supplies. Significant changes were made to the rules for services and intangibles. (See: Schedule IX to the ETA and the *New Harmonized Value-added Tax System Regulations*.)

(vi) a registered education savings plan,

(vii) a registered retirement income fund,

(viii) an employee benefit plan,

(ix) an employee trust,

(x) a mutual fund trust,

(xi) a pooled fund trust,

(xii) a unit trust, or

(xiii) a retirement compensation arrangement,

as each of those terms is defined for the purposes of the Income Tax Act or the Income Tax Regulations;

(b) an investment corporation, as that term is defined for the purposes of that Act;

(c) a mortgage investment corporation, as that term is defined for the purposes of that Act;

(d) a mutual fund corporation, as that term is defined for the purposes of that Act;

(e) a non-resident owned investment corporation, as that term is defined for the purposes of that Act;

(f) a corporation exempt from tax under that Act by reason of paragraph 149(1)(o.1) or (o.2) of that Act; and

(g) a prescribed person, or a person of a prescribed class, but only where the person would be a selected listed financial institution for a reporting period in a fiscal year that ends in a taxation year of the person if the person were a listed financial institution included in subparagraph 149(1)(a)(ix) during the taxation year and the preceding taxation year of the person.

A segregated fund of an insurer is a listed financial institution per paragraph 149(1)(1)(vi) of the ETA. Subsection 123(1) of the ETA defines a segregated fund of an insurer to mean a specified group of properties that is held in respect of insurance policies all or part of the reserves for which vary in amount depending on the fair market value of the properties. By virtue of section 131 of the ETA, a segregated fund of an insurer is deemed to be a trust and the insurer is deemed to be the trustee of the trust.

For simplicity, we refer to an investment plan and a segregated fund collectively as an investment plan. These plans are the subject matter of our paper.

b. Prescribed financial institution

Section 11 of the Draft Regulations tells you that paragraphs 225.2(1)(a) to (c) of the ETA do not apply in determining if an investment plan is a SLFI.[10] The determination is based only on paragraph 225.2(1)(d) of the ETA – i.e., a prescribed financial institution. Section 11 of the Draft Regulations defines who is a

[10] See: Draft Regulations subsection 11(2).

prescribed financial institution for purposes of ETA paragraph 225.2(1)(d). Per section 11 prescribed financial institutions include:

- a financial institution that has at any time in the taxation year a permanent establishment in a participating province and in any other province; and
- where the financial institution above is a qualifying small investment plan for the fiscal year, it has made an election per subsection 12(1) of the Draft Regulation to be treated as an SLFI.[11]

An investment plan now only looks to the current year to determine if it is a SLFI. An investment plan no longer has to satisfy a "permanent establishment" test in the current taxation year ***and preceding taxation year***. Section 10 of the Draft Regulations removes the words "and preceding taxation year" from the preamble to subsection 225.2(1) of the ETA**.**

4. Permanent Establishment

The concept of permanent establishment is pivotal to determining whether a listed financial institution is a SLFI. A listed financial institution is a SLFI if it has a permanent establishment in a participating province and in any other province. The existing definition in the ETA is based on the federal income tax definition and is fairly narrow in scope compared to the definition in the Draft Regulations.[12] In addition to the federal income tax definition, the definition is broadened by the deeming provisions in the Draft Regulations. These provisions deem a permanent establishment to exist based on the province where investors/plan members reside or the province where investments are sold. The effect is that most investment plans are now SLFIs. Previously, most investment plans were not SLFIs.

Section 4 of the Draft Regulations defines the term permanent establishment. Paragraphs (d), (e) and (f) of section 4 set out the relevant definitions for investment plans.

<u>Segregated fund of an insurer</u> (paragraph (d)) – deemed to have a permanent establishment in a province throughout a taxation year of the financial institution if, at any time in the taxation year,

> (a) the insurer is qualified, under the laws of Canada or a province, to sell units of the financial institution in the province; or
>
> (b) a person resident in the province holds one or more units of the financial institution.

For example, a nationally distributed segregated fund of an insurer would have a permanent establishment in all of the provinces in Canada and would be considered a SLFI.

<u>Distributed investment plan</u> other than a segregated fund of an insurer (paragraph e) – deemed to have a permanent establishment in a province throughout a taxation year of the financial institution if, at any time in the taxation year,

> (a) the financial institution is qualified, under the laws of Canada or a province, to sell or distribute units of the financial institution in the province, or
>
> (b) a person resident in the province holds one or more units of the financial institution;

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[11] Subparagraph 11(1)(b)(i) and section 13 of the Draft Regulations provide for an additional situation as to when a qualifying small investment plan can be a SLFI.

[12] The definition is found in subsections 400(2) and 2600(2) of the Income Tax Regulations.

For example, a nationally distributed mutual fund would have a permanent establishment in all of the provinces in Canada and would be considered a SLFI.

Private investment plan (paragraph (f)) – deemed to have a permanent establishment in the province throughout the taxation year if at any time during the year a plan member is resident in the province. For example, health and welfare trust that has plan members across Canada would have a permanent establishment in all of the provinces and would be a SLFI.

5. Residency

The province in which an investor or member of an investment plan resides is key to determining an investment plan's PVAT liability. More specifically, the residence of an investor or member is used as a proxy for an investment plan's consumption or use in a participating province. The proxy is determined as a percentage of the total investors/members per the attribution rules and then applied in accordance with the SAM formula.

Section 6 of the Draft Regulations set out the rules to determine when a person resident in Canada is resident in a province. It must first be determined whether a person is resident in Canada. Subsection 123(1) of the ETA defines "non-resident" to mean not resident in Canada. A person can be resident in Canada by virtue of the common law. Further, section 132 of the ETA sets out certain deeming rules as to when a person is resident in Canada. Some of these rules are summarized in the table below.

PERSON	DEEMED RESIDENT IN CANADA
Corporation	Incorporated or continued in Canada and not continued elsewhere
Partnership	A member or majority of the members having management and control of the partnership is/are resident in Canada
Association	A member or majority of the members having management and control of the association is/are resident in Canada
Individual	Deemed under paragraph 250(1)(b) to (f) of the *Income Tax Act* to be resident in Canada

Unlike the above rules which specifically deem certain vehicles to be resident in Canada, there is no similar rule for trusts. The residence of a trust is determined based on common law which generally looks to the residence of the trustee.

Section 6 of the Draft Regulations set out new rules, for purposes of the Draft Regulations, to determine the province of residence for a person resident in Canada. They apply "despite" the deeming rules for residency in a province in subsection 132.1(1) of the ETA.[13] The rules are summarized in the Table below.

[13] Subsection 132.1(1) of the ETA sets out deeming rules as to when a person resident in Canada is resident in a province. The rules do not apply for determining the place of residence of an individual in his/her capacity as a consumer.

PERSON	RESIDENCY DETERMINATION DRAFT REGULATIONS
Individual	Principal mailing address in Canada
Corporation	Principal business address in Canada
Partnership	Principal business address in Canada
Trust governed by an registered retirement savings plan, registered retirement income fund, registered education savings plan, registered disability savings plan, tax free savings account	Principal mailing address of the annuitant, subscriber, or holder (as applicable)
Trust other than above	Trustee's principal business address in Canada or if the trustee does not carry on business in Canada, the trustee's principal mailing address in Canada
Any other case	Person's principal business address in Canada and if the person does not carry on business in Canada, the person's principal mailing address in Canada

6. Investment plan, distributed investment plan, qualifying small investment plan, exchange traded fund, & private investment plan

The rules are specific in their application to the various types of investment plans; so it is important to identify the type of plan for purposes of the rules. For example, a distributed investment plan (described below) is excluded from being a qualifying small investment plan (described below). Qualifying small investment plans are generally not SLFIs whereas distributed investment plans are generally SLFIs. Also for example, a private investment plan (described below) is not a distributed investment plan and follows a different approach to determining its liability for PVAT.

An investment plan ("Investment Plan") is defined in subsection 1(1) of the Draft Regulations to mean a listed financial institution that is a segregated fund of an insurer (defined in ETA subparagraph 149(1)(a)(vi)) or an investment plan (defined in ETA subparagraph 149(1)(a)(ix) and subsection 149(5)). The definition excludes a registered retirement savings plan ("RRSP"), registered retirement income fund ("RRIF"), and a registered education savings plan ("RESP") which are investment plans and listed financial institutions per ETA subsection 149(5).

Finance indicated in the May 19, 2010 Backgrounder that the proposed rules "would not apply to treat as SLFIs investment plans of **individuals** that are trusts governed by a" RRSP, RRIF, or a RESP. Therefore, these investment plans are subject to the general place of supply rules as the application of those rules should yield the appropriate results for determining their HST liability. We understand from our discussions with Finance that the underlying pooled investment structures in which these individual plans may invest are under review.

A distributed investment plan ("Distributed Investment Plan") is defined in subsection 1(1) the Draft Regulations to mean an Investment Plan that is a mutual fund trust, mutual fund corporation, unit trust, mortgage investment corporation, investment corporation, non-resident-owned investment corporation, or a segregated fund of an insurer.

A qualifying small investment plan ("Qualifying Small Investment Plan") is defined in subsection 8(2) of the Draft Regulations. It generally means an Investment Plan whose unrecoverable tax amount for the preceding year's reporting period(s) is $10,000 or less. Unrecoverable tax amount generally means the unrecoverable GST for the plan. It is calculated by using the "A" – "B" formula in subsection 225.2(2) of the ETA without reference to the modifications made to the SAM by the Draft Regulations as if the plan were a SLFI for the reporting period(s) in the preceding year. These formulas are described later. (The calculation is based on the current year where it is the first year of the Investment Plan.) A Distributed Investment Plan is excluded from being a Qualifying Small Investment Plan.

An exchange traded fund ("Exchange Traded Fund") is defined in subsection 1(1) of the Proposed Regulations to mean a Distributed Investment Plan the units of which are listed or traded on a stock exchange or other public market.

A private investment plan ("Private Investment Plan) is defined in subsection 1(1) of the Proposed Regulations to mean an investment plan that is an employee benefit plan, an employee life and health trust, a registered supplementary unemployment benefit plan or a trust governed by a deferred profit sharing plan, an employee trust, an employee profit sharing plan, or a retirement compensation arrangement. Private Investment Plans have plan members for purposes of the Draft Regulation. Only an individual can be a plan member which means that a Private Investment Plan uses the address of each individual to determine its provincial attribution percentage. As explained in more detail later, there is no look-through requirement. The term is defined in subsection 1(1) of the Draft Regulations as follows:

> "plan member" of an investment plan that is a private investment plan or a pension entity of a pension plan means an individual who has a right, either immediate or in the future and either absolute or contingent, to receive benefits under
>
> (*a*) if the investment plan is an employee benefit plan, an employee life and health trust or a registered supplementary unemployment benefit plan, the investment plan;
>
> (*b*) if the investment plan is a pension entity of a pension plan, the pension plan; or
>
> (*c*) in any other case, the deferred profit sharing plan, the employee trust, the employees profit sharing plan or the retirement compensation arrangement, as the case may be, that governs the investment plan.

The definitions of Investment Plan, Distributed Investment Plan, Qualifying Small Investment Plan, Private Investment Plan and Exchange Traded Fund are summarized in the Table below.

INVESTMENT PLAN ETA 149(1)(a) (vi) and (ix)	DRAFT REGULATIONS				
	INVESTMENT PLAN	**DISTRIBUTED INVESTMENT PLAN**	**PRIVATE INVESTMENT PLAN**	**QUALIFYING SMALL INVESMENT PLAN***	**EXCHANGE TRADED FUND (publicly traded)**
Segregated fund of an insurer	Yes	Yes	No	No	No[14]
RPP trust	Yes	No	No	Yes	No
EPSP trust	Yes	No	Yes	Yes	No
Registered supplementary unemployment benefit plan trust	Yes	No	Yes	Yes	No
RRSP trust	No	No	No	No	No
DPSP trust	Yes	No	Yes	Yes	No
RESP trust	No	No	No	No	No
RRIF trust	No	No	No	No	No
Employee benefit plan trust	Yes	No	Yes	Yes	No
Employee trust	Yes	No	Yes	Yes	No
Mutual fund trust	Yes	Yes	No	No	Yes, if publicly traded
Pooled fund trust[15]	N/A	N/A	N/A	N/A	N/A
Unit trust	Yes	Yes	N/A	No	Yes, if publicly traded
Retirement compensation arrangement	Yes	No	Yes	Yes	No
Investment corporation	Yes	Yes	No	No	Yes, if publicly traded
Mortgage investment corporation	Yes	Yes	No	No	No
Mutual fund corporation	Yes	Yes	No	No	Yes, if publicly traded
Non-resident owned investment corporation	Yes	Yes	No	No	No

14 Contracts of a segregated fund of an insurer are not listed or traded on a stock exchange or other public market.

15 This vehicle is no longer relevant. It was defined in subsection 149(5) by reference to the definition in the *Income Tax Act* (Canada) or the *Income Tax Regulations*. That definition has been repealed.

INVESTMENT PLAN ETA 149(1)(a) (vi) and (ix)	DRAFT REGULATIONS				
	INVESTMENT PLAN	DISTRIBUTED INVESTMENT PLAN	PRIVATE INVESTMENT PLAN	QUALIFYING SMALL INVESMENT PLAN*	EXCHANGE TRADED FUND (publicly traded)
Pension and similar corporation exempt from income tax per paragraph 149(1)(o.1) or (o.2) of the ITA	Yes	No	No	Yes	No
Prescribed person, or a person of a prescribed class, where the person would be a SLFI for a reporting period in a fiscal year that ends in a taxation year of the person if the person were a listed financial institution included in subparagraph 149(1)(a)(ix) during the taxation year and the preceding taxation year of the person[16]	Yes	No	No	Yes	No

* Assumes unrecoverable tax amount is $10,000 or less.

7. Stratified investment plan & non-stratified investment plan

These terms distinguish between Distributed Investment Plans that have series of units versus those that do not. The Draft Regulations generally set out separate rules for the provincial attribution percentages and the SAM formula for each type of plan. The rules generally parallel each other with some exceptions.

A stratified investment plan ("Stratified Investment Plan") is defined in subsection 1(1) of the Draft Regulations to mean a Distributed Investment Plan, the units of which are issued in two or more series. A non-stratified investment plan ("Non-stratified Investment Plan") is defined in subsection 1(1) of the Draft Regulations to mean a Distributed Investment Plan that is not a Stratified Investment Plan.

8. Provincial series, series, & unit

The PVAT liability for an investment plan is determined for each series where the plan has series of units. The meaning of a provincial series is important because such a series is not subject to the SLFI rules and therefore is not required to determine its PVAT liability using the SAM formula. A provincial series uses the "normal" rules to determine its PVAT liability.

A provincial series ("Provincial Series") is defined in the Draft Regulations subsection 1(1) as follows:

> "provincial series" for a fiscal year of a stratified investment plan means a series of the stratified investment plan that meets the following conditions throughout the fiscal year in respect of a particular province:

[16] Section 9 of the Draft Regulations prescribes an employee life and health trust as a prescribed person.

(*a*) units of the series are permitted, under the laws of Canada or a province, to be sold or distributed in the particular province;

(*b*) units of the series are not permitted, under the laws of Canada or a province, to be sold or distributed in any province other than the particular province;

(*c*) pursuant to the terms of the prospectus, registration statement or other similar document for the series, or pursuant to the laws of Canada or a province, the conditions for a person owning or acquiring units of the series include

(i) that the person be resident in the particular province when the units are acquired,
and

(ii) if the person ceases to be resident in the particular province on a particular day, that the units be sold, transferred or redeemed within a reasonable time after that day;

and

(*d*) the stratified investment plan's percentage for the series and for the particular province for the taxation year in which the immediately preceding fiscal year ends, or the percentage that would be the stratified investment plan's percentage for the series and for the particular province for that taxation year if the particular province were a participating province, is 90% or more.

