



INVESTMENT INDUSTRY ASSOCIATION OF CANADA  
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Ian C.W. Russell, FCSI  
President & CEO

August 24, 2006

Mr. David Wilson, Chair  
Ontario Securities Commission  
20 Queen Street West, Suite 800, Box 55  
Toronto, ON M5H 3S8

Dear Mr. Wilson:

I am writing on behalf the Investment Industry Association of Canada's members to request an opportunity to meet with you and your staff to discuss the status of proposed IDA By-Law 39 (and Appendices B & D) permitting the incorporation of registered brokers of IDA member firms (the Proposed By-law). We have recently become aware of reluctance on the part of Commission staff to approve the Proposed By-law and would like to understand the reasons underlying this position.

The Proposed By-law, an extension of the existing By-Law that allows the principal-agent relationship, was approved by the IDA Board of Directors and submitted to the OSC for formal approval in January 2006. We note that the issue of advisor incorporation in the investment industry has been under review since prior to 1999 when the MFDA rules prohibiting this structure were temporarily suspended in recognition of such structures having existed in the industry for some time, with such suspension due to expire on December 31, 2006.

As you know, the Canadian securities industry worked closely with SRO staff over a two-year period, consulting regularly with Commission staff, to develop the Proposed By-Law that obligates the member firm and the incorporated entity, both through contractual arrangement and legal precedent, to comply with all applicable SRO laws and meet the standards of supervision and liability for the incorporated entity that is presently applicable to the firm and the individual broker in both the employer/employee and principal/agent models. Legal opinions confirming this outcome were provided by Davies Ward Phillips Vineberg and Borden Ladner Gervais and have been filed with the OSC. A condensed version of Borden's opinion previously submitted to the OSC in support of the Proposed By-Law in March 2006 and Davies' original opinion (without attachments), are attached for your reference. It should be further noted that the principal/agent model has a similar mechanism imposing compliance, supervision and liability and has been in effect for the past three years without incident.

The incorporated structure provides flexibility for the Canadian investment dealer industry to respond effectively to the changing organizational structure of financial service operations. In recent years the relationship between a member firm and an individual broker has been evolving into relationships between the member firm and broker groups. This was recognized by certain securities commissions in Canada including the OSC with the grant and subsequent extension of the MFDA incorporation exemption. These broker groups operate within existing member firms

with operations that are increasingly independent, in terms of the advisory and product lines, branding, location and control over business revenues and operating expenses while maintaining regulatory compliance with applicable laws and liability to clients by the firm. The corporate model offers the most tax-efficient structure for these groups to manage business cash flow and disbursements, provide for efficient succession planning and business transfer, provide tax planning flexibility, extend limited liability for the non-core ancillary business and provide efficient governance.

We understand that a similar structural evolution has been underway for some time in the U.S. securities industry although the design of the corporate structure is somewhat different reflecting differences in our tax systems. We understand that investment advisors are permitted to "roll up" revenue into personal and professional corporations which are not registered, recognizing revenue in such corporations and deducting related expenses to determine taxable net income. The Canadian tax system, however, does require the corporate entity to carry on the business earning the taxable revenue in order for the corporate entity to properly recognize the revenue.

The Proposed By-law is also important to the investment dealer industry to achieve uniformity in organizational structure across the wealth management sector that will enable restructuring for the efficient delivery of financial services. At present, mutual fund registrants and insurance brokers are permitted to utilize incorporated entities. Investment dealer firms are interested in attracting mutual fund registrants to the IDA business platform to broaden distribution capabilities and similarly mutual fund registrants that have been operating within corporate structures for a number of years are interested in migrating their businesses to IDA firms. However, the inability for investment dealer registrants to incorporate creates a barrier preventing the migration of mutual fund registrants to IDA member firms. There is no rationale why this distribution structure should be permitted to continue within MFDA firms but not permitted at all within IDA firms. We would be pleased to discuss the current MFDA model with you at our meeting. We also note that other professionals in Canada as well as the U.S. such as lawyers, accountants and doctors are able to incorporate thereby taking advantage of the corporate model and its advantages.

We recognize that any new business structure related to investment services must meet the required standard of integrity to protect the investing public. Considerable effort has been taken in the design of the Proposed By-Law to ensure that standard has been met. We have demonstrated a strong business case for incorporation, a structure we believe is integral to the cost-effective delivery of financial services, the facilitation of fair and open competition in the wealth management business and the standardization of industry practices while maintaining investor protection. Regulations should not impose barriers to restructuring business operations to promote efficient markets, where the result does not undermine the integrity of the marketplace. We respectfully submit that proposed By-law 39 meets the public interest standard and would appreciate an opportunity to make our case with you and your staff.

Yours sincerely,



Attachments





August 23, 2006

Ms. Morag MacGougan  
Vice-President  
Investment Industry Association of Canada  
Suite 1600  
11 King Street West  
Toronto, Ontario  
M5H 4C7

Dear Morag:

**Re: Incorporated Salespersons**

You have asked us to summarize our views with respect to proposed amendments to the by-laws of the Investment Dealers Association of Canada ("IDA") relating to the relationship between IDA Members and their agents who are "Sales Company/Agents" as defined. In short, the proposed amendments to IDA By-law 39 will permit individuals who would otherwise be the employees or agents of a Member to conduct their activities as registrants through an incorporated entity which would be an agent of the Member.

We are of the view that the legal and regulatory concerns that have been or will likely be identified in connection with Members conducting securities related activities through incorporated salespersons under the proposed IDA By-law 39 amendments can be satisfied through a combination of IDA Rules, legislation, agreements and disclosure practices. In this respect, the proposed amendments to By-law 39 appear to us to address the required safeguards.

As you know, we have provided to you detailed written analyses of individual salespersons of IDA Members conducting securities-related activities either (i) as employees or individual agents of Members or (ii) as incorporated salespersons. Subject to the discussion in those detailed analyses, it appears to us that the level of legal and regulatory risk that would exist if incorporated salespersons were permitted pursuant to the amendments to IDA By-law 39 would not be materially greater than arises from the current permitted use by Members of either employees or individual agents. In this regard, we have considered a number of legal and regulatory matters such as the extent of membership supervision, the liability of incorporated salespersons and Members to customers, bonding and insurance, access to records and premises and others.

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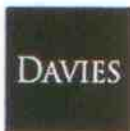
There is no doubt that the use of incorporated salespersons introduces a further degree of complexity and, therefore, risk in the regulation of investment dealers (as was the case with the introduction of individuals as agents), but an adequate framework of legal and regulatory protection has, in our view, been established with the introduction of the proposed amendments to IDA By-law 39.

We refer you to our detailed analyses referred to above and we note that we have not been asked to advise or comment on the relevant income tax implications to Members or salespersons. We will be pleased to discuss the foregoing with you at your convenience.

Yours very truly,

A handwritten signature in cursive script, appearing to read "RPH/ck".

RPH/ck



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January 12, 2006

Ronald S. Wilson  
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rwilson@dwpv.com

File No. 21498

**DELIVERED**

Investment Dealers Association of Canada  
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121 King Street West  
Toronto, ON M5K 3T9

**Attention: Ms Morag MacGougan**

Dear Sirs/Mesdames:

**Tax Treatment of Sales Company/Agents**

You have advised us that the IDA is proposing to enact amendments to its by-laws to permit corporations to carry on securities related activities as agents of IDA members ("Members"). Such corporations are referred to as "sales company/agents" in the proposed amendments. Proposed IDA By-law 39.5(p) provides as follows:

Where there is a relationship between a Member and a person who is a sales company conