Tax memo

Canadian tax updates

pwc

Asset management industry tax issues: France's new filing requirements and Canada's prohibited investment rules

Explains the implications of changes to France's filing requirements and outlines limited relief from Canadian prohibited investment rules.

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This *Tax memo* discusses two recent tax items of interest to those in the asset management industry. First, new French filing requirements that could affect trustees of Canadian trust funds are outlined, followed by recent changes to the prohibited investment rules.

1. France's new filing requirements for Canadian investment trusts

The French parliament adopted the Amended Finance Bill for 2011 on July 31, 2011, which provides new rules regarding the taxability of trust assets for wealth tax purposes and related reporting requirements. The purpose of the new French Tax Reform is to clarify and complete existing tax provisions as they apply to trusts. The legislation was enacted to plug holes in the taxation of trusts that the administration discovered during its voluntary disclosure program in 2010. The new provisions apply as of January 1, 2012.

Article 1649AB of the French General Tax Code introduced an obligation for a trustee to report to the French tax administration certain information relating to the trust. The administration released its Instruction on July 18, 2012. This indicated that it will be formalizing the contents of the reporting obligations in a decree in the "near future," but this decree has not yet been released.

Based on the information that has been released, there are new filing requirement(s) if you are a trustee of certain trusts and if any of the following fact-specific criteria applies:

- the grantor/settlor is a French resident;
- at least one of the beneficiaries is a French resident; or
- the trust has assets located in France.

Exceptions are expected, which could apply to Canadian investment trusts. However, the final form will not be released until the decree is released.

Filing requirements

If a Canadian trust is subject to these new filing requirements, the trustee is required to file an annual declaration regarding:

- the creation, modification, or termination of the trust;
- the principal terms of the trust document; and
- the market value of the trust assets as of January 1 each year.

This annual declaration is mandatory, regardless of any liability to pay French tax.

Deadlines and penalties

The filing deadline was originally June 15, 2012 and has since been extended to September 15, 2012. Going forward, the filing deadline would be June 15 following the taxation year end.

Failure to file the annual declaration will result in a penalty that is the higher of:

- €10,000; and
- 5% of the trust assets.

Beneficiaries of the trust and the trustee are jointly liable for payment of the penalty.

PwC observations

We emphasize caution with respect to the implications of the new French Tax Reform, because many questions are still outstanding. We suggest that you:

1. Identify the trusts that you administer for which the grantor or beneficiary are French residents. Citizenship is not a factor; look instead to where the beneficiary lives.

2. Identify the trusts that you administer that have assets located in France, such as securities of French issuers.

3. Maintain close communication with the interested parties and your tax liaison or tax department with respect to these trusts. This is key to ensuring that all reporting requirements and potential payment obligations can be met on time.

The decree, expected in the next month, should provide further French tax administration guidelines. This should provide further insight and clarification regarding the details, requirements and reporting deadlines of the new French Tax Reform and will allow trustees of Canadian investment trusts to determine their reporting obligations. PwC will continue to monitor the development of these French trust filing requirements.

The drive for transparency has resulted in several countries implementing tax reporting regimes that affect foreign investors. We expect that more countries will introduce some form of these tax regimes. For example, this month, a committee of the U.K. parliament recommended that the U.K. government introduce legislation similar to relevant sections of the U.S. Foreign Account Tax Compliance Act (FATCA).

2. Finance recommendations provide some relief from prohibited investment rules

The extension of the prohibited investment rules to RRSPs and RRIFs (registered plans) announced in the 2011 federal budget and implemented as part of Bill C-13 has received considerable scrutiny by concerned members of the tax community.

One major criticism is that the rules go far beyond the policy objective of preventing certain perceived abuses using registered plans. This has resulted in taxpayers inadvertently being caught by the broad scope of the rules.

To address some of these concerns, the Department of Finance (Finance) responded in a comfort letter to the Joint Committee on Taxation of The Canadian Bar Association and The Canadian Institute of Chartered Accountants that it is prepared to recommend a number of technical amendments to the prohibited investment rules, to apply retroactively after March 22, 2011. Finance indicated that it was also responding to the Investment Funds Institute of Canada, the Portfolio Management Association of Canada and the Alternative Investment Management Association, three industry groups that also have been pushing for changes to these rules as they affect the investment industry.

Of particular significance to the asset management industry are the proposed amendments to narrow the definition of a prohibited investment.

- Finance proposes to amend the definition of a prohibited investment to ensure these rules do not apply when the annuitant both lacks a significant interest in, and deals at arm's length with, the issuer. To this end, Finance proposes to eliminate from the part of the definition of prohibited investment, that makes a share of, interest in or a debt of the issuer corporation, trust or partnership a prohibited investment for a registered plan when the plan annuitant holds a significant interest in an entity that does not deal at arm's length with the issuer. This proposed change will be of particular interest to individuals who may have a significant interest in an investment manager and for whom the current rules may be problematic.

- Finance also recommends a new exclusion from the definition of prohibited investment when certain conditions are met. In general, the proposed amendment is intended to exclude certain investments from the definition of prohibited investment if, in general, 90% of substantially similar investments are held by persons dealing at arm's length with the plan annuitant and there is no tax avoidance purpose. This change will address situations in which the value of an annuitant's direct investment through a registered plan is small, relative to the capitalization of the entity, and is substantially the same as the investment of numerous other arm's length parties in the same entity. This proposed change will provide relief for registered plans investing in a class or series of shares of a mutual fund corporation that may represent a significant interest in the corporation.

- The current rules provide a limited exclusion from the definition of a prohibited investment for certain investment funds during their start-up phase. This concession applied only to mutual fund trusts and mutual fund corporations that are subject to, and substantially comply with *National Instruments 81-102*. Concerns were raised that this exclusion was too narrow and did not address similar circumstances in the wind-up phase of an investment fund. In response, Finance recommended expanding this carve-out to registered investments, provided these funds meet a basic diversification test and are not established with a tax avoidance objective. Finance also recommended expanding this exclusion to accommodate a reasonable wind-up period.

As well, Finance recommended changes to the transitional measures that provide, if an election is filed before July 2012, partial relief from the 100% advantage tax on income and capital gains from prohibited investments held by a registered plan on March 23, 2011 for the period after March 22, 2011 and before 2022. Finance has recommended the removal of the termination date, in effect providing for an indefinite transitional period. Subsequent to the release of the comfort letter, Finance also announced that it will be recommending that the June 30, 2012 deadline to make the transitional relief election be extended to December 31, 2012.

The proposed amendments recommended by Finance alleviate some of the far-reaching effects of these rules. However, a number of technical issues and practical concerns raised by the Joint Committee and other interested organizations representing the investment community have not been addressed. Further, draft legislation effecting these proposed changes has yet to be released and will require close review.

For more help

If you have questions on France's new rules or Canada's prohibited investment rules and the proposed amendments to them, please contact your PwC adviser or the individuals listed below.

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