The terms series and unit are defined to capture various types of investment vehicles and the specific terminology used in the context of such vehicles.

A series ("Series") is defined in subsection 1(1) of the Draft Regulations as follows:

"series"

(*a*) of a trust, means a class of units of the trust; and

(*b*) of a corporation, means a class of the capital stock of the corporation.

A unit ("Unit") is defined in subsection 1(1) of the Draft Regulations as follows:

"unit"

(a) in respect of a trust, means a unit of the trust;

(*b*) in respect of a series of a trust, means a unit of the trust of that series;

(*c*) in respect of a corporation, means a share of the capital stock of the corporation;

(*d*) in respect of a series of a corporation, means a share of the capital stock of the corporation of that series; and (*e*) in respect of a segregated fund of an insurer, means an interest of a person, other than the insurer, in the segregated fund.

An individual ("Individual") is defined in subsection 1(1) of the Draft Regulations to include the estate of a deceased individual. Subsection 123(1) of the ETA defines individual to mean a natural person.

Note that the type of investor (e.g., individual, corporation, partnership, trust etc.) is relevant for a number of reasons. Most importantly, it is used to determine the province of residence of an investor resident in Canada and from there the proper provincial attribution percentage to apply in calculating an Investment Plan's PVAT liability or refund using the SAM formula.

9. Specified investor

Relief is given to a Distributed Investment Plan in respect of institutional investors who qualify as "specified investors". Specifically, no look-through as to the residency of such institutional investors is required by the Distributed Investment Plan in order to determine its provincial attribution percentage. (We discuss the look-through requirement in detail in the section on calculating the provincial attribution percentage.) The Distributed Investment Plan can use the residence of the specified investor to determine its provincial attribution percentage. A specified investor, for example, would only be required to provide its principal business address (if it is a corporation or partnership), its general partner's principal business address (if it is a partnership and the partnership itself does not have a principal business address) or the trustee's business address (if it is a trust).

A specified investor ("Specified Investor") is a person who holds Units in an Investment Plan with a value of less than $10,000,000. A Specified Investor includes: (i) all Qualifying Small Investment Plans; and (ii) all Investment Plans except for mutual fund trusts, mutual fund corporations, segregated funds, unit trusts, and mortgage investment corporations.

An Individual cannot be a Specified Investor. No look-through is required because the residence of the Individual is based on the person's principal mailing address in Canada. Hence, there is no reason to have a look-through requirement in the first place.

Below is a summary of the announcements by Finance as to the **type** of entities that can be a Specified Investor.

- The May 19, 2010 Backgrounder proposed that an institutional investor that is not an Investment Plan (i.e., a non-investment corporation, partnership, or family trust) be treated as a Specified Investor where the value of the institutional investor's investment in the Investment Plan (i.e., in the investee) is less than $10 million on the attribution date (i.e., the date when investment plans and segregated funds would generally be required to determine their attribution percentages).

- In addition, the May 19, 2010 Backgrounder proposed that a Qualifying Small Investment Plan (e.g., a trust governed by a registered pension plan or an employee benefit plan) also be treated as a Specified Investor.

- As a result of comments received on the May 19, 2010 Backgrounder, Finance proposed in its June 30, 2010 Backgrounder that all Investment Plans other than mutual fund trusts, mutual fund corporations, segregated funds, unit trusts and mortgage investment corporations qualify as Specified Investors, whether or not they are Qualifying Small Investment Plans provided that the plan's investment in the investee is less than $10 million on the attribution date of the investee.

The definition of Specified Investor in subsection 14(1) of the Draft Regulations was not updated to reflect this announcement in the June 30, 2010 Backgrounder.

The table below summarizes the **types of investors** that should and should not qualify as Specified Investors.

TYPES OF INVESTORS	PROPOSED REGULATIONS			
	INVESTMENT PLAN	DISTRIBUTED INVESTMENT PLAN	QUALIFYING SMALL INVESMENT PLAN *	SPECIFIED INVESTOR **
Corporation other than a mutual fund corporation, investment corporation, mortgage investment corporation, non-resident owned corporation	No	No	No	Yes
Association	No	No	No	Yes
Partnership	No	No	No	Yes
Trust other than a unit trust	No	No	No	Yes
RRSP trust	No	No	No	Yes
RESP trust	No	No	No	Yes
RRIF trust	No	No	No	Yes
RPP trust	Yes	No	Yes	Yes
EPSP trust	Yes	No	Yes	Yes
Registered supplementary unemployment benefit plan trust	Yes	No	Yes	Yes
DPSP trust	Yes	No	Yes	Yes
Employee benefit plan trust	Yes	No	Yes	Yes
Employee trust	Yes	No	Yes	Yes
Retirement compensation arrangement	Yes	No	Yes	Yes
Corporation exempt from income tax per paragraph 149(1)(o.1) or (o.2) of the ITA	Yes	No	Yes	Yes
Exchange traded fund other than a mutual fund trust, mutual fund corporation, segregated fund, unit trust, and mortgage corporation	Yes	Yes	No	Yes
Investment corporation	Yes	Yes	No	Yes
Non-resident owned investment corporation	Yes	Yes	No	Yes

TYPES OF INVESTORS	PROPOSED REGULATIONS			
	INVESTMENT PLAN	DISTRIBUTED INVESTMENT PLAN	QUALIFYING SMALL INVESMENT PLAN *	SPECIFIED INVESTOR **
Individuals	No	No	No	No
Segregated fund of an insurer	Yes	Yes	No	No
Mutual fund trust	Yes	Yes	No	No
Unit trust	Yes	Yes	No	No
Mortgage investment corporation	Yes	Yes	No	No
Mutual fund corporation	Yes	Yes	No	No

* Assumes unrecoverable tax amount is $10,000 or less.
** Assumes $10,000,000 threshold test is satisfied.

The $10,000,000 threshold test to qualify as a Specified Investor is based on the value of Units held in each Series where the plan has separate Series or on the value of the Units held in the plan where the plan does not have any Series. Finance announced a related party anti-avoidance test in its June 30, 2010 Backgrounder that applies to an Investment Plan in calculating the $10,000,000 threshold for investors. Finance states:

> A related party restriction is proposed to apply to an investment plan in determining the specified investor test in relation to particular investments of the plan in an investee, if the investment plan or a person related to the investment plan holds other investments and if those other investments combined with the particular investment of the plan in the investee would exceed the $10 million threshold. In such cases, the Investment Plan would be required to provide information to the investee on the residency of its individual investors and the value of their investments in the plan.

The proposed related party requirement and the challenges in application are discussed later.

10. Manager

"Who" is a manager is important for making the reporting elections (which are discussed in detail later). Only a manager can make certain joint elections with the Investment Plans. The term manager ("Manager") is defined in subsection 1(1) of the Draft Regulations. The Manager is the person that has ultimate responsibility for the management and administration of the assets and liability of the Investment Plan except in the case of a pension entity of a pension plan, where the Manager is the administrator of the pension plan.

D. SAM FORMULA

1. Basic SAM

The basic SAM formula is set out in ETA subsection 225.2(2). Where the actual PVAT paid/payable by the SLFI in the reporting period per the general place of supply rules is greater than the PVAT liability determined using the SAM formula, the SLFI is entitled to a refund of the difference (i.e., a deduction in the net tax calculation). Where the actual PVAT paid/payable by the SLFI in the reporting period per the general place of supply rules is less than the PVAT liability determined using the SAM formula, the SLFI is required to pay the difference (i.e., an addition in the net tax calculation).

(A – B) x C x D/E – F +/– G

(A – B) = Unrecoverable 5% GST (A is the 5% GST paid/payable and B is ITCs claimed)

C = Provincial attribution percentage

D = PVAT rate

E = Federal GST rate

F = Actual PVAT paid or that became payable

G = Total of all positive or negative adjustments of PVAT

Practically, for Investment Plans, the component G adjustments relate to, for example, events that take place subsequent to and in relation to the initial transactions giving rise to amounts that were included in components A, B and F. These subsequent events are governed by special rules in the ETA such that, in the absence of component G, the net tax impact is not otherwise properly covered within components A, B and F, e.g. a subsequent price reduction.

The Draft Regulations "adapt" this basic formula by virtue of a number of additional rules. These new rules are explained below. Despite the adaptations, the overall conceptual framework of the formula remains intact. As is seen from the descriptions below, the adaptations made depend on: (i) the type of Investment Plans (i.e., stratified versus non-stratified); and (ii) the attribution method the Investment Plan chooses to determine its provincial attribution percentage for the participating province. The distinctions are summarized in a table at the end of the section.

2. Adapted SAM for stratified investment plans

The SAM in subsection 225.2(2) of the ETA is adapted as follows to determine a Stratified Investment Plan's net tax for a reporting period:

[[A x B/C] – D] + E

A = Unrecoverable GST for the Series for the ***participating province***

B = PVAT rate for the ***participating province***

C = Federal GST rate

D = Actual PVAT paid or that became payable for the ***participating province***

E = Amounts prescribed for purposes of paragraph G of ETA subsection 225.2(2)

See: See Draft Regulations subsection 48(1). Component E is the equivalent to component G in the basic SAM formula. The adjustments (set out in section 46 of the Draft Regulations) appear to have limited application to Investment Plans, e.g., paragraph 46(a) adjustment where a supplier refunds amounts to a plan is one example of an adjustment that may apply.

Component **A** is the total of all positive or negative amounts, each of which is determined for a Series of the financial institution **other than a Provincial Series of the financial institution**.[17] The specific formula used depends on whether the real time election (in section 49 of the Draft Regulations as described in more detail below) is in effect for determining the provincial attribution percentage. When the real time election is in effect, current year values are generally used to determine the percentage.

Where the **real time election is in effect**, component **A** is determined by the following formula:[18]

$$(A_1 - A_2) \times A_3$$

A_1 = Federal GST that was paid or that became payable relating to the Series as determined under section 52 of the Draft Regulations

A_2 = ITC to the extent that it relates to the Series as determined under section 52 of the Draft Regulations

A_3 = Provincial attribution percentage for each Series for the participating province on the particular day or where determined monthly, on the first day of the calendar month

See: Draft Regulations paragraph 48(1)(a). Applicable to Distributed Investment Plans excluding mortgage investment corporations and Exchange Traded Funds. Section 52 sets out the methodology to use in allocating expenses to a Series. It must be fair, reasonable, and used consistently.

Where the **real time election is <u>not</u> in effect** and the preceding year method (described in more detail below) is used or the preceding year method with reconciliation is used (described in more detail below) to determine the provincial attribution percentage, component **A** is determined by the following formula:

$$(A_4 - A_5) \times A_6$$

A_4 = Federal GST that was paid or that became payable relating to the Series as determined under section 52 of the Draft Regulations

A_5 = ITC to the extent that it relates to the Series as determined under section 52 of the Draft Regulations

A_6 = Provincial attribution percentage for each Series for the participating province for the **immediately preceding taxation year** or if an election is in effect under section 50 of the Draft Regulations to use the preceding year with reconciliation method, the provincial attribution percentage for the Series and for the participating province for the taxation year determined for financial institutions of that class in accordance with Part 2 of the Draft Regulations;

See: Proposed Regulation paragraph 48(1)(b). Applicable to Distributed Investment Plans and Exchange Traded Funds. Section 52 sets out the methodology to use in allocating expenses to a Series. It must be fair, reasonable, and used consistently.

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17 Provincial Series of a Stratified Investment Plan do not use SAM to determine its PVAT liability/refund. Rather, a PVAT rebate is available and self-assessment of the PVAT may be required. The rules are discussed later.

18 A mortgage investment corporation and an Exchange Traded Fund cannot use the real time method as per paragraph 49(5)(b) in the Draft Regulations.

The preceding year method without reconciliation is the default method that applies to determine an Investment Plan's provincial attribution percentage. The plan determines its percentage based on values for the preceding fiscal year. If an election is filed to use the preceding year method with reconciliation, an Investment Plan uses the same method but then does a reconciliation to adjust the calculation based on the current year values.

3. Adapated SAM for non-stratified investment plans

Where an election is in effect under section 49 (i.e., the election to determine an Investment Plan's provincial attribution percentage using the real time method), the adaptations to the rules for calculating net tax in subsection 225.2(2) of the ETA generally parallel those described above for Stratified Investment Plans, modified as necessary because the plan does not have different classes of Units. See: Proposed Regulation subsection 48(2).

Where no election is in effect under section 49 (i.e., the election to determine an Investment Plan's provincial attribution percentage using the real time method) or section 50 (i.e., the election to determine an Investment Plan's provincial attribution percentage using the preceding year election with reconciliation), the SAM formula in subsection 225.2(2) is used where component **C** of the SAM is the provincial attribution percentage for the **immediately preceding year**. This applies where a Non-stratified Investment Plan uses the preceding year method (i.e., the default method) to determine its provincial attribution percentage. See: Draft Regulations subsection 48(3).

Where an election is in effect under section 50 (i.e., the election to determine an Investment Plan's provincial attribution percentage using the preceding year method with reconciliation) no specific adaptations are made under section 48 of the Draft Regulation to the net tax calculation in subsection 225.2(2) of the ETA. The basic SAM formula applies.

4. Summary of SAM formulas by plan type and provincial attribution method

The table below summarizes the SAM formulas by plan type and the provincial attribution method.

TYPE OF INVESTMENT PLAN	ATTRIBUTION METHOD	SAM FORMULA IN SUBSECTION 225.2(2) OF THE ETA
Stratified Investment Plan Excluding Exchange Traded Funds	Real time method (election made)	- Adapted by subsection 48(1) of the Draft Regulations - See paragraph 48(1)(a) of the Draft Regulations for reference to the provincial attribution percentage; component A_3 - See section 49 of the Draft Regulations
Stratified Investment Plan Including Exchange Traded Funds	Preceding year method without reconciliation or preceding year method with reconciliation (election made)	- Adapted by subsection 48(1) of the Draft Regulations - See paragraph 48(1)(b) of the Draft Regulations for reference to the provincial attribution percentage; component A_6 -See section 50 of the Draft Regulations
Non-stratified Investment Plan Excluding Exchange Traded Fund	Real time method election is made	- Adapted by subsection 48(2) of the Draft Regulations - See section 49 of the Draft Regulations

TYPE OF INVESTMENT PLAN	ATTRIBUTION METHOD	SAM FORMULA IN SUBSECTION 225.2(2) OF THE ETA
Non-stratified Investment Plan Including Exchange Traded Funds	Preceding year method without reconciliation	- Adapted by subsection 48(3) of the Draft Regulations - SAM formula in subsection 225.2(2) of the ETA is used where component C of the SAM is the provincial attribution percentage for the immediately preceding year
Non-stratified Investment Plan Including Exchange Traded Funds	Preceding year method with reconciliation (election is made)	- No adaptations to the SAM formula in subsection 225.2(2) of the ETA are made - See section 50 of the Draft Regulations
Private Investment Plans	Preceding year method without reconciliation or preceding year with reconciliation	- Adapted by subsection 48(3) of the Draft Regulations - SAM formula in subsection 225.2(2) of the ETA is used where component C of the SAM is the provincial attribution percentage for the immediately preceding year

E. PROVINCIAL ATTRIBUTUION PERCENTAGE CALCULATIONS

1. Overview

a. Current rules for investment plans

Under the existing attribution rules, an Investment Plan's provincial attribution percentage is based on gross revenue earned and salaries and wages of employees in a province. More specifically, the provincial attribution percentage for an Investment Plan for a reporting period for a participating province in which it has a permanent establishment is generally the amount, expressed as a percentage, that is equal to one-half of the total of:

- the percentage that the total gross revenue of the SLFI that is reasonably attributable to its permanent establishment in the participating province for the reporting period is of the total gross revenue of the SLFI that is reasonably attributable to its permanent establishments in Canada for the reporting period, and

- the percentage that the total of all salaries and wages paid in the reporting period by the SLFI to the employees of its permanent establishment in the participating province is of the total of all salaries and wages paid in the reporting period by the SLFI to employees of its permanent establishments in Canada.

Because most Investment Plans are flow through entities for income tax purposes, the existing provincial attribution percentage does not adequately represent the Investment Plan's consumption of inputs in a province, from an investor or member perspective. As indicated earlier, historically most Investment Plans have not been SLFIs based on the income tax permanent establishment tests previously applied for HST purposes. It is only with British Columbia and Ontario harmonizing effective July 1, 2010, that most Investment Plans became SLFIs on this day per the proposed rules.

b. Proposed rules for investment plans

The Draft Regulations provide specific rules to calculate the provincial attribution percentage for the various types of Investment Plans. Below is a high-level description of the attribution percentage calculation for each type of plan. A detailed description follows later.

A Stratified Investment Plan calculates its attribution percentage for each Series. Therefore, where there are two or more Series of Units in a plan, the SAM formula is calculated separately for each Series. The provincial attribution percentage for each Series of Units in a Stratified Investment Plan for a participating province is the percentage that is:

- the value of Units of a Series held by Unit holders resident in a participating province; and
- the value of Units of a Series held by all Unit holders unless an election is made to include only residents of Canada. See discussion below.

A Non-stratified Investment Plan calculates its provincial attribute percentage at the plan level using the same basic formula.

A Private Investment Plan calculates its provincial attribution percentage by reference to the residency of its members either based on the value of the holdings or the number of members. The calculation ratio is like the one noted above for the other Investment Plans.

Where a plan manager or administrator has created a provincial plan or a Provincial Series where the Units in the plan or Series, as the case may be, cannot be sold or distributed outside of the particular province, that plan or Series is not subject to the SAM formula. In this case, the general self-assessment and rebate rules apply. This is discussed later.

2. Attribution point (date)

An Investment Plan is required to calculate its provincial attribution percentage for a particular participating province at least once (i.e., at a point in time) in each fiscal year. A Stratified Investment Plan is required to do so in respect of each Series of the plan. This single point in time calculation is referred to as the attribution point ("Attribution Point"). The general rules for each type of Investment Plan are summarized in the table below per Draft Regulations subsection 14(1) and have application to the provincial attribution percentage methods except for the real time method:

INVESTMENT PLAN	ATTRIBUTION POINT
Distributed Investment Plan (other than an Exchange Traded Fund)	September 30th of the particular fiscal year
Exchange traded fund	September 30th and one or more of March 31st, June 30th, and December 31st of the particular fiscal year as determined by the Investment Plan
Other Investment Plans (other than defined benefit pension plans)	Last day on which all or substantially all of the data required to calculate the Investment Plan's percentage for each participating province for the particular fiscal year is reasonably available to the Investment Plan in the particular fiscal year and the immediately preceding fiscal year of the Investment Plan or September 30th if no such day exists

An Investment Plan may elect under section 51 of the Draft Regulations to calculate the attribution percentage as an average of quarterly, monthly, weekly or daily percentages with September 30th as the end date for averaging for a 12-month period. Where the election is made under section 51 of the Draft Regulations to calculate the provincial attribution percentage at more frequent points in time, the Attribution Points and specific dates for the calculation are as follows:

ATTRIBUTION POINTS	DATES
Quarterly	March 31st, June 30th, and September 30th of the particular fiscal year and December 31st of the preceding fiscal year
Monthly	Last day of each month in the twelve-month period ending on September 30th of the particular fiscal year
Weekly	Each Friday in the twelve-month period ending on September 30th of the particular fiscal year
Daily	Each day in the twelve-month period ending on September 30th of the particular fiscal year

The May 19, 2010 Backgrounder says that anti-avoidance rules will be in place to prevent inappropriate tax planning relating to artificial manipulation of the attribution percentages around the Attribution Point.

3. Look-through

To calculate the provincial attribution percentage for a participating province generally the Investment Plan must know the residency of its investors and the value of the investment held at a particular time. Distributed Investment Plans (other than Exchange Traded Funds) must "look through" its institutional investors to determine the ultimate investor and the residency of that investor. The rationale for the look-through requirement is that it provides a more accurate proxy as to where a plan uses/consumes its inputs. Consider for example an employee pension plan resident in Alberta with employees (i.e., beneficiaries of the plan) located across Canada investing in a mutual fund. With no look-through, the mutual fund would simply look to the Alberta address of the plan to determine its provincial attribution percentage. This would not accurately reflect the provincial attribution for the fund.

The look-through requirement described below is only relevant for Distributed Investment Plans (other than Exchange Traded Funds) because they may have institutional investors. Private Investment Plans have no need to look-through their investors because all of their Plan Members are Individuals.[19] There are no institutional investors. An Individual Plan Member's address is used to determine the place of residence and hence the provincial attribution percentage.

An investor other than an Individual and Specified Investor would be required to provide to the underlying Distributed Investment Plan (other than an Exchange Traded Funds) its attribution percentages for each participating province in respect of its investment in the plan. We refer to this type of investor as an institutional investor. This investor may be required to look through to its institutional investors to determine its attribution percentage.

For example, where a mutual fund (i.e., a top fund) invests in another mutual fund, the provincial attribution percentage relating to the investment held by the top fund would be included in calculating the underlying fund's attribution percentage when calculating the latter's PVAT liability. A mutual fund is not a Specified Investor and therefore no relief from the look through would be available even where the value of the mutual fund's investments in the Investment Plan is less than $10,000,000.

[19] See the definition of Plan Member in the Draft Regulations which is reproduced above.

The May 19, 2010 Backgrounder proposed that a Manager be required to obtain investor residency information for 90% or more of the value of investments in an Investment Plan. For example, a mutual fund Manager would be required to obtain the provincial distribution of 90% or more of the value of Units in each Series. If investor residency information for 90% or more of the value of Units in a Series is obtained, the portion of the value of Units in the Series for which the investor residency is not obtained is assumed to follow the distribution of the rest of the value of Units for purposes of calculating provincial attribution percentages.[20]

Further, it was proposed that, if the Manager does not obtain investor residency information in respect of 90% or more of the value of units in a Series, the value of Units for which information is not available be required to be reported as "unallocated". These Units would, in determining the PVAT liability under the SAM formula, be subject to the highest provincial tax rate among all participating provinces on January 1 of the fiscal year for which the Investment Plan is reporting. For example, if residency can only be determined for 85% of the value of units in a Series, the unallocated 15% would be subject to the highest PVAT rate among all participating provinces.

As a result of comments received by Finance, an exception is proposed in the June 30, 2010 Backgrounder to limit the extent to which an Investment Plan would be subject to the highest PVAT rate. The exception which is described below is not included in the Draft Regulations.[21]

If the Manager obtains investor residency information for more than 50% of the value of investments in a particular Series of an Investment Plan, only the portion for which investor residency information is needed to reach the 90% threshold for that Series would be subject to the highest PVAT rate, rather than to the entire unallocated portion of the Series. The remaining 10% follows the distribution of the value of the Units for which the investor has obtained residency information for more than 50% of the value of the investments.

Example (June 30, 2010 Backgrounder)

The residency of the investors is determined for 65% of the value of Units in a Series.

The distribution for the unallocated Units is:

- 25% of the value of the units in the Series are subject to the highest PVAT rate for purposes of SAM; and
- the remaining unallocated 10% follows the distribution of the 65% of the value of the Units for which the investor information is obtained.

Where the Manager does not obtain investor residency information for more than 50% of the value of investments in the Investment Plan, the entire portion for which investor residency information is not obtained is regarded as unallocated and subject to the highest PVAT rate.

20 If an Investment Plan knows the residency information for more than 90% of its investors, it must use the information to determine the provincial attribution percentage.

21 The look-through rules are included in the sections of the Draft Regulations that determine the provincial attribution percentages. For Stratified Investment Plans, see sections 29 and 30. For Non-stratified Investment Plans, see sections 31 and 32.

Example (June 30, 2010 Backgrounder):

The residency of the investors is determined for 40% of the value of Units in Series.

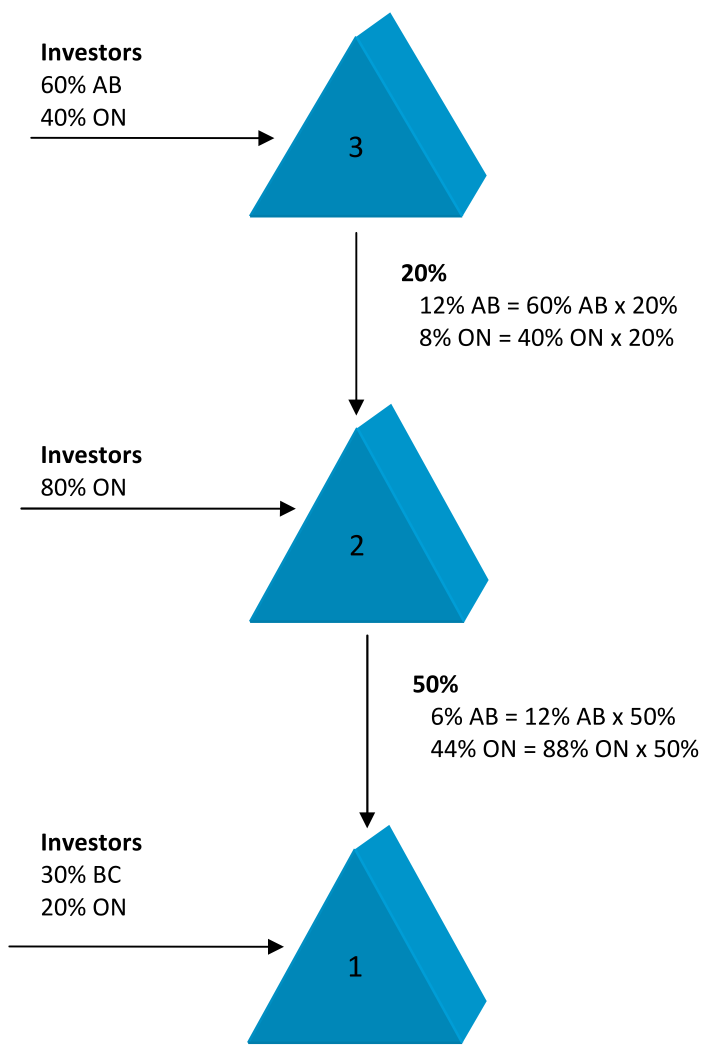
- 60% of the value of the Units in the Series are subject to the highest PVAT rate for purposes of SAM.

Distributed Investment Plans (other than Exchanged Traded Funds) are also required to obtain information from distribution agents (e.g., a dealer, broker, salesperson or a transfer agent that holds investor information) in respect of Units of the Investment Plan held by such investors where they do not otherwise have the necessary residency information. Where the Investment Plan does not request the required information from the investors or the distribution agents, those Units would be subject to the highest PVAT rate among all participating provinces.

4. Look-through example

Facts

Mutual fund 3 invests in mutual fund 2. Mutual fund 2 invests in mutual fund 1. The mutual funds are SLFIs. The investor holdings are illustrated below.



Analysis

By definition, the mutual funds are not Specified Investors or Qualifying Small Investment Plans. Therefore, mutual fund 1 must "look-through" to mutual fund 2's investors and mutual fund 2 must "look-through" to mutual fund 3's investors in order to calculate the respective provincial attribution percentages for each applicable participating province.

Mutual fund 1 is required to send an information request to mutual fund 2 requesting its provincial attribution percentage for each participating province. Mutual fund 2 is required to send a similar information request to mutual fund 3.

The provincial attribution percentages for mutual fund 1 reflect those of both mutual fund 2 and mutual fund 3 and the residence of its other non-institutional investors. The provincial attribution percentages for each participating province and mutual fund are set out in the table below.

Mutual Fund	**Provincial Attribution Percentages**	
	ON	**BC**
Mutual fund 3	40% = 40% + 0%	0% = 0% + 0%
Mutual fund 2	88% = 80% + 8%	0% = 0% + 0%
Mutual fund 1	64% = 20% + 44%	30% = 30% + 0%

5. Requirement to provide information

To comply with the look-through requirements, the Draft Regulations include rules to facilitate compliance and information flows between plans and investors and between plans and intermediaries such as agents, brokers, and dealers involved in selling and distributing Units of Investments Plans.[22]

All investors resident in Canada except for Individuals and Specified Investors that hold Units of a SLFI Distributed Investment Plan (other than an Exchange Traded Fund) are required at the request of the Distributed Investment Plan to provide the following information:

- the investor's percentage of the Distributed Investment Plan for every participating province as of September 30th of the calendar year; and
- the number of Units held as of that day in the Distributed Investment Plan and if applicable in each Series of the plan. As discussed later, there are concerns with providing the number of Units as opposed to providing the investor's attribution percentage for the province. See: Draft Regulation subsection 53(1).

A Specified Investor resident in Canada that holds Units of a SLFI Distributed Investment Plan (other than an Exchange Traded Fund) is not required to provide its provincial attribution percentage to a SLFI Investment Plan in which it invests, but it is required at the request of the Distributed Investment Plan to provide the following information:

- its address to determine residency per section 6 of the Draft Regulations as of September 30th of the calendar year, e.g., its principal business address (if it is a corporation or partnership), its general partner's principal business address (if it is a partnership and does not have a principal business address) or its trustee's business address (if it is a trust); and
- the number of Units held as of that day in the Distributed Investment Plan and if applicable in each Series of the plan. As discussed later, there are concerns with providing the number of

[22] The May 19, 2010 Backgrounder indicates that the use of a calendar year as a fiscal year for all SLFIs that are Investment Plans facilitates this information exchange.

Units as opposed to providing the investor's attribution percentage for the province. See: Draft Regulation subsection 53(2).

In some cases, accounts are registered in the names of distributors or other sellers. Such distributors and sellers (e.g., brokers, dealers, salespersons or other intermediaries) of Units in a SLFI Distributed Investment Plan (other than an Exchange Traded Fund) are required at the request of the Distributed Investment Plan to provide the following information for each participating province:

- the number of Units of the plan and if applicable, the number of each Series of the plan, held by clients or customers of the seller/distributor resident in the participating province as of September 30th of the calendar year;

- the total number of units of the plan and if applicable, the number of Units of each Series of the plan held by clients resident in Canada as of that day. As discussed later, there are concerns with providing the number of Units opposed to providing the investor's attribution percentage for the province. See: Draft Regulation subsection 53(3).

In each of the three cases described above, the person must provide the information the later of: November 15 of that calendar year; and 45 days after the day on which the person receives the information request.

An investor or distributor (e.g., broker, dealer, salesperson or other intermediary) that does not provide the requested information to the Distributed Investment Plan as required or when required is subject to a penalty for each such failure equal to the lesser of $10,000 and 0.01% of the value of the amounts. See: Draft Regulations subsection 53(5). Where a Distributed Investment Plan fails to request the information on or before October 15th of the fiscal year and the plan does not know the information on or before December 31st of the year, the following rules apply:

- the units are deemed to be held on September 30th by an Individual;

- the Individual is deemed to be resident on that day in any one of the participating provinces with the highest tax rate; and

- the Investment Plan is deemed to know the province of residency on that day. See: Draft Regulations subsection 53(6).

