

## Loss of “Mutual Fund Trust” Status: Temporary Statutory Relief

In times of upheaval, changing asset values and heightened unitholder redemption requests can cause a trust to cease to be a “mutual fund trust” for the purposes of the *Income Tax Act* (Canada) (the “**Tax Act**”). However, a special provision of the Tax Act can potentially provide temporary relief if a trust ceases to be a “mutual fund trust”.

### Qualification as a “Mutual Fund Trust”

To qualify as a “mutual fund trust”, a trust must generally satisfy the following conditions on an ongoing basis:

- (a) The trust must be resident in Canada for the purposes of the Tax Act;
- (b) The trust must be a “unit trust” for the purposes of the Tax Act;

*To qualify as a “unit trust”, the trust must generally pass one of the following tests:*

*(i) at least 95% of the units of the trust (based on their fair market value) have conditions attached to them requiring the trust to accept, at the demand of the unitholder and at prices determined and payable in accordance with the conditions, the surrender of the units (the “**Redeemable on Demand Condition**”), or*

*(ii) the assets, activities and income of the trust satisfy a prescribed set of character and dispersal requirements.*

- (c) The trust must restrict its undertakings to (i) the investing of its funds in certain property, and (ii) certain activities relating to real property; and

- (d) The trust must satisfy certain prescribed conditions, including the requirement that 150 separate unitholders each hold, in respect of a single qualifying class of units, not less than one “block of units”<sup>1</sup> of the class having an aggregate fair market value of at least \$500 (the “**150 Unitholder Condition**”).

Under certain circumstances, a trust may also cease to be a mutual fund trust if it can reasonably be considered to have been established or maintained primarily for the benefit of non-residents.<sup>2</sup>

## Temporary Preservation of “Mutual Fund Trust” Status

The Tax Act contains a special provision – subsection 132(6.2) of the Tax Act – that generally provides that:

- (a) if a trust was a “mutual fund trust” at the beginning of a particular calendar year, and
- (b) the trust ceases to be a “mutual fund trust” during that year solely because it failed to satisfy (i) the Redeemable on Demand Condition, or (ii) the 150 Unitholder Condition,

*the trust will be deemed to be a “mutual fund trust” for the duration of the calendar year.*

In effect, subsection 132(6.2) of the Tax Act grants a trust the ability to re-establish its qualifications as a “mutual fund trust” by the end of the calendar year without ever losing the benefits afforded to a mutual fund trust under the Tax Act.

***This summary is for informational purposes only. No transactions should be executed, or decisions made, based on the contents of this summary alone. Investors and investment funds should seek independent legal advice prior to executing any transaction.***

For more information, please contact:

Toronto

Michael Friedman

416.865.7914

[michael.friedman@mcmillan.ca](mailto:michael.friedman@mcmillan.ca)

---

<sup>1</sup> What constitutes a “block of units” is specifically defined in Regulation 4803(1) of the *Income Tax Regulations*.

<sup>2</sup> For further information on the conditions that must be satisfied for a trust to constitute a “mutual fund trust”, please see <https://mcmillan.ca/webfiles/Preparing-for-Unexpected-Tax-Traps-for-Investment-Funds-in-Midst-COVID-19-Pandemic-PMAC.pdf>.

## Appendix: Example

The following example illustrates the potential application of subsection 132(6.2) of the Tax Act.

### Factual Background

The ABC Fund was formed on March 1, 2018.

At all times, the ABC Fund was a “unit trust” for the purposes of the Tax Act because all of its units satisfied the Redeemable on Demand Condition.

From March 1, 2018 until April 1, 2020 the ABC Fund satisfied all of the conditions to qualify as a “mutual fund trust” for the purposes of the Tax Act.

As a consequence of the COVID-19 pandemic, more than half of the unitholders of the ABC Fund redeemed their units on April 1, 2020 such that, after the redemptions, the ABC Fund had only 90 unitholders that each held a “block of units” of the same class having a fair market value of at least \$500.

### Analysis

Absent subsection 132(6.2) of the Tax Act, the ABC Fund would have ceased to be a “mutual fund trust” on April 1, 2020. However, since the ABC Fund was a “mutual fund trust” at the beginning of 2020, so long as the only reason that the ABC Fund ceased to be a “mutual fund trust” was because it did not satisfy the 150 Unitholder Condition, the ABC Fund will be deemed to be a “mutual fund trust” until the end of 2020.

If the ABC Fund does not attract at least an additional 60 qualifying unitholders by the end of 2020 (such that it will again satisfy the 150 Unitholder Condition), the ABC Fund will no longer be a “mutual fund trust” beginning on January 1, 2021.

April 9, 2020

© McMillan LLP 2020