Research Advisory

Canadian Research Group

Hewitt

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Highlights

Proposed tax changes may impact pension fund investment.

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The Hewitt Research Advisory is a regular Hewitt newsletter designed to provide a detailed overview of specific legislative and regulatory developments in Canada relating to human resources.

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Status Update: Proposed New Tax Rules for Pension Fund Investments

Background

Bill C-33, *An Act to amend the Income Tax Act*, *including amendments in relation to foreign investment entities and non-resident trusts*, was originally introduced on November 22, 2006 and amended through the Committee process. The Bill was not passed during the previous session of Parliament, and was re-introduced as Bill C-10 on October 29, 2007. After third reading in the House of Commons, the legislation was referred to the Senate Committee on Banking, Trade and Commerce for debate, where it remains. The legislation has not yet become law.

The intention of the draft legislation is to address tax avoidance by Canadians using offshore trust vehicles. The issue being considered by the Senate is whether to apply these proposed rules where the taxpayer is tax-exempt, such as a pension plan or other non-taxable entity. In this regard, the Pension Investment Association of Canada (PIAC) made a submission to the Senate recommending that the Non Resident Trust (NRT) proposals be amended such that they would not apply to registered pension funds.

The Proposed New Rules

The legislation amends taxation rules, effective for trust taxation years beginning after 2006, to provide that if a Canadian resident contributes property to a non-resident trust, such a trust is deemed resident in Canada. As a result, the contributor, the trust, and certain Canadian-resident beneficiaries may become jointly and severally liable to pay Canadian tax on the trust's worldwide income.

Exemptions for certain foreign trusts have been proposed but generally do not apply to trusts established for retirement or employee benefits. As well, Bill C-10 requires taxpayers who invest in "foreign investment entities" to include income amounts attributed to their investment in

such entities when calculating their total income, subject to provisions designed to prevent double taxation.

In the context of pension funds, a potential ramification of the legislation is that pension plans may be taxed on all Canadian income if they hold investments such as: deemed NRTs; non-Canadian Real Estate Investment Trusts (REITs); trusts established outside Canada which invest primarily in non-Canadian securities; publicly-traded trusts listed on foreign stock exchanges; and vehicles established as trusts under foreign laws to hold direct investments of Canadian pension funds in other countries.

In their submission to the Senate, PIAC stated that as a result of these proposed new investment rules in Canada, some foreign trusts are already prohibiting participation by Canadian investors.

Hewitt Comment: *If Bill C-10 is passed in its present form, pension funds will no longer be able to invest in commingled vehicles established under an NRT, including foreign domiciled pooled funds and foreign domiciled REITs, without attracting negative tax consequences. As a result, plan sponsors will need to examine alternative investment strategies in order to achieve similar objectives. As well, plan sponsors may no longer have access to the same investment managers.*

In addition, if Bill C-10 is passed in its present form it will, subject to certain exceptions, be retroactive and apply to taxation years or fiscal periods that begin after 2006, and to dispositions and exchanges that occur after 2006. As a result, even if pension funds divest themselves of the NRTs, there will still be tax consequences arising from 2006 to the point of divestiture.

Hewitt will continue to keep you informed as developments warrant. Pension plan sponsors would be well advised to obtain legal and investment advice on point.

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