The rules for determining the investor's percentage are set out in section 28 of the Draft Regulations. They are summarized as follows:

TYPE OF INVESTOR	INVESTOR'S PERCENTAGE	DRAFT REGULATIONS
SLFI that is a Non-stratified Investment Plan	Percentage for the participating province calculated as if the real time election were in effect	Para 28(a)
SLFI that is a Stratified Investment Plan	Percentage for each series determined by formula A x (B/C) A: percentage for the Series and participating province as if real time election in effect B/C: investor's percentage in the Series	Para 28(b)
SLFI that is not one of the above	Percentage calculated under the general rules in the ETA per component C in the SLFI's own calculation of SAM under subsection 225.2(2)	Para 28(c)

TYPE OF INVESTOR	INVESTOR'S PERCENTAGE	DRAFT REGULATIONS
Non-SLFI	Percentage calculated by person's taxable income earned in the particular participating province is of the person's total income per *Income Tax Act* Regulations Parts IV and XXVI	Para 28(d)

A summary of the information requirements for each type of investor is as follows:

TYPE OF INVESTOR	INFORMATION REQUIRED	DRAFT REGULATIONS
SLFI Investment Plans that are: • **mutual fund trusts** • **mutual fund corporations** • **unit trusts** • **mortgage investment corporations** • **investment corporations** • **non-resident-owned investment corporations** • **segregated funds**	Investor percentage determined by Distributed Investment Plan's as of September 30th Number of Units held as of September 30th	Section 28 Subsection 53(1)
SLFI Investment Plans *other than*: • **mutual fund trusts** • **mutual fund corporations** • **unit trusts** • **mortgage investment corporations** • **investment corporations** • **non-resident-owned investment corporations** • **segregated funds**	Most recent attribution percentage determined for SLFI purposes prior to the fund's attribution date Number of Units held as of September 30th	Section 28 Subsection 53(1)
SLFIs that are <u>not</u> Investment Plans or Specified Investors and are: • **banks** • **partnerships** • **corporations** • **trusts**	Most recent attribution percentage determined for SLFI purposes prior to the fund's attribution date Number of Units held as of September 30th	Section 28 Subsection 53(1)
Non-SLFI that are <u>not</u> Specified Investors and are: • **banks** • **partnerships** • **corporations** • **trusts**	Most recent attribution percentage determined for income tax purposes prior to the fund's attribution date Number of Units held as of September 30th	Section 28 Subsection 53(1)
Specified Investors and Qualifying Small Investment Plans (not elected to be a SLFI)	**Trusts** – trustees business address **Corporations** – principal business address **Partnership** – principal business address of the partnership, or, where it does not have a principal business address, the principal business address of its general partner Number of Units held as of September 30th	Section 6 Subsections 53(1),(2)

TYPE OF INVESTOR	INFORMATION REQUIRED	DRAFT REGULATIONS
Individuals	Principal mailing address in Canada	Section 6 Subsections 53(1),(2)
Intermediaries	Number of Units of the Investment Plan/Series held by clients or customers of the intermediary resident in the participating province as of September 30 of the calendar year set out in the request and the total number of Units of the Investment Plan/Series held by clients as of that day	Section 6 Subsection 53(3)

6. Exclusion of non-resident investors

In the May 19, 2010 Backgrounder Finance proposed to exclude the value of Units held by non-residents when calculating the provincial attribution percentage of an Investment Plan. This is appropriate where services provided with respect to non-residents holdings would generally be zero-rated and an SLFI Investment Plan is entitled to ITCs for tax paid on the inputs used to provide the zero-rated services to non-resident investors, resulting in no unrecoverable tax.

Based on industry comments, it appears that most Investment Plans do not claim ITCs and prefer to treat the non-resident investors in the same manner as residents, i.e., to include non-resident investment holdings in the calculation of the provincial attribution percentages. Therefore, Finance proposed in the June 30, 2010 Backgrounder to include non-resident investors in the calculation of the provincial attribution percentages of an Investment Plan where the non-residents "are treated as residents for GST/HST purposes" by the Investment Plan with respect to the non-resident investment holdings in the plan, and therefore do not claim ITCs for tax paid on the related inputs. The Investment Plan is subject to the same rules in their dealings with both resident and non-resident investors.

Finance recognizes that some Investment Plans may wish to opt out of this treatment and claim ITCs for tax paid on input costs with respect to non-resident investor holdings. Such Investment Plans may do so by filing an election with the Minister of National Revenue to exclude non-residents from the provincial attribution calculation and allow the Investment Plan to claim ITCs in respect of the non-resident holdings. The Investment Plan is allowed to revoke the election after five years, or at an earlier date if approved by the Minister of National Revenue. A discussion and an example of making the election versus not making the election are set out later.[23]

7. Distributed investment plans – calculation of provincial attribution percentage

A Stratified Investment Plan and a Non-stratified Investment Plan other than an Exchange Traded Fund can use one of three methods for determining its provincial attribution percentage for the fiscal year.

- preceding year with no reconciliation (general default rule, no election);
- real time method (election); and
- preceding year with reconciliation (election).

[23] See Appendix A for a summary of the attributes for this election.

a. Preceding year method with no reconciliation (general default rule)

Section 30 of the Draft Regulations sets out the preceding year method for a SLFI that is Stratified Investment Plan other than an Exchange Traded Fund. The method does not apply where the Stratified Investment Plan has made an election under section 49 of the Draft Regulations to use the real time method for determining its provincial attribution percentage.[24]

The SLFI's provincial attribution percentage for each participating province in which it has a Permanent Establishment in the particular period is determined by the following formula:

$$A/B$$

$$A = (A_1 + A_2)/A_3$$

A = Total of all amounts, each of which is determined for an Attribution Point in respect of the Series for the particular period

A_1 = Total value of all amounts, each of which is the total value of the Units of the Series held by an Individual or Specified Investor in the financial institution, resident in the participating province as of the Attribution Point

A_2 = Total of all amounts, each of which it the total value of Units of the Series held by a person resident in Canada that is not an Individual or Specified Investor in the financial institution (i.e., institutional investors) multiplied by the person's investor percentage for the participating province as of the Attribution Point

A_3 = Total of all amounts, each of which is the total value of the Units of the Series held by a person whether or not the person is resident in Canada (assuming an election is not made to exclude non-residents)

B = Number of attribution points in respect of the Series for the particular period

See: Draft Regulations subsection 30(1). The Draft Regulations do not include Finance's announcement in the June 30, 2010 Backgrounder that non-resident investors are included in the calculation unless the Investment Plan makes an election not to include the non-resident investors.

In summary, the provincial attribution percentage for a particular Series of a Stratified Investment Plan for a particular fiscal year is based on the value of the Units in that Series held by investors in a participating province at the Attribution Point (generally, September 30th) of the year immediately *preceding* the particular fiscal year (i.e., a single point in time). See paragraph 48(1)(b) of the Draft Regulations and specifically component A_6. We refer you to our earlier discussion in the subsection entitled "Look through" as to the threshold tests to apply in determining the residency of the investors including the look-through rules for institutional investors.

Under this method, the Stratified Investment Plan is not required to reconcile its PVAT liability at the end of the fiscal year based on its actual provincial attribution percentage for the current year.

Section 32 of the Draft Regulation sets out a parallel rule for Non-stratified Investment Plans.

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24 The election is discussed later. See also Appendix A for a summary of the elections for Investment Plans.

b. <u>Real time method (election required)</u>

Section 29 of the Draft Regulations set out the real time method for a Stratified Investment Plan other than an Exchange Traded Fund. The Stratified Investment Plan must elect under section 49 of the Draft Regulations in order to use this method. The election is not required to be filed with the Minister. It is effective the first day of the Investment Plan's fiscal year. At the time of writing, the election form is not prescribed. Details on how to make the election in the interim are set out in Appendix A.

If no election is made under section 49 (or section 50 to use the preceding year method with reconciliation) the general rule discussed above applies.

The real time method does not apply where the Stratified Investment Plan has made an election under section 50 to use the preceding year method with reconciliation or has made the election under section 51 to use more frequent Attribution Points. The election cannot be used by a mortgage investment corporation or an Exchange Traded Fund. [25] When the election is in effect, the provincial attribution percentage for the plan that has a Permanent Establishment in a participating province in the taxation year in which the fiscal (calendar year) ends is determined by the following formula:

(A + B)/C

A = Total of all amounts, each of which is the total value of the Units of the Series held by an Individual or a Specified Investor in the financial institution, resident in the participating province as of the particular day

B = Total of all amounts, each of which is the total value of the Units of the Series held by a person resident in Canada that is not an Individual or Specified Investor in the financial institution (i.e., institutional investors) multiplied by the person's investors percentage for the participating province as of the particular day

C = Total of all amounts, each of which is the value of the total value of Units of the Series held by a person as of a particular day, whether or not the person is resident in Canada (assuming an election is not made to exclude non-residents)

See: Draft Regulations subsection 29(1). The Draft Regulations do not include Finance's announcement in the June 30, 2010 Backgrounder that non-resident investors are included in the calculation unless the Investment Plan makes an election not to include the non-resident investors.

The real time method could be used where 90% or more of the value of Units in a Series are held by Individuals and Specified Investors and the Investment Plan elects to use the method to determine its attribution percentage for a participating province. No look-through rules apply. The provincial distribution of these investors are applied to determine the attribution percentage of 100% of the value of Units. See: Draft Regulations section 29. The attribution percentage is based on the residency of the investors determined either on a daily basis or on the first day of each month. See: Draft Regulations paragraph 49(4)(c). Where the attribution percentage is determined on the first day of each month, it would be applied for the whole month.

If the proportion of Units in the Series that are held by these investors falls below the 90% threshold on a particular day after the election is made, the plan is required to apply, for the remainder of the fiscal year,

[25] See paragraph 49(5)(b).

an attribution percentage obtained by averaging its daily or monthly attribution percentages from the first day of the fiscal year until the day before the particular day. See: Draft Regulation section 29. [26]

Section 31 of the Draft Regulations sets out a parallel rule for Non-stratified Investment Plans.

c. <u>Preceding year with reconciliation (election)</u>

Stratified Investment Plans and Non-stratified Investment Plans that elect under section 50 of the Draft Regulations to use the preceding year method with reconciliation follow the rules in section 30 and 32, respectively, to determine their provincial attribution percentages. These rules were described earlier for the preceding year method with no reconciliation.

The election is not required to be filed with the Minister. It is effective the first day of the Investment Plan's fiscal year. At the time of writing, the election form is not prescribed. Details on how to make the election in the interim are set out in Appendix A.

An Investment Plan that elects to use this method determines installments for the current fiscal year with a reconciliation on the final SLFI return (due six months after the fiscal year end) based on the provincial attribution percentage calculated using current year values (i.e., the actual PVAT liability for the current year would be determined based on the attribution percentage for the participating province determined using current year values). See: Draft Regulations subsection 48(6).

The provincial attribution percentage is calculated at a single point in time (generally, September 30th of the preceding fiscal year) or the election under section 51 of the Draft Regulations can be made to use averaging as described earlier.

Example (May 19, 2010 Backgrounder):

A mutual fund trust that is an annual filer using quarterly averaging would determine its attribution percentage for the installment base calculation for 2015 (calendar year) using the average of the value of the units in a particular series on December 31, 2013; March 31, 2014; June 30, 2014; and September 30, 2014. The mutual fund trust would use this average to calculate its provincial attribution percentage to calculate its PVAT installments for the particular participating province.

For the reconciliation for 2015, the mutual fund trust would determine its attribution percentage using the average of value of investments on December 31, 2014; March 31, 2015; June 30, 2015 and September 30, 2015. The reconciliation between amounts paid by installments and the final PVAT liability would be made on the mutual fund trust's SLFI return due on June 30, 2016.

8. Exchange traded funds – calculation of provincial attribution percentage

Exchange Traded Funds may use two methods to determine their provincial attribution percentage:

- preceding year method with no reconciliation (default); or
- preceding year method with reconciliation (election required).

[26] If the particular day is the first day of the particular fiscal year, the provincial attribution percentage for the Series for the particular province as of every day in the particular fiscal year is: (i) if no election under section 49 of the Draft Regulations was in effect in the preceding fiscal year (i.e., to use the real time method), the provincial attribution percentage for the preceding year; and (ii) in any other case, the total of all amounts, each of which is the financial institution's percentage for the Series and for the participating province as of a day in the preceding fiscal year divided by the number of these days in the preceding fiscal year.

Exchange Traded Funds may not use the real time method.[27] Units of Exchange Traded Funds are traded on public exchanges. As a result, limited investor information is available to calculate the provincial attribution percentage for an Exchange Traded Fund. Special rules are in place to address the limited availability of information. Specifically, there is no look-through requirement for Exchange Traded Funds. They are not required to look through to their institutional investors (i.e., investors other than Individuals and Specified Investors) in determining their provincial attribution percentage.

An Exchange Traded Fund is required to use at least two points in time in its immediately preceding fiscal year, one of which must be September 30th, to determine its provincial attribution percentage for its current fiscal year (i.e., calendar year). The Exchange Traded Fund uses the average of the provincial attribution percentage determined at these multiple points in time to determine its current fiscal year provincial attribution percentage. See: Subsection 14(1) definition of Attribution Point and sections 33 and 34.

The provincial attribution percentage for an Exchange Traded Fund that is a Stratified Investment Plan that has a Permanent Establishment in a particular period in a participating province is determined by the following formula:

$$A/B$$

$$A = A_1/A_2$$

A = Total of all amounts, each of which is determined for an Attribution Point in respect of the Series for the particular period

A_1 = Total of all amounts, each of which is the total value of the Units of the Series held by a person resident in the participating province as of the Attribution Point

A_2 = Total of all amounts, each of which is the total value of the Units of the Series held by a person as of the Attribution Point, whether or not the person is resident in Canada (assuming an election is not made to exclude non-residents)

B = Number of Attribution Points in respect of the Series

See: Draft Regulations subsection 33(1). The Draft Regulations do not include Finance's announcement in the June 30, 2010 Backgrounder that non-resident investors are included in the calculation unless the Investment Plan makes an election not to include the non-resident investors.

To the extent that the 90% test for determining the value of investments held in provinces cannot be met, an Exchange Traded Fund is allowed to seek pre-approval for the calculation of the provincial allocation percentage of a participating province from the CRA. This relieving rule was not included in the Draft Regulations. However, we understand from Finance that it will be included in the final legislation or regulations.

Similar rules to those described above apply to Exchange Traded Funds that are Non-stratified Investment Plans. See: Draft Regulations section 34.

27 See: Draft Regulations paragraph 49(5)(b).

9. Private investment plans – calculation of provincial attribution percentage

a. Deferred profit sharing plans, employee profit sharing plans, retirement compensation arrangements

A trust governed by a deferred profit sharing plan ("DPSP"), employee profit sharing plan ("EPSP"), retirement compensation arrangement ("RCA") may use one of two methods to determine their provincial attribution percentage:

- preceding year method with no reconciliation (default); or
- preceding year method with reconciliation (election required).

Such trusts may not use the real time method.

Generally, the benefits available to members or beneficiaries of a trust governed by a DPSP, EPSP, RCA are based on the assets in these plans. The provincial attribution percentage for the trusts is the percentage that the total assets that are reasonably attributable to Plan Members resident in a participating province is of the total assets of the plan that are reasonably attributable to the Plan Members. The percentage is determined by the following formula:

$$A/B$$

$$A = A_1 / A_2$$

A = Total of all amounts, each of which is determined for an Attribution Point in respect of the financial institution for the particular period

A_1 = Total of all amounts, each of which is the total value of the assets of the Investment Plan that are reasonably attributable to a Plan Member of the plan that is resident in a participating province as of the Attribution Point

A_2 = Total of all amounts, each of which is the total value of the assets of the Investment Plan that are reasonably attributable to a Plan Member of the plan whether or not the Plan Member is resident in Canada (assuming an election is not made to exclude non-residents)

B = Number of Attribution Points in respect of the financial institution

See: Draft Regulations subsection 37(1). The Draft Regulations do not include the change announced by Finance in the June 30, 2010 Backgrounder that non-resident investors are included in the calculation unless the Investment Plan makes an election not to include the non-resident investors.

The Draft Regulations say that where the total value of the assets of the plan that are reasonably attributable to Plan Members for which the plan knows the province of residency is 90% or more of the value of the assets reasonably attributable to Plan Members resident in Canada,[28] the remaining 10% unallocated follows the distribution of the 90% or more allocated. If not, the highest tax rate for the participating provinces is used for the unallocated portion. See: Draft Regulations subsection 37(2) and

[28] See comment above regarding Plan Members not resident in Canada.

