



**Securing & Sustaining
“Mutual Fund Trust” Status – Tips & Traps**

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Part I

Securing and Sustaining “Mutual Fund Trust” Status – Tips & Traps

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Agenda – Mutual Fund Trusts

- I. Mutual Fund Trust Status – An Overview**
- II. Basic Qualification Requirements**
- III. Retroactive MFT Status Election**
- IV. Loss of MFT Status – Mitigation Strategies**

“Mutual Fund Trust”

A conventional, *inter vivos* trust that satisfies certain qualifying conditions set out in the *Income Tax Act* and the regulations thereunder (the “**Tax Act**”).

- As of December 2010, interests in mutual funds and mutual fund wraps accounted for almost 27% of Canadians’ financial wealth
- As of June 2010, almost 35% of Canadian households invested in mutual funds

Advantages of MFT Status

- Units may be “qualified investments” for RRSPs, RRIFs, RESPs, TFSAs and other registered plans
- Exemption from Part XII.2 tax
- Capital gains refund mechanism
- Exemption from alternative minimum tax
- Exemption from 21 year deemed disposition rule

Mutual Fund Trust Misconceptions

- “Mutual fund trust status can’t be lost.”
- “There are no real limits on non-resident ownership of a mutual fund trust.”
- “All a trust needs are 150 unitholders to achieve mutual fund trust status.”
- “The activities of mutual fund trusts are unrestricted.”
- “Redemption rights associated with the units of a mutual fund trust may be significantly limited.”

Basic Qualification Requirements

Five statutory tests must be satisfied for a trust to qualify as a “mutual fund trust” at any particular time:

1. “Trust” test
2. “Unit Trust” test
3. “Resident in Canada” test
4. “Sole Undertaking” test
5. “Prescribed Conditions” test

“Trust” Test

- A “mutual fund trust” must be a trust
- Three “certainties” of a trust
- Proper formation, documentation and administration
- CRA audit initiatives – several focused on trusts and trust-related issues



“Unit Trust” Test

- “*inter vivos* trust the interest of each beneficiary under which was described by reference to units of the trust” and one of two conditions is satisfied

“Redeemable on demand” condition

1. Issued units have conditions requiring the trust to accept, at the demand of the holder and at prices determined and payable in accordance with the conditions, the surrender of the units.

“Unit Trust” Test

2. The fair market value of such units was not less than 95% of the fair market value of all of the issued units of the trust.

Property Holdings condition

- Restrictions on activities/types of property owned
- Income source requirements
- Restrictions on concentration of property holdings

“Resident in Canada” Test

- Evolving jurisprudence
- Historical perspective – many focused on residence of the trustee
- Recent jurisprudence focusing more particularly on the situs of the management and control of the trust (*Garron*)

“Sole Undertaking” Test

- Permitted undertakings
 - Investing of funds in property (other than rights/interests in real property); and
 - Acquiring, holding, maintaining, improving, leasing or managing rights/interests in real property that is capital property of the trust
- Trust cannot carry on business
- Special statutory deeming rules

“Prescribed Conditions” Test

- Prescribed conditions contained in Regulation 4801
- Two basic prescribed tests:

1. A class of units is “qualified for distribution to the public”; or

There has been a lawful distribution of units to the public and a prospectus, registration statement, or similar document was not required to be filed in respect of the distribution.

“Prescribed Conditions” Test

2. In respect of any one class of units of the trust that satisfied the first test:
 - There are no fewer than 150 beneficiaries, each of whom holds:
 - Not less than one “block of units” of the class; and
 - Units of the class having an aggregate fair market value of not less than \$500

“Prescribed Conditions” Test

“Block of Units”

- a) 100 units, if the fair market value of one unit of the class is less than \$25,
- b) 25 units, if the fair market value of one unit of the class is \$25 or more but less than \$100, and
- c) 10 units, if the fair market value of one unit of the class is \$100 or more.

“Prescribed Conditions” Test

Group Holdings

- Special deeming rules in the *Income Tax Regulations* may apply to aggregate smaller group holdings to represent a “beneficiary” holding a “block of units” having a fair market value of not less than \$500



Retroactive Status Election

- If a trust becomes a “mutual fund trust” at any particular time before the 91st day after the end of its first taxation year, and the trust properly elects in its first tax return, the trust is deemed to have been a “mutual fund trust” from the beginning of its first taxation year until the particular time.

Jan. 1, 2011



March 30, 2012

Loss of Mutual Fund Trust Status

- Failure to Satisfy Qualification Requirements
- Trust established or maintained primarily for the benefit of non-residents
 - Statutory provision historically in flux
 - Objective, point-in-time test
 - Not applicable if substantially all of the property of the trust is not “taxable Canadian property”
 - Permanent loss of status

Loss of Status Mitigation Strategies

- Initial Loss of Status Saving Provision
 - “Redeemable on demand” condition / “Prescribed Conditions” Test
 - Applies in respect of calendar year in which status is lost
 - Trust required to have been a “mutual fund trust” at the beginning of the year
- “Registered Investment” Approach
 - May permit preservation of “qualified investment” status

Questions



Cautionary Note

The foregoing commentary is summary in nature and does not address all of the issues and considerations that may be relevant under any particular set of circumstances.

The statements and material presented herein do not represent legal or tax advice.

No transactions should be executed on the basis of the foregoing statements, diagrams, and commentary. Formal legal, tax, and accounting advice should be obtained prior to making any investment or executing any transaction.



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