Submission to the
The Minister of Finance,
the House of Commons Finance Committee
and the Senate Banking, Trade and Commerce Committee

Recommendation to revise Bill C-10 and the application of “non-resident trust” rules to Canadian pension funds

December 11, 2007

The Pension Investment Association of Canada (PIAC) has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC’s member funds are responsible for the oversight and management of over $910 billion in assets on behalf of millions of Canadians. PIAC’s mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

Provisions set out in Bill C-10 (known as Bill C-33 in the previous parliamentary session) would enact new “non-resident trust” (NRT) rules in the Income Tax Act. The general intention of the provisions is to address concerns relating to tax avoidance by Canadians involving the use of offshore trust vehicles.

But the NRT proposals, if enacted without amendment, would inappropriately and unnecessarily (1) expose tax-exempt Canadian pension funds to possible significant tax liabilities, (2) lead them to avoid potential investments that would otherwise be in their best interests, and (3) cause them unreasonable tax compliance costs. This would occur despite the fact that Canadian pension funds are heavily regulated and subject to extensive regulatory oversight, and despite the fact that Canadian pension funds have no reasons to avoid Canadian income tax by using offshore trust vehicles to invest, since they are exempt from income tax in Canada.
The Pension Investment Association of Canada (PIAC) strongly recommends that the NRT proposals be amended so that the NRT regime would not apply to registered pension funds. There is no sound policy rationale for applying the NRT regime to registered pension funds, and it will result in significant and unnecessary costs for Canadian pension funds.

Canadian pension funds are generally exempt from income tax under the Income Tax Act, whether they invest inside or outside of Canada. These funds do not have a motive to invest outside of Canada in order to avoid the Canadian income tax regime – to the contrary, they may have a preference to invest in Canada, because their Canadian non-taxable status is generally not replicated when they invest outside of Canada. The benefits to Canadian pension funds from investing abroad as well as domestically (in terms of diversification, risk reduction, and potential higher long-term returns) has been recognized by the federal government – among other things, the previous foreign content limit was eliminated altogether from the Income Tax Act in 2005.

As proposed, a foreign trust will be subject to the NRT rules if it has a Canadian-resident contributor (whether or not the Canadian resident is taxable in Canada). When the foreign trust is subject to the NRT rules, the trust is deemed resident in Canada for tax purposes and becomes liable for Canadian tax on its worldwide income. Canadian-resident contributors to the trust (including tax-exempt pension funds) will be jointly and severally liable with the trust for those Canadian tax obligations.

While the NRT rules would not apply to “exempt foreign trusts”, that exemption is very narrowly drafted, and in many situations it will not even be possible for an investor to be aware of whether or not the exemption applies to a particular foreign trust.1

Examples of foreign trusts that many Canadian pension funds are already invested in, likely to the degree of billions of dollars, are investment funds that are trusts established outside Canada and which invest primarily in non-Canadian securities; publicly-traded trusts listed on foreign stock exchanges (such as non-Canadian real estate investment trusts, or REITs); and vehicles established as trusts under foreign laws to hold direct investments of Canadian pension funds in other countries (such as private equity, real estate, or infrastructure investments). If the NRT regime is applied to Canadian pension funds, they will be forced to divest of many of these holdings, and avoid them altogether in their future investment activities. Some foreign trusts are already prohibiting investments by Canadian investors in light of the proposed investment rules – thereby limiting the investment alternatives available for Canadian pension funds. The overall effect will be to leave Canadian pension funds with investment portfolios that are sub-optimal.

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1 Notably, Mercer Human Resource Consulting recently stated concerning the proposed NRT rules, “[Pension funds] these entities will generally not be able to make an independent determination as to the tax status of the foreign trust investment and its holders. They will need to rely on the foreign trust to provide the necessary information. It is questionable whether the foreign trust will itself be willing to shoulder the Canadian compliance burden.” (Mercer Communiqué: Non-resident Trust Rules Impact Registered Plans, November 20, 2007).
Canadian capital markets represent a very small proportion of global capital markets, and diversification beyond the Canadian markets is essential to the establishment of prudent portfolios for Canadian investors. As the October 2007 federal budget correctly recognized, “Increased access to global capital markets and a wider range of investment instruments will provide greater opportunities to earn higher returns.” That budget also proposed certain measures to lower tax barriers for domestic investors in international markets.

But, without amendment, the NRT proposals would cause a significant and unnecessary impediment for Canadian pension funds investing outside of Canada in order to meet their financial obligations to their pension plan members. PIAC believes that public policy should promote a sound retirement income system for Canadians, and unnecessarily limiting the investment opportunities available for Canadian pension funds (as well as exposing them to significant potential tax costs that diverge from the general scheme of taxation of pension funds in Canada) would be inconsistent with that objective.