(3). The 50% look-through rule announced in the June 30, 2010 Backgrounder and described earlier should also apply here based on our discussion with Finance.

b. Employee benefit plans, employee life and health trusts, registered supplementary unemployment benefit plans, employee trusts

A trust that is governed by an employee trust, an employee benefit plan, a health and welfare trust or a registered supplementary unemployment benefit plan may use one of two methods to determine its provincial attribution percentage:

- preceding year method with no reconciliation (default); or
- preceding year method with reconciliation (election required).

Such trusts may not use the real time method.

An employee benefit plan, an employee life and health trust, a registered supplementary unemployment benefit plan or a trust governed by an employee trust is often structured to provide benefits to Plan Members in participating and non-participating provinces. For these plans, the assets held in the plan do not always correlate to the benefits paid under these plans. Finance concluded that asset-based provincial attribution percentages do not necessarily represent consumption in a participating province.

The provincial attribution percentage for a trust governed by an employee trust, an employee benefit plan, a health and welfare trust or a registered supplementary unemployment benefit plan is the percentage that the total number of the Plan Members resident in a particular province is of the total number of the Plan Members. The percentage is determined by the following formula:

$$A/B$$

$$A = A_1/A_2$$

A = Total of all amounts, each of which is determined for an Attribution Point in respect of the financial institution for the particular period

A_1 = Number of Plan Members of the Investment Plan that is resident in a participating province as of the Attribution Point

A_2 = Number of Plan Members of the Investment Plan, whether or not the Plan Member is resident in Canada, as of the Attribution Point (assuming an election has not been made to exclude non-residents)

B = Number of Attribution Points in respect of the financial institution

See: Draft Regulations subsection 38(1). The Draft Regulations do not include the change announced by Finance in the June 30, 2010 Backgrounder that non-resident investors are included in the calculation unless the Investment Plan makes an election not to include the non-resident investors.

A similar 90% rule applies here as described above for DPSPs, EPSPs, and RCAs. See: Draft Regulations subsections 38(2) and (3).

10. Transitional year modifications to SAM

Depending on the particular type of plan, a special rule may apply to determine a plan's provincial attribution percentage and Attribution Point for the July 1, 2010 to December 31, 2010 transitional period. Transitional rules applicable to Distributed Investment Plans (other Exchange Traded Funds), Exchange Traded Funds, and Private Investment Plans are described below. Also, new SLFIs are addressed.

The Attribution Point for a Distributed Investment Plan for the transitional period July 1, 2010 to December 31, 2010 and for the preceding taxation year is any point in time on or after July 1, 2009 and before July 1, 2010. The Attribution Point is deemed to be for both the current and preceding year. Hence, the preceding year method with or without reconciliation should render the same results. See: Draft Regulations section 60. There is no Attribution Point for the real time method as the point in time is either daily or monthly per section 49 of the Draft Regulations.

a. <u>Distributed investment plans (other than Exchange Traded Funds)</u>

During this transitional period, a Distributed Investment Plan can use the preceding year method or the real time method. Alternatively, a Distributed Investment Plan may elect to use a special transitional method. The transitional method is meant to facilitate compliance for the transitional year commencing July 1, 2010 and ending December 31, 2010.[29] For this period, many plans may not possess information on individual Unit holders (applying the look-through rules on a province-by-province basis) and would not be able to correctly determine their provincial attribution percentage on July 1, 2010.

To use the transitional year method, a Distributed Investment Plan is required to make an election.[30] The election must be made in prescribed form containing prescribed information and maintained in the plan's books and records. It is not required to be filed with the Minister. At the time of writing, the election form is not prescribed. Details on how to make the election in the interim are set out in Appendix A.

A summary of the general rules as provided in the May 19, 2010 Backgrounder used to determine the provincial attribution percentage under the transitional year method are described below.

- If 90% or more of the value of Units of a Series are held by Individuals and Specified Investors, no look-through of institutional investors would be required. In that case, the provincial distribution of the value of Units held by Individuals and Specified Investors applies to determine the provincial attribution percentage of 100% of the value of Units in that Series.

- If more than 10% of the value of Units of a Series is held by institutional investors and the Investment Plan is able to look through 90% or more of the value of Units in that Series held by institutional investors, the Investment Plan applies the provincial distribution of the value of the Units held by institutional investors in respect of which the plan can look through, to determine the provincial attribution percentage of 100% of the value of Units in that Series that are held by institutional investors.

- If more than 10% of the value of Units of a Series is held by institutional investors and the Investment Plan is ***unable*** to look through 90% or more of the value of Units held by institutional investors, the plan uses the residence of each institutional investor to determine the provincial attribution percentage of 100% of the Units of the Series held by institutional investors. The residence of an institutional investor is determined as follows:

[29] Investment Plans that are SLFIs are required to have calendar years as their fiscal years. This is discussed in more detail later.

[30] See sections 61 and 62 of the Draft Regulations.

- a corporation – principal business address;
- a trust – residence of the trustee;
- a partnership – principal business address of the partnership, and, if that is not applicable, principal business address of its general partner.

The provincial attribution percentage for Stratified Investment Plans (other than Exchanged Traded Funds) under the transitional year method is set out in section 61 of the Draft Regulations. The percentage determined by the following formula:

$$A/B$$

$$A = (A_1 + A_2) / A_3$$

A = Total of all amounts, each of which is determined for an Attribution Point in respect of the Series for the specified taxation year (i.e., that straddles July 1, 2010)

A_1 = Total of all amounts, each of which is the total value of the Units of the Series held by an Individuals or a Specified Investor in the financial institution, resident in the participating province as of the Attribution Point

A_2 = Total of all amounts, each of which is the total value of the Units of the Series held by a person resident in Canada that is not an Individual or Specified Investor in the financial institution multiplied by

a. Person's investor percentage for the participating province if the plan knows the percentages for all participating provinces as of the Attribution Point

b. 100% if person is resident in the province and an (a) above does not apply

c. 0% in any other case

A_3 = Total of all amounts, each of which is the total value of the Units of the Series held by an investor as of the Attribution Point whether or not the investor is resident in Canada, (assuming an election is not made to exclude non-residents)

B = Number of Attribution Points in respect of the Series for the specified taxation year

See: Draft Regulations subsection 61(1). The Draft Regulations do not include the change announced by Finance in the June 30, 2010 Backgrounder that non-resident investors are included in the calculation unless the Investment Plan makes an election not to include the non-resident investors.

The provincial attribution percentage for Non-stratified Investment Plans (other than Exchange Traded Funds) is set out in section 62 of the Draft Regulations. Parallel rules apply as those described above for Stratified Investment Plans.

b. <u>Exchange traded funds</u>

For the transitional period July 1, 2010 to December 31, 2010, an Exchanged Traded Fund will have the same Attribution Point as indicated above for the other Distributed Investment Plans and will use the preceding year method as indicated above for the other Distributed Investment Plans. See: Draft

Regulations section 60. An Exchange Traded Fund may not use the real time method per paragraph 49(5)(b) of the Draft Regulations.

c. Private investment plans

For the transitional period July 1, 2010 to December 31, 2010, the normal rules described above for determining a Private Investment Plan's provincial attribution percentage apply. The Attribution Point is determined using subsection 14(1) of the Draft Regulations. Section 60 of the Draft Regulations does not apply.

d. New SLFIs

In determining the PVAT liability of an Investment Plan under SAM for a reporting period that begins before July 2010 and ends after June 2010 (e.g., a calendar year), an Investment Plan that became a SLFI on July 1, 2010 by virtue of the proposed rules, would not include any amount of GST or PVAT payable before July 1, 2010 or any amount of an ITC in respect of GST payable before July 1, 2010. However, an Investment Plan that was a SLFI under the current rules before July 1, 2010 would include such amounts in the SAM formula. See: Draft Regulations section 59.

11. Mergers and newly created plans

The Draft Regulations do not include the proposed rules contained in the May 19, 2010 Backgrounder to determine the provincial attribution percentage for new Investment Plans and the merger of existing Investment Plans or Series or the amendments and clarifications explained in the June 30, 2010 Backgrounder.

a. Mergers (i.e., merger of existing plan or series)

Finance announced in the May 19, 2010 Backgrounder the rules to determine the provincial attribution percentage where two or more predecessor Investment Plans or Series of Units of a plan merge to create a new plan or Series. The provincial attribution percentage for the merged Investment Plan or merged Series of an Investment Plan in the fiscal year in which the merger occurred is the percentage obtained by adding the percentages, each of which is determined for a predecessor plan or Series of Units that merged to create the new plan or Series of Units, by multiplying A by B, where:

- A is the attribution percentage for the province used immediately before the merger by the predecessor plan or Series; and

- B is the predecessor plan's or Series' proportion of the total value of Units in the new plan or Series immediately after the merger.

If a merger occurs after September 30th of a particular fiscal year, the attribution percentage determined for the new Series or the new plan upon the merger is used for both the first fiscal year ending after the merger and the subsequent fiscal year. Finance clarified in the June 30, 2010 Backgrounder that the percentage determined as calculated above for the new plan or Series created by way of merger applies on the day of the merger.

b. Other than merger (i.e., brand new plan or series)

Finance proposed in the May 19, 2010 Backgrounder two options to calculate the provincial attribution percentage of an Investment Plan or of a Series within a plan that is created otherwise than by way of a merger of previously existing plans. They are: (i) the modified real time method; and (ii) the gross-up method. We understand that Finance is considering additional alternative methods to the gross-up method as a result of industry consultation where issues have been raised. This is further discussed later in the paper.

(i) Modified real time method election

Finance announced in the June 30, 2010 Backgrounder that this method applies effective the first day the new Investment Plan or Series of the plan is created. The 90-day rule for the gross-up method (described below) does not apply here. The Investment Plan or Series must elect to use the modified real time method for the first year of the plan or Series. The rules for the real time method are modified as follows:

- there is no requirement that all or substantially all (generally interpreted by the CRA to mean 90% or more) of the value of Units in the plan or Series be held by Individuals and Specified Investors;

- Units held by institutional investors are not ignored in the determining the provincial attribution percentage, therefore the plan/Series must account for Units held by institutional investors in determining the percentage; and

- the location of an institutional investor is the location of the institution unless the Investment Plan or Series opts to "look-through" for all or substantially all of the institutional investors.

The election to use the modified real time method must be made in prescribed form containing prescribed information and maintained in the Investment Plan's books and records. See Appendix A for details on the attributes of the election and the procedure to follow until the election form is prescribed.

(ii) Gross-up method

Under this method, the provincial attribution percentage for a new Investment Plan or Series in the period that is 90 days after the initial distribution (including the initial distribution date) is nil. However, the provincial attribution percentage calculated on the attribution date (i.e., Attribution Point), which is the day that is 90 days after the initial distribution date, is grossed up to account for the PVAT attributable to the initial 90-day period. The gross-up factor that applies to the attribution percentage for a Series during the first fiscal year (i.e., including the day of distribution) is the number of days in the fiscal year after the initial distribution of the Units in the new Series divided by the number of days that are 90 days after the initial distribution in the fiscal year.

Finance proposed in the June 30, 2010 Backgrounder that the gross-up method to account for the initial 90 days be spread over two fiscal years rather than just the first year of the Investment Plan or Series. Finance indicated that the new approach would prevent unreasonably high PVAT rates which could arise from the original gross-up proposed method if a new plan or Series has an attribution date which is near the end of the year. For example, under the original gross-up method, if the attribution date (i.e., 90 days after the initial distribution of Units) of a new Series of a plan was December 15, its PVAT rate for the year would be grossed up by a factor of 6.6 (106 days from the initial distribution to the year-end (90 + 16) divided by the 16 days after the 90-day point which are the days during which tax for the year is assessed).

Under the new approach, using the above example, for the year the new Series is created and the following fiscal year, the gross up would be 1.2, i.e., (i) 106 days from the initial distribution to the year-end plus the 365 days in the second year divided by (ii) the 16 days after the 90-day point which are the days during which tax for the year is assessed plus the 365 days in the second year.

The grossed-up attribution percentage would apply to all of the unrecoverable GST (including the unrecoverable GST for the initial 90 days) in the year the new Series is created and the unrecoverable GST in the following fiscal year. However, the unrecoverable GST would be reduced based on a factor that would be the inverse of the above gross-up factor to reflect the inclusion of unrecoverable GST incurred in the initial 90-day period. Based on the above example, this factor would be (16+365)/(106+365).

The following example illustrates how the PVAT would be calculated under the gross-up method in the first and second year of a new plan Series created (otherwise than by a merger of Series or plans).

Example (June 30, 2010 Backgrounder)

A new single series fund is created on July 1, 2011. For its initial 90-day period (July 1 - September 28, 2011), the fund has total unrecoverable GST of $2,500. For the remaining 94 days of the fiscal year (September 29 - December 31, 2011), the fund has total unrecoverable GST of $4,000. The total unrecoverable GST for the fund for its first fiscal year, therefore, equals $6,500. The unrecoverable GST for the fund for its second fiscal year (January 1 – December 31, 2012 with 366 days in the year), equals $15,000. The attribution percentage determined on September 30, 2011 for Ontario is 50%.

- The gross-up factor in this case would be: (90+94+366)/((94+366) = 1.196
- The inverse of this gross-up factor would be: (94+366)/(90+94+366) = 0.836
- Ontario PVAT liability for year 1:
  - ((6,500 x 0.836) x (50% x 1.196) x (8/5)) = $5,199.25
- Ontario PVAT liability for year 2:
  - ((15,000 x 0.836) x (50% x 1.196) x (8/5)) = $11,998.27

* Interestingly, the gross-up factor multiplied by the inverse of the gross-up factor is 1.

Per the May 19, 2010 Backgrounder Finance indicated the following:

- If the initial distribution date and the initial attribution date do not fall within the same fiscal year, the attribution percentage determined on the attribution date would apply to the fiscal year that includes the initial distribution date and to the fiscal year following the initial distribution date.

- Look-through rules would not apply.

- The 90% test would be lowered to 80%. If the location of individual investors holding 80% or more of the value of the units is identified, the attribution percentage for that 80% or more of the units would be used to determine the attribution percentage of 100% of the value of the units.

12. Summary of provincial attribution percentages

TYPE OF INVESTMENT PLAN	PROVINCIAL ATTRIBUTION METHOD	CHARACTERISTICS[31]		DRAFT REGULATIONS
		General	Look-through requirement	
NORMAL RULES				
Stratified Investment Plan (other than an Exchanged Traded Fund)	Preceding year method with no reconciliation (default) Preceding year method with reconciliation (election required)	- Provincial attribution percentage based on the ratio of the value of investments held by investors in the participating province to the total value of investments - Look through rules apply -Use highest PVAT for unallocated - Cannot use when real time election is in effect	Yes	Section 30
Non-stratified Investment Plan (other than an Exchange Traded Fund)	Preceding year method with no reconciliation (default) Preceding year method with reconciliation (election required)	- Provincial attribution percentage based on value of investments held by investors in the participating province to the total value of investments - Look-through rules apply - Use highest PVAT for unallocated - Cannot use when real time election is in effect	Yes	Section 32
Stratified Investment Plan (other than an Exchange Traded Fund)	Real time method (election required)	- Provincial attribution percentage based on value of investments held by investors in the participating province to the total value of investments - 90% or more of the value of the Units are held by Individuals or Specified Investors - Look-through rules do not apply - Not available when an election is made under section 51 of the Draft Regulations to use more frequent Attribution Points - Must indicate in election whether Series percentages are determined monthly or daily	No	Section 29 Section 49
Non-stratified Investment Plan (other than an Exchange Traded Fund)	Real time method (election required)	- Provincial attribution percentage based on value of investments held by investors in the participating province to the total value of investments - 90% or more of the value of	No	Section 31 Section 49

31 The provincial attribution percentage may or may not included non-resident investors/members, depending on whether or not the election is made to exclude them from the denominator.

