BUDGET 2017: "SWITCH" FUND REORGANIZATION RULES INTRODUCED

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In Budget 2017, the federal Government proposed new rules that will permit mutual fund corporations constituted as “switch” funds to be reorganized, on a tax-deferred basis, as separate mutual fund trusts. The new reorganization proposals come as welcome relief to members of the investment fund community that have strongly asserted that the restrictions on “switch” funds introduced as part of Budget 2016 have created operational difficulties without offering any avenue to efficiently respond to the legislative amendments.

Background

In Budget 2016, the federal Government introduced legislative proposals to effectively prohibit investors in mutual fund corporations from exchanging their shares of a particular class for shares of a different class on a tax-deferred basis.

Historically, many mutual fund corporations were established with multiple, separate classes of shares. The equity invested in each class of shares was dedicated to the acquisition of a separate pool of underlying investments. Investors in such mutual fund corporations were permitted to exchange their shares of a particular class (corresponding to a particular pool of assets) for shares of another class (corresponding to a different pool of assets) on a tax-deferred basis by virtue of certain rollover provisions in the Income Tax Act (the “**Tax Act**”). These multi-class mutual fund corporations became known as “switch” funds.

However, in Budget 2016, the Government asserted that the ability of investors in “switch” funds to exchange their shares, on a tax-deferred basis, for new shares that tracked a different investment portfolio raised policy concerns. Accordingly, the Government proposed to amend the Tax Act to provide that exchanges of select shares of one class of a mutual fund corporation for shares of another class could only occur on a taxable basis. (For further details on the Budget 2016 proposals relating to “switch” funds, please see our previous bulletin on the topic, accessible here.)

Budget Proposals

In the months following the release of Budget 2016, members of the investment fund community called for the

Government to introduce legislative amendments that would permit the assets associated with a particular class of shares of a "switch" fund to effectively be reorganized as a separate mutual fund trust on a tax-deferred basis.

The Tax Act currently permits a mutual fund corporation to be reorganized as a single mutual fund trust; however, the existing reorganization rules do not permit a mutual fund corporation constituted with several separate classes of shares to be reorganized into more than one mutual fund trust.

The Government has accepted the concerns voiced by members of the investment fund community and now proposes to amend section 132.2 of the Tax Act to permit the reorganization of a mutual fund corporation, which is structured as a "switch" fund, into multiple mutual fund trusts on a tax-deferred basis.

Under the proposed amendments, a tax-deferred reorganization of a "switch" fund into multiple mutual fund trusts will be permitted where, among other things, (i) all or substantially all of the assets associated with the particular classes of shares of the "switch" fund are transferred to one or more mutual fund trusts, and (ii) in exchange for their shareholdings, the shareholders of a particular class of the "switch" fund solely receive units in a new mutual fund trust to which the assets associated with their previous shareholdings were transferred.

The new reorganization rules relating to "switch" funds will apply to qualifying reorganizations that occur on or after March 22, 2017.

by Michael Friedman

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.