TYPE OF INVESTMENT PLAN	PROVINCIAL ATTRIBUTION METHOD	CHARACTERISTICS[31]		DRAFT REGULATIONS
		General	Look-through requirement	
		the Units are held by Individuals or Specified Investors - Look-through rules do not apply - Not available when an election is made under section 51 of the Draft Regulations to use more frequent Attribution Points - Must indicate in election whether plan's percentages are determined monthly or daily		
Exchange traded funds	Preceding year method with no reconciliation (default) Preceding year method with reconciliation (election required)	- No look-through requirement - Provincial attribution percentage based on value of investments held by investors in the participating province to the total value of investments - To the extent that the 90% test for determining the value of investments held in the participating provinces cannot be met, plan can seek pre-approval from the CRA for the calculation of the provincial attribution percentage	No	Section 33
Private Investment Plans – DPSP, EPSP, RCA	Preceding year method with no reconciliation (default) Preceding year method with reconciliation (election required)	- Provincial attribution percentage based on the value of investments reasonably attributable to a Plan Member in the participating province to the total value - Plan Members are all Individuals, therefore no look-through - Use highest PVAT rate for unallocated	N/A	Section 37
Private Investment Plans – employee benefit plan, employee life and health trust, registered supplementary unemployment benefit plan, trust governed by an employee trust	Preceding year method with no reconciliation (default) Preceding year method with reconciliation (election required)	- Provincial attribution percentage based on the number of plan members that are resident in the participating province to the total members - Plan Members are all Individuals, therefore no look-through - Use highest PVAT rate for unallocated	N/A	Section 38

TYPE OF INVESTMENT PLAN	PROVINCIAL ATTRIBUTION METHOD	CHARACTERISTICS[31]		DRAFT REGULATIONS
		General	Look-through requirement	
TRANSITIONAL YEAR (July 1, 2010 to December 31, 2010)				
Distributed Investment Plans other than Exchange Traded Funds	Preceding year method, real time method (election required), or transitional year method (election required) Note: preceding year methods should render the same results because the Attribution Percentage for the current year and the prior year are the same	- See above for "normal" methods - Must elect to use the special transitional rule - No look-through on institutional investors if know 90% or more of the value held by Individuals and Specified Investors - If more than 10% of the value is held by institutional investors and the plan can look through 90% or more of the value of the institutional investors, the plan can apply this provincial distribution to the remaining, and if not the plan can use the location of the institutional investors to determine the provincial attribution percentage - Attribution Point for calculating the provincial attribution percentage under any method is any point in time on or after July 1, 2009 and before July 1, 2010 provided no election is made under section 51 of the Draft Regulations to use more frequent Attribution Points	If available, otherwise no look-through	Section 61
Exchange Traded Funds	Preceding year method Note: preceding year methods should render the same results because the Attribution Percentage for the current year and the prior year are the same	- See "normal" method above - Attribution Point for calculating the provincial attribution percentage is any point in time on or after July 1, 2009 and before July 1, 2010 provided no election is made under section 51 of the Draft Regulations to use more frequent Attribution Points	No	Section 33
Private Investment Plans	See "normal" method	See "normal" method above	N/A	Section 37

<table>
<tr><th rowspan="2">TYPE OF INVESTMENT PLAN</th><th rowspan="2">PROVINCIAL ATTRIBUTION METHOD</th><th colspan="2">CHARACTERISTICS[31]</th><th rowspan="2">DRAFT REGULATIONS</th></tr>
<tr><th>General</th><th>Look-through requirement</th></tr>
<tr><td colspan="5">MERGERS & NEW PLANS</td></tr>
<tr><td>Merger of existing Investment Plans</td><td>Special method</td><td>- Based on provincial attribution percentage of predecessor plans
- Provincial attribution percentage applies on the day of the merger
- If the merger occurs after September 30th of a particular fiscal year, the attribution percentage is used for both the first fiscal year ending after the merger and the subsequent fiscal year
- Look-through is not applicable</td><td>N/A</td><td>Not in Draft Regulations</td></tr>
<tr><td>Creation of brand new Investment Plans</td><td>Modified real time method, gross-up method, and additional possible alternative(s)</td><td><u>Modified real time method</u>
- Based on the real time method but modified, e.g., no requirement that 90% or more of the investors are Individuals or Specified Investors, institutional investor holdings are not ignored, for institutional investors can opt to look-through or use the location of the institutional investor to determine the provincial attribution percentage
- Election required
- Effective for the first day the new plan or Series is created
<u>Gross-up method</u>
- Provincial attribution percentage for the period that is 90 days after the initial distribution date is nil
- Provincial attribution percentage for the first and second year of the plan or Series is grossed-up based on a specific factor to account for the initial 90 day spread
<u>Alternative methods</u>
- Finance considering alternative methods per industry consultations</td><td>No
Optional</td><td>Not in Draft Regulations</td></tr>
</table>

F. COMPLIANCE CONSIDERATIONS

1. Investment plans registering for HST

Finance indicated in the May 19, 2010 Backgrounder that Investment Plans would generally be required to register for GST/HST to account for PVAT. However, in the June 30, 2010 Backgrounder, Finance indicated that registration is required only where the SLFI Investment Plan makes a reporting entity election, a consolidated filing election, or a tax transfer adjustment election. For reporting purposes, SLFI Investment Plans that have jointly made the consolidated filing election would be permitted to use a single GST/HST registration number. The elections are described in detail later in this section.

At the time of writing, the registration form is not prescribed. The CRA indicates in Notice 255 that a letter of intent to register a group of Investment Plans should be sent to the Summerside Tax Centre. See Appendix A for further details.

Investment Plans that are already registered who wish to make the consolidated filing election will obtain a new registration number for purposes of the election. This will be the GST/HST number associated with that Investment Plan. We understand from discussions with the CRA that an Investment Plan will not have two GST/HST registration numbers associated with it, and that a process will be in place to facilitate the transition to the one GST/HST number used for the consolidated filing. The letter of intent should indicate the Investment Plan's existing GST/HST registration number.

Note that Investment Plans that do not register (and are not registrants) are still required to file the GST 494 annually to compute their PVAT liability or refund, and are required to file the GST 34 return on a monthly basis.[32]

2. Calendar year as fiscal year for investment plans

Finance indicated in the May 19, 2010 Backgrounder that SLFI Investment Plans are required to have calendar years as their fiscal years. This requirement is not set out in the Draft Regulations. It will be in the form of an amendment to the ETA or included in a regulation.

In the June 30, 2010 Backgrounder Finance said that certain[33] Investment Plans who are already GST/HST registrants and do not have the calendar year as their fiscal year are required to file two separate SLFI GST 494 returns during the transitional year for investment plans and segregated funds (i.e., the fiscal year that ends December 31, 2010). Specifically, for the transitional year, an Investment Plan that is already a GST/HST registrant and has a fiscal year ending after June 2010 but before December 31, 2010 is required to file one SLFI GST 494 return for the fiscal year which includes July 1, 2010 and one for the rest of the transitional year ending on December 31, 2010.

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32 Investment Plans can register voluntarily to avoid the monthly filings. In these cases where they default to being an annual filer as is the case for all listed financial institutions (other than those that are listed financial institutions by virtue of having made a section 150 election), instalment payments may be required.

33 We understand from discussions with Finance that there could be possible exceptions to this rule. However, it appears likely that the exceptions would be limited.

Example (June 30, 2010 Backgrounder)

An Investment Plan that has a fiscal year commencing October 1, 2009 and ending September 30, 2010 files the SLFI GST 494 return for that fiscal year, and an additional SLFI GST 494 return for the period commencing October 1, 2010 and ending December 31, 2010. For subsequent reporting periods, the Investment Plan has a calendar year as its fiscal year (e.g., January 1, 2011 to December 31, 2011 fiscal year) and files the SLFI GST 494 return six months after that fiscal year in respect of its PVAT liability for that year.

3. Compliance reporting elections

The reporting entity election, consolidating filing election and the tax adjustment transfer election facilitate compliance with the PVAT. These are joint elections made by the Investment Plan and the Manager that are filed with the Minister of National Revenue. See Appendix A for a summary of the attributes for these elections and the procedures to follow to make elections until the prescribed forms are available. At the time of writing, the prescribed forms to make the elections are not available.

a. Reporting entity election

A SLFI Investment Plan and a Manager may jointly elect to have the Manager file the returns of the Investment Plan. See: Draft Regulations section 54. The election is effective from the first day of the Investment Plan's fiscal year. When the election is in effect, the Manager is required to file the Investment Plan's returns. The Investment Plan is not required to file the returns. However, the Investment Plan is required to have a GST/HST registration number in order to make the election. The Manager files the Investment Plan's GST/HST returns using this GST/HST number unless the consolidated filing election is also made in which case the GST/HST number obtained for the consolidated group is used.

b. Consolidated filing election

A Manager or any two or more SLFI Investment Plans with whom the Manager has made the reporting entity election may jointly elect to file the returns of the Investment Plan on a consolidated basis. See: Draft Regulations section 55. However, the CRA will have the authority to allow a Manager to file more than one consolidated return where it meets the criteria for separating groups of Investment Plans. In this case, CRA may require each consolidated group to apply for a separate GST/HST registration number.

When the election is in effect, the Manager files a single joint return for the reporting period on behalf of the Investment Plans. The Investment Plans are not required to file the return for the reporting period. The Manager is required to use a single GST/HST registration number obtained for all of the Investment Plans that are under consolidated filing such that the plans are relieved of the obligation to register separately for GST/HST purposes.

The PVAT liability and all elements of the SAM formula determined for each plan and Series under consolidation are aggregated on a single return and detailed records of the SAM calculations for each such plan and Series are required to be maintained in the books and records of the Manager. The election is effective from the first day of a fiscal year of the Investment Plans. The joint election can only be made if the fiscal years and the reporting periods of the Investment Plans coincide with each other.

Example (May 19, 2010 Backgrounder)

Fund ABC and Fund XYZ are mutual funds managed by the same fund manager. Fund ABC has 2 series – Series A and B and Fund XYZ has 2 series – Series X and Y. The trustee(s) of Funds ABC and XYZ have made both the reporting entity election and consolidated filing election with the fund manager. Therefore, on behalf of the funds, the fund manager would be required to file a single consolidated GST/HST return for both Funds ABC and XYZ. The fund manager would be required to determine PVAT for each series of Funds ABC and XYZ that would be aggregated to a single consolidated return for both funds.

c. Tax adjustment transfer election

A SLFI Investment Plan and the Manager of the Investment Plan may jointly elect to transfer the Investment Plan's adjustments to net tax under subsection 225.2(2) of the ETA to the Manager. See: section 56 of the Draft Regulations. As a result of making the election, the Manager charges the Investment Plan an "effective" or "blended" GST/HST rate on its management fees based on the provincial attribution percentage for each plan. This preserves cash flow to the Investment Plans where the applicable GST/HST rate based on the general place of supply rules is higher than the blended rate, e.g., rate based on the place of supply rules is 13% and the blended rate based on investor residency is 10%. Conversely, where the applicable GST/HST rate based on the general place of supply rules is lower than the blended rate, e.g., rate based on place of supply is 5% and the blended rate based on investor residency is 15%, the plan pays the higher blended rate and therefore will not have a SAM liability at the end of the year.

The rules generally operate as follows:

- the tax adjustment transfer amount is the positive or negative net tax adjustment transfer amounts determined by the application of the SAM formula to each plan/Series, as the management fees are charged to the plan/Series;

- the positive or negative tax adjustment transfer amount applies to all amounts of PVAT paid by the plan including PVAT paid to the plan manager on management fees and when the reporting entity election is made, on third-party charges to the plan (e.g., audit fees, custodial fees);[34]

- the tax adjustment transfer amount is made on an ongoing basis, with the **net** PVAT charged on the management fees adjusted to reflect the tax refund or tax liability resulting from the application of the SAM formula;

- the tax adjustment transfer amount determined for each Series/plan is aggregated on the Manager's return and where the consolidated filing election is made, the adjustment is aggregated on the consolidated return(s) for the Investment Plans otherwise it is reported on respective individual returns of the Investment Plans;

- there is no requirement for the reporting periods of the Manager and the Investment Plan to coincide; and

[34] Where both the tax adjustment transfer election and reporting entity election are made, the tax adjustment transfer can be made in respect of third party fees as well as the management fees charged by the Manager. Where only the tax adjustment transfer election is made (i.e., and no reporting entity election), the amount of PVAT that can be credited/refunded or assumed as a liability is limited to the PVAT on management fees charged by the Manager.

- detailed records of the tax adjustment transfer amounts made by the Manager for each Series/plan and tax adjustment transfer amounts made at the aggregated level are to be maintained in the books and records of the plan by the Manager.

The Manager reports the tax adjustment transfer amounts on lines 105 (net tax liability) and 108 (net tax refund) of its GST/HST electronic return. Lines 103 (i.e., GST/HST collected and that became collectible in the reporting period) and 107 (i.e., adjustments to be deducted in determining net tax) no longer exist for electronic returns.[35] Below is an example of how the Manager would report the tax adjustment transfer amounts on its electronic return.

[35] Effective July 1, 2010, certain GST/HST registrants are required to file electronic returns. We expect that most Managers are now required to file on-line. See: June 17, 2010 SOR2010-150 "Electronic Filing and Provision of Information (GST/HST) Regulations".

Examples: reporting of adjustments on Manager's GST/HST return

<u>"Refund" to the Investment Plan</u>

- Management fee charged = $100
- GST/HST rate per place of supply = 13%, therefore $13 of GST/HST is to be reported on the management fee
- Effective rate* after application of provincial attribution percentage = 11%, $11 of GST/HST paid by the plan
- Therefore, tax adjustment transfer amount (refund) on management fee = $2 (i.e., $13 GST/HST collectible, $11 payable by the plan based on SAM)

Line	Description	Amount
Line 105	Total GST/HST and adjustments for the period	$13
Line 108	Total ITCs and adjustments (tax adjustment transfer amount transferred from the plan)	$2
Line 109	Net tax remitted by Manager	$11

The net $11 should not be reported on line 105. The amounts must be shown separately on the two lines as indicated above.

<u>"Liability" to the Investment Plan</u>

- Management fee charged = $100
- GST/HST rate per place of supply = 5%, therefore $5 GST/HST to be reported on the management fee
- Effective rate* after application of provincial attribution percentage = 10%, $10 GST/HST paid by plan
- Therefore, tax adjustment transfer amount (payable) on management fee = $5 (i.e., GST collectible, $10 payable by the plan based on SAM liability)

Line	Description	Amount
Line 105	Total GST/HST and adjustments for the period (tax adjustment transfer amount transferred from the plan)	$10
Line 108	Total ITCs and adjustments	$0
Line 109	Net tax remitted by Manager	$10

Where the GST/HST rate based on the place of supply rules is lower than the blended rate, resulting in an amount owing by the plan, this amount is added to line 105 (i.e., $5 + $5).

* The term "effective rate" (or blended rate) is not a defined term. The term is used to illustrate the calculation of tax adjustment transfer amount transferred from the plan to the Manager.

The Investment Plans, or the Manager if the reporting entity election or consolidating filing election is made, report the total tax adjustments transfer amounts for the fiscal year on GST 494. Where a Manager and an Investment Plan have made the reporting entity election but not the consolidated filing election, the Manager and the plan can still make the tax adjustment transfer election. Where a reporting entity election has not been made, the Investment Plan is required to register for GST/HST in order to make the tax adjustment transfer election.

d. Summary

The possible combinations of elections that can be made between the Manager and an Investment Plan are summarized in the table below:

Reporting Entity Election	Consolidated Filing Election	Tax Adjustment Transfer Election
X	X	X
X	X	
X		X
		X
X		

When only the tax adjustment transfer election is in effect, the tax adjustment transfer amount is limited to the amount of PVAT (credit or liability) in respect of the management fees only. PVAT adjustments in respect of charges to the fund by third parties (e.g., audit fees and custodial fees charged directly to the funds) cannot be transferred.

4. General rules for the compliance reporting elections

The following general rules apply for each of the three elections described above including revocations thereof:

- the Manager and the Investment Plans are jointly and severally liable for the net tax of the Investment Plans for the reporting and interest and penalties in respect of the net tax or in respect of a return for the reporting period;
- the elections must be made in a prescribed form and contain prescribed information; and
- the elections must be filed in prescribed manner with the Minister of National Revenue.

Finance announced in the June 30, 2010 Backgrounder that discretion will be provided to the Minister of National Revenue with respect to the deadline for filing elections with the Minister.

At the time of writing, the election forms are not prescribed. The CRA indicates in Notice 255 that the Investment Plan and Manager should send a letter of intent for each election to the Summerside Tax Centre. For further details on the letter of intent see Appendix A.

5. Example 1

Facts

Fund A has two Series – Series 1 and Series 2. Fund A is a SLFI located in Alberta. Fund A has a December 31st fiscal year end. Fund A uses the preceding year method to determine its provincial attribution percentage for fiscal year 2011. The Attribution Point is September 30, 2010. Fund A has 100,000 Units with a total value of $50,000,000 on September 30, 2010 (i.e., value of $500/Unit). The ownership of the Units is as follows: Individuals own 99,800 of the Units; Specified Investor owns 100 Units; and Institutional Investor owns 100 Units. The residency of the investors is as follows: 60% British Columbia; and 40% Alberta. Series 1 of Fund A invests in Fund B. Fund A is not a Specified Investor. Fund B is located in Toronto, Ontario. Series 1 of Fund A paid 5% GST on the $1,000,000 management fees (GST = $50,000) Series 1 paid no PVAT and claimed no ITCs.

SAM Calculation for series 1

Fund A is a SLFI and required to file an annual SLFI return (GST 494). Provincial attribution percentage for British Columbia:

$$A/B$$

$$A = (A_1 + A_2)/A_3$$

A = All amounts for each Attribution Point in respect of the Series for the particular period

A_1 = Total value of the Units of the Series held by Individuals or Specified Investors resident in the participating province as of the Attribution Point

A_2 = Total value of Units of the Series held by persons resident in Canada that are not Individuals or Specified Investors (i.e., institutional investors) multiplied by the person's investor percentage for the participating province as of the Attribution Point

A_3 = Total value of the Units of the Series held by residents and non-residents of Canada (assuming an election is not made to exclude non-residents)

B = Number of attribution points in respect of the Series for the particular period

A/B = $30,000,000/$50,000,000 = **60%**

SAM Calculation:

$$[[A \times B/C] - D] + E$$

A = Unrecoverable GST for the Series for the participating province

B = PVAT rate

C = Federal GST rate

D = Actual PVAT paid or that became payable

E = Amounts prescribed for purposes of paragraph G

$$A = (A_4 - A_5) \times A_6$$

A_4 = Federal GST that was paid or that became payable

A_5 = Input tax credits

A_6 = Provincial attribution percentage for the participating province for the immediately preceding taxation year

A = (\$50,000 - \$0) x 60% = \$30,000

Therefore, remainder of SAM = [[\$30,000 x 7/5] - \$0] + \$0 = \$42,000

As the SAM formula yields a positive amount, the fund would have a PVAT liability for British Columbia of \$42,000 which the fund would have to report on its GST/HST return. Fund A is required to provide its provincial attribution percentage to Fund B upon request by Fund A because it invests in Fund B and Fund A is not a Specified Investor. The information sent by Fund A will be based on information available on September 30, 2010 (i.e., the same provincial attribution percentage % used to calculate its own PVAT liability for each participating province).

6. Example 2

Facts

Fund B is located in Toronto and distributed in all provinces. It has one series. Fund B determines is provincial attribution percentage for fiscal year 2012 using the preceding year method. Its Attribution Point is September 30, 2011. The value of Fund B is \$100,000,000 on September 30, 2011. The investor distribution on September 30, 2011 is as follows: Fund A: 30% (assume 50% BC and 50% Alberta); and Individuals: ON – 40%, NB – 3%, NS – 3%, NFLD – 2%, Other (AB, SK, MN, QU, PEI, NU, NT, YK) – 37%. Fund B is managed from Toronto. Fund B paid \$290,000 HST (13%) in 2012. Fund B paid the following fees and taxes for fiscal year 2011: management fees \$2,200,000 (HST = \$286,000); and audit/custodian fees \$30,770 (HST = \$4,000).

Analysis

Fund B is a SLFI and required to file an annual SLFI return for 2012 to account for its PVAT for 2012. The return is due to be filed by June 30, 2013. Fund B must obtain from Fund A Fund A’s provincial attribution percentage. Fund A must provide its provincial attribution percentage as of Sept 30, 2011. This is the Attribution Point for Fund A.

No tax adjustment transfer election: Where the tax adjustment transfer election is not made, the Manager collects $286,000 from Fund B and remits the same to CRA. Fund B claims a refund of $68,040 (see table below with calculation of the refund) when it files its GST/HST return for the 2012 fiscal year.

Reporting entity election and tax adjustment transfer election: The resulting implications of the Manager and Fund B making both the reporting entity election and the tax adjustment transfer election are summarized below.

- The Manager effectively credits the refund of $68,040 to Fund B.

- The Manager claims a deduction of $68,040 on line 108 of Fund B's electronic GST/HST return for each applicable reporting period. If the manager has no other amount to report on its GST/HST return, the fund manager would have a net tax liability of $217,960 ($286,000 GST/HST collected minus $68,040 net tax deduction).

- The tax adjustment transfers are made at the time tax is charged to plan such that Manager would only have to collect the net tax calculated at the effective tax rate of 9.95% on the management fees (i.e., $2,200,000 x 9.95% = $218,900). Further adjustment would also be made by the Manager for the tax transfer related to the tax refund on other charges payable by the plan (e.g., audit) resulting from the application of SAM.[36]

Tax adjustment transfer election (only): The resulting implications of the Manager and Fund B having made the tax adjustment transfer election only (and not the reporting entity election), are summarized below:

- The Manager credits the Fund B for $67,100 which is the tax adjustment transfer amount calculated with respect to the management fees charged by the Manager.

- Fund B claims a refund of $940 (related to other fees not charged by the Manager) when it files its GST/HST return for the reporting period and makes the tax adjustment transfer amount to account of the PVAT of $67,100 credited to it by the Manager.

<u>Calculations</u>

Provincial attribution percentage for Fund B

Investors	Value of Units	BC	ON	NS	NB	NF	Other Canada
Retail	70%		40%	3%	3%	2%	22%
Fund A	30%	15%*	0%	0%	0%	0%	15%*
Total	100%	15%	40%	3%	3%	2%	37%

* 30% x 50%

36 We understand that the CRA will be releasing an amended form GST 494 which will include a line item for the adjustments.

PVAT liability for Fund B

Province	Net tax (A – B) ($290,000)(5/13) - 0	Provincial attribution percentage C	Gross-up for provincial HST rate D/E	Liability for HST provincial component (A – B) x C x D/E	Actual provincia l portion of HST paid F	Net (refund) or payable (A – B) x C x D/E – F
BC	$111,538	15%	7/5	$23,423	$0	$23,423
ON	$111,538	40%	8/5	$71,384	$178,462	($107,078)
NB	$111,538	3%	8/5	$5,354	$0	$5,354
NS	$111,538	3%	10/5	$6,692	$0	$6,692
NF	$111,538	2%	8/5	$3,569	$0	$3,569
Total				$110,422	$178,462	($68,040)

Effective or blended GST/HST rate paid by Fund B is 9.95%

PROVINCE	ALLOCATION	GST/HST RATE	EFFECTIVE RATE
British Columbia	15%	12%	1.8%
Ontario	40%	13%	5.2%
New Brunswick	3%	13%	0.39%
Nova Scotia	3%	15%	0.45%
Newfoundland	2%	13%	0.26%
Other Canada	37%	5%	1.85%
Total			**9.95%**

PVAT refund summary

	FEES	Tax @ 13%	Tax @ 9.95%	Net Refund
Management fees	$2,200,000	$286,000	$218,900	$67,100
Other fees	$ 30,770	$ 4,000	$ 3,060	$ 940
TOTALS	**$2, 230,770**	**$290,000**	**$221,960**	**$68,040**

7. Election to include non-residents in the base

Finance announced in the June 30, 2010 Backgrounder that Investment Plans can elect so as not to include holdings of non-residents in calculating the provincial attribution percentage and to permit the Investment Plan to claim applicable ITCs in respect of the non-resident investors. The Investment Plan is allowed to revoke the election after five years, or an earlier date if approved by the Minister.

At the time of writing, the election form is not prescribed. The CRA indicates in Notice 255 that a letter of intent to file the election should be sent to the Summerside Tax Centre. For further details on the letter of intent see Appendix A.

With respect to whether the election should be made, a cost/benefit analysis is required to determine whether an Investment Plan would be better off claiming the ITCs versus forgoing the ITCs and including non-residents in the calculation.[37] The example below illustrates the type of analysis required.

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[37] Certain supplies of financial services made by financial institutions to non-residents are zero-rated for GST/HST purposes. Accordingly, such are taxable supplies and provide an opportunity for GST/HST registered financial institution to claim ITCs with respect to the HST paid on associated input costs, e.g., HST paid by a mutual fund on management fees attributable to holdings of non-resident investors.

8. Example 3

Facts

Fund A is a SLFI and is distributed in all provinces. Value of Fund A is $100,000,000. Based on the residency of the investors, the allocation of value is as follows: BC – 15%; ON – 40%; NB – 3%; NS – 3%; ND – 2%; other (AB, SK, MN, QU, PEI, NU, NT, YK) – 29%; and **non-residents – 8%**. Fund A is managed and audited from Toronto. It pays 13% Ontario HST to the manager, auditor, custodian, etc. totaling HST of $290,000. Fund A claims $4,500 in ITCs because it makes zero-rated supplies of financial services,

Analysis

No ITCs claimed (non-resident investors included in denominator)

Province	**Net 5% unrecoverable GST = $290,000 x 5/13 (A – B)**	**Provincial attribution percentage C**	**Gross-up for provincial HST rate D/E**	**Liability for HST provincial component (A-B) x C x D/E**	**Actual provincial portion of HST paid =$290,000 x 8/13 F**	**Net (refund) or payable (A-B) x C x D/E – F**
BC	$111,538	**15%**	7/5	**$23,423**	$0	$23,423
ON	$111,538	**40%**	8/5	**$71,384**	$178,462	($107,078)
NB	$111,538	**3%**	8/5	**$5,354**	$0	$5,354
NS	$111,538	**3%**	10/5	**$6,692**	$0	$6,692
ND	$111,538	**2%**	8/5	**$3,569**	$0	$3,569
Total	$111,538			**$110,422**	$178,462	($68,040)

ITCs claimed (non-resident investors not included in denominator)

Province	**Net 5% unrecoverable GST = $290,000 x 5/13 - $4,500 (A – B)**	**Provincial attribution percentage C**	**Gross-up for provincial HST rate D/E**	**Liability for HST provincial component (A-B) x C x D/E**	**Actual provincial portion of HST paid =$290,000 x 8/13 F**	**Net (refund) or payable (A-B) x C x D/E – F**
BC	$107,038	**16.3%**	7/5	**$24,426**	$0	$24,426
ON	$107,038	**43.5%**	8/5	**$74,498**	$178,462	($103,964)
NB	$107,038	**3.3%**	8/5	**$5,652**	$0	$5,652
NS	$107,038	**3.3%**	10/5	**$7,065**	$0	$7,065
ND	$107,038	**2.2%**	8/5	**$3,768**	$0	$3,768
Total	$107,038			**$115,409**	$178,462	($63,053)

Summary impact

	Fund A Claims ITCs	Fund A Claims NO ITCs	IMPACT
HST paid to suppliers	$290,000	$290,000	
Less: provincial component of HST (fully recoverable)	($178,462)	($178,462)	
ITCs claimed	($4,500)	$0	
SAM liability	$115,409	$110,422	
HST cost	**$222,447**	**$221,960**	**$487**

In this example, Fund A is better off not to claim the ITCs. Fund A therefore would not make the election to claim ITCs and would include non-resident holdings in the provincial attribution percentage calculation. Investment Plans will have to calculate the cost benefit analysis in order to decide whether to make the election.

9. Reporting periods, filings, & installments

a. Reporting periods

The reporting period of a SLFI who is a registrant is a fiscal year unless an election is made to have reporting periods of fiscal months or fiscal quarters. See: subparagraph 245(2)(a)(iv) of the ETA. The reporting period of a SLFI who is not a registrant is a calendar month. See: subsection 245(1) of the ETA.

b. Filings

SLFIs are required to file an annual final return (GST 494) which includes the reporting of the SAM calculation. The return is required to be filed six months after the end of the fiscal year (effective for fiscal years after September 23, 2009). See: subparagraph 238(1)(a)(i) of the ETA.

Where a SLFI's reporting period is a fiscal year, the SLFI files only the GST 494. Where a SLFI's reporting period is a fiscal month or fiscal quarter, the SLFI is required to file an interim return (GST 34) for the fiscal month or fiscal quarter within one month of the reporting period.

SLFI's are not required to file their GST/HST returns electronically.[38] We understand that a SLFI may voluntarily file the GST 34 form electronically. However, the GST 494 (annual SLFI return) is not available electronically.

c. Installments

No installments will be required for the transitional year (i.e., July 1, 2010 to December 31, 2010) by Investment Plans that became SLFIs on July 1, 2010 by virtue of the proposed rules. Such plans would not have a SAM liability for the preceding year on which to base the installment payments. See: ETA section 237. Since most Investment Plans became SLFIs only on July 1, 2010, installments for this period are not an issue.

For subsequent years, installment payments are only required where the Investment Plan has a SAM liability (i.e., an amount owing in the preceding year) ***and*** has not made ***both*** the tax adjustment transfer election and the reporting entity election. Where these elections have been made, installments are not necessary because the tax adjustments are done throughout the year by the Manager.

[38] See: Draft Regulations Part 4, section 8 and paragraph (b) of amended section 4. See also: subsection 278.1(2.1) of the ETA and section 2 of the *Electronic Filing and Provision of Information GST/HST Regulations*.

10. Information request to institutional investors

At the time of writing, the government has not indicated that it would prescribe a form for institutional investors and distributors to complete in order to comply with the information request from Managers on investor residency where look-through is required to determine an Investment Plan's provincial attribution percentage(s) for the participating provinces. It is understood that, industry is working to develop such a form in order to standardize and streamline the request.

11. Non-SLFI investment plans & provincial series of stratified SLFI

Non-SLFI Investment Plans and Provincial Series of Stratified Investment Plans do not use SAM to determine their PVAT liability or refund, as applicable. Theoretically, the application of HST to these types of plans versus SLFI plans and non-Provincial Series should be neutral. Rebate and self-assessment provisions should operate to achieve this neutrality. Finance has indicated that the rebate provision would not capture the PVAT on costs charged to it by persons other than the Manager (e.g., third-party custody costs). It is understood that the issue is under review. The rules are discussed below.

a. <u>Rebate of PVAT for management services</u>

A rebate in respect of PVAT payable on "management or administrative services"[39] is available under section 261.31 of the ETA to:

- Investment Plans who are not SLFIs (e.g., Qualifying Small Investment Plans who have not elected to be an SLFI); and
- Investment Plans who are SLFIs, but only in respect of a Stratified Investment Plan with one or more Provincial Series. Units of a Provincial Series can only be sold or distributed in one province and are precluded from being sold or distributed in any other province.

An Investment Plan or a Provincial Series of a Stratified Investment Plan that does not calculate its PVAT liability through the SAM formula but has investors resident in a non-participating province can receive a rebate of the PVAT payable in respect of management or administrative services to reflect the fact that consumption or use of the services acquired is in a non-participating province.

Like the provincial attribution percentages, the residence of the investors is used as proxy to determine consumption or use by the Investment Plan or Series in the case of a Provincial Series of a Stratified Investment Plan in a particular province. The rebate must be filed within one year after the tax became payable. See sections 261.31, 261.4, 262, and 263.01 of the ETA and Part 3 of the Draft Regulations.

Note that a "management or administrative service" is defined in subsection 123(1) of the ETA to include an "asset management service". An "asset management service" is defined as follows:

> "asset management service" means service (other than a prescribed service) rendered by a particular person in respect of the assets or liabilities of another person that is a service of
>
> (a) managing or administering the assets or liabilities, irrespective of the level of discretionary authority the particular person has to manage some or all of the assets or liabilities,

[39] The financial institution must be the recipient of a supply of a "specified service" which is defined as follows:
…a management or administrative service and any other service provided to the recipient of a supply of a management or administrative service by the supplier of that management or administrative service.

(b) providing research, analysis, advice or reports in respect of the assets or liabilities,

(c) determining which assets or liabilities are to be acquired or disposed of, or

(d) acting to realize performance targets or other objectives in respect of the assets or liabilities;

No services have been prescribed to date. Query whether the definition of "management or administrative services" is broad enough to capture third-party suppliers?

b. Self-assessment of PVAT

The PVAT self-assessment provisions are in Division IV.1 of the ETA. They apply to non-SLFIs and to Provincial Series of Investment Plans and are meant to ensure that non-SLFIs and Provincial Series pay the appropriate amount of PVAT.

Specifically, they provide for self-assessment of the PVAT for property and services brought into a participating province for use, consumption, or supply. Section 220.08, for example, sets out the self-assessment of PVAT for intangible personal property and services.[40] The self-assessment rules normally do not apply to SLFIs. However, there is an exception for Provincial Series since they do not determine their PVAT liability using the SAM formula. Section 220.04 of the ETA provides:

> If tax under this Division would, in the absence of this section, become payable by a person when the person is a selected listed financial institution, that tax is not payable unless it is a prescribed amount of tax.

The PVAT for a Provincial Series is a "prescribed amount of tax". This prescribed amount is determined per subsection 40(c) and subsection 41(a) of the Draft Regulations. The amount of tax is:

> …any amount of tax that became payable by a stratified investment plan, or that was paid by a stratified investment plan without having become payable, in respect of property or a service, to the extent that the property or service was acquired, imported or brought into a participating province for consumption, use or supply in the course of the activities relating to a provincial series of the stratified investment plan.[41]

G. INDUSTRY CONSULTATIONS

Finance is continuing to consult with industry to refine the HST proposals in order to address industry concerns and issues. We highlight below some of the key areas of ongoing consultation at the time of writing.

1. Gross-up method for new plans or series

The industry expressed concern with Finance's proposal to use the gross-up method (discussed earlier) to determine an Investment Plan's provincial attribution percentage for the first 90 days of the plan as it may not properly reflect the residence of the investors during those first 90 days. To improve accuracy, industry has suggested that an estimate be used for the first 90 days followed by a true-up soon after based on the provincial distribution of assets as at the end of the first quarter of operation.

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40 Note that prior to July 1, 2010, the property or service had to be acquired by the person for consumption, use or supply primarily in the participating provinces. This primary test has been removed resulting in a lower threshold test for self-assessment.

41 See: Paragraph 40(c) of the Draft Regulations.

Example Assume a series is launched on December 1, 2010 and that the estimated rate at launch is 10%; the return for 2010 for the one month would be based on 10% of the fees for the series. Assume after 90 days the rate is found to be 10.19%; the return filed for 2011 would be equal 10.19% of the fees plus an adjustment for .19% of fees for the month of December 2010.

Also, the industry is consulting with Finance on appropriate approaches for special cases such as when a new fund company is established or a completely new product is launched. In response to the concerns and to provide more flexibility, we understand that Finance is considering additional alternative methods to the gross-up method for new plans.

2. Specified investors & "related party" requirement

The Government has proposed to apply a "related-party" requirement in determining whether the $10,000,000 investor asset value test is satisfied at both the Investment Plan level and the Manager level. This would require investors to aggregate the value of their holdings across plans, Series, and Managers. The requirement is meant to address anti-avoidance strategies, i.e., possible structuring so that Investment Plans do not have to look through institutional investors and thus such investors do not have to provide their provincial attribution percentages to the plan. The requirement presents a number of potential challenges to both Investment Plans and investors. Finance has been working with industry to address these challenges. Some of the potential challenges raised with Finance are noted below.

- Investment Plans would not be able to determine with any certainty whether investors are "related". Obtaining the level of detail needed to make the determination would be difficult if not impossible in many if not most cases. Even if the plan could obtain the details, the analysis can be complex and potentially costly. Where investors invest in a number of plans all managed by the same Manger, this too can be logistically difficult to track requiring costly new systems and processes to be put in place.

- Investors may in some cases track investments in plans managed by the same Manager particularly where the investments are administered by the same person. However, in many other cases the investments are not administered by the same person and no systems or processes are in place to track the information on a consolidated basis, e.g., a company or group of related companies that has various employee benefit plans (e.g., DPSP, employee benefit plan trust) administered by different people.

Finance is considering the details around how this "related-party" requirement will apply. The understanding is that investors, as opposed to Managers or Investment Plans, will have the responsibility under the information sharing rules to determine whether the requirement applies, both at the Manager level and the investor level.

3. Information required from institutional investors

The information required in section 53 the Draft Regulations that institutional investors provide the number of Units held by the investor for each participating province appears to be not necessary for an Investment Plan to calculate its provincial attribution percentage. Only residency information is needed, e.g., an institutional investor's provincial attribution percentage for each participating province. Industry has raised the issue with Finance.

4. Specific provincial attribution percentage calculation dates

Industry has raised some practical operational concerns with calculating the provincial attribution percentages on very specified dates (i.e., the Attribution Point). For example, data reports may be run during off-peak periods (e.g., weekends) which do not coincide precisely with the Attribution Point. They have requested that some flexibility be provided as to the date on which the provincial attribution percentages are calculated, recommending that the calculation be done using data obtained within a seven day period of the Attribution Point.

5. Annual information returns for financial institutions

Financial institutions registered for HST who have annual revenues that exceed $1,000,000 are required to file an Annual Information schedule. See: section 273.2 of the ETA. It is hoped that Investment Plans that register for HST in order to make the reporting entity election, consolidated filing election or tax adjustment transfer election will not be required to complete an Annual Information Return. Section 273.2 of the ETA provides a mechanism which Finance can use to "exempt" such financial institutions by way of regulation from having to file. Finance is aware of this concern and is considering the matter.

H. CONCLUSION

The introduction of HST in Ontario and BC on July 1, 2010 has changed the world for many Investment Plans in a substantial manner. Most of them became SLFIs as a result and are now subject to accounting for the provincial portion of HST by following the SAM. Conceptually, the SAM is simple to understand and easy to administer. However, the proposed rules as indicated in the two backgrounders and the Draft Regulations make it complex to apply in practice. Add to this that there are known and admitted gaps in the proposed rules, as well as guidance and much needed forms from the CRA that are still being developed.

Managers, administrators and others that have responsibility for the management and administration of Investment Plans need to keep close watch for pending releases from Finance and the CRA. Finance's future releases will deal with further refinements to the rules as a result of its ongoing consultation with industry. They will deal, as well, with the logistical approach to effecting announcements previously made that are not contained in the ETA or the Draft Regulations. Concurrently, the CRA is working with the same set of proposed rules to: publish new forms (e.g., for the many new elections that need to filed or maintained); make modifications to returns (e.g., GST 494 and GST 111); and develop important written guidance where appropriate.

Amidst these compliance and transitional challenges, it should not be forgotten that HST is adding significantly to the cost of management and administration of Investment Plans. As indicated in the introduction, this factor makes these investment products less competitive compared to certain other competing products (e.g., GICs) and to similar products sold in certain other countries in the world. Notwithstanding the HST is a tax on the Investment Plans themselves and not specifically to their investors or beneficiaries, the investors and beneficiaries certainly and appropriately view it as a tax on them. For nationally distributed/held Investment Plans, individual investors and beneficiaries thereof who are resident in non-participating provinces are feeling unfairly taxed. There is talk of developing new products and, in some cases, new products have already been developed, such as provincial only series or funds. This is being done to attract investors and, of course, to avoid the application of the provincial component of HST on the management and administrative costs of investments or assets that are beneficially held by the individuals resident in non-participating provinces. However, this has the potential to alienate investors and beneficiaries who are resident in the participating provinces and who ultimately will pay proportionately more tax as a result.

Stakeholders need to stay closely tuned for the pending Government releases that will no doubt affect compliance for the HST. As well, it will be interesting to watch how the market will react to the higher tax cost being incurred by Investment Plans. Will all of these challenges and pending outcomes lead to the Government undertaking a general policy review on the application of GST/HST to financial services and financial instruments? Only time will tell; but the expectation is that there are interesting times ahead in the world of GST/HST.

APPENDIX A

SUMMARY OF ELECTIONS

NAME	PURPOSE	DURATION	EFFECTIVE	FILED WITH MINISTER	DRAFT REGULATIONS
Provincial attribution percentage elections					
Attribution Point	To have quarterly, monthly, weekly, or daily Attribution Points Not available if election to use real time attribution method is in effect	Three years until it can be revoked	First day of Investment Plan's fiscal year	No	Subsection 14(1) Section 51
Real time attribution method	To calculate provincial attribution percentage using current year values	Three years until it can be revoked	First day of Investment Plan's fiscal year	No	Section 49
Preceding year attribution method with reconciliation	To calculate provincial attribution percentage using current year values. Installments are based on preceding year. Reconciliation for current year on final SLFI return.	Three years until it can be revoked	First day of Investment Plan's fiscal year	No	Section 50
Non-resident s excluded from total investor base	To exclude non-residents from the provincial attribution percentage calculation and allow the Investment Plan to claim ITCs with respect to non-resident investor holdings.	Five years until revoked, or at an earlier date if approved by the Minister	Presumably, first day of Investment Plan's fiscal year	Yes	June 30, 2010 Backgrounder
Transitional year election (July 1, 2010 to December 31, 2010)	To simplify the calculation of a Distributed Investment Plan's (other than an Exchange Traded Fund's) provincial attribution percentage for the transitional period.	Transitional year	Transitional year	No	Sections 61, 62
Modified real time method for the first year of a new plan or series	To calculate the provincial attribution percentage for the first fiscal year of a new Investment Plan or Series in a plan that is created otherwise than by merger of	First fiscal year	First fiscal year	No	May 19, 2010 Backgrounder

NAME	PURPOSE	DURATION	EFFECTIVE	FILED WITH MINISTER	DRAFT REGULATIONS
	predecessor plans or Series using a modified version of the real time method.				
Reporting elections					
Reporting entity election	To have the manager file the returns of the Investment Plan. Joint election by manager and Investment Plan.	Until revoked	First day of Investment Plan's fiscal year	Yes	Sections 54, 57
Consolidating filing election	To have the manager and two or more Investment Plans file the returns on a consolidated basis. Reporting entity election must be made. Joint election between manager and each Investment Plan.	Until revoked	First day of Investment Plans' fiscal year	Yes	Sections 55, 57
Tax adjustment transfer election	Transfers Investment Plan's adjustment's to net tax under ETA subsection 225.2(2) to the Manager. Manager charges Investment Plan HST rate based on the Investment Plan's provincial attribution percentage. Manager and Investment Plans make necessary adjustments on respective returns.	Until revoked	First day of Investment Plans' fiscal year	Yes	Sections 56, 57
Other					
Qualifying Small Investment Plan	To treat the Qualifying Small Investment Plan as a SLFI.	3 years or earlier upon application to the Minister.	First day of Investment Plan's fiscal year.	Yes	Sections 11, 12

NOTES:

1. Finance announced in the June 30, 2010 Backgrounder that discretion will be provided to the Minister of National Revenue with respect to the deadline for filing elections with the Minister.

2. At the time of writing, the CRA has not released the prescribed forms for the elections and obtaining a GST/HST registration number for purposes of the consolidated filing election. The CRA indicates in Notice 255, what Investment Plans and Managers should do in the interim. This information is summarized below.

3. Compliance reporting elections: The Investment Plan and Manager should file a letter of intent for each election with the CRA, Summerside Tax Centre, 275 Pope Road, Summerside, PE C1N 6A2 containing the following information:

    - the legal name, business number and contact information (telephone number and mailing address) of the Manager;
    - the name, business number and contact information (telephone number and mailing address) of the Investment Plan;
    - the first day of the fiscal year to which the election would apply;
    - a statement from each party to the election(s) confirming the party's intent to make the particular election(s); and
    - signatures of authorized signatories of each party to the election.

    Where the Investment Plans and Manager are making a reporting entity election and a consolidated filing election, the letters of intent should be sent together with the letter of intent to register a group of investment plans.

    The Notice indicates that once the election forms are available, the Investment Plan/Manager, as applicable, is required to file the election with the Minister "in prescribed form and manner" in respect of the period for which the letter of intent was filed.

4. Register a Group of Investment Plans for the Consolidated filing election: The Manger should send a letter of intent to register the group of Investment Plans to the Summerside Tax Centre, 275 Pope Road, Summerside, PE C1N 6A2 containing the following information:

    - the legal name and contact information for the investment plan manager (telephone number and mailing address) with respect to the group being registered;
    - the name and address of the investment plans in respect of which the group registration would apply;
    - the effective date of the intended registration;
    - the name of the group based on the following standardized naming convention: Consolidated SLFI group – legal name of investment plan manager – unique name to identify the group; and
    - signature of an authorized signatory of the investment plan manager.

    The CRA says that once the registration form is prescribed, the Manager would be required to file the registration form with the Minister in prescribed form and manner.

5. Qualifying Small Investment Plan Election to be a SLFI: The Investment Plan should send a letter of intent to the Summerside Tax Centre, 275 Pope Road, Summerside, PE C1N 6A2 containing the following information:

   - the name, business number and contact information (telephone number and mailing address) of the Investment Plan;
   - a statement of intent to file the election for a qualifying small investment plan to be an SLFI;
   - the first fiscal year of the investment plan for which the election is to be effective; and
   - signature of an authorized signatory of the investment plan.

   Once the election form is prescribed, the plan is required to file the election with the Minister, in prescribed form and manner, in respect of the period for which the letter of intent was filed.

6. Elections not required to be filed with the Minister: The Investment Plan should keep a document in its books and records evidencing its intent to make a particular election. The document should include:

   - the name of the Investment Plan;
   - a statement of intent to make the particular election;
   - the first day of the period for which the election would apply; and
   - a signature of an authorized signatory of the Investment Plan.

   Once the election form is prescribed, the Investment Plan is required to make the election in prescribed form and manner, in respect of the period for which the document setting out its intent was made and to keep the election in its books and records.

7. Election to exclude non-residents in the provincial attribution percentage calculations: The Investment Plan should send a letter of intent to the Summerside Tax Centre, 275 Pope Road, Summerside, PE C1N 6A2 containing the following information:

   - the name, business number and contact information (telephone number and mailing address) of the Investment Plan;
   - a statement of intent to file the election to exclude non-residents from the calculation of the provincial attribution percentage;
   - the first day the election would be in effect; and
   - signature of an authorized signatory of the Investment Plan.

   The CRA says that once the election form is prescribed, the Investment Plan would be required to file the election with the Minister in prescribed form and manner, in respect of the period for which the letter of intent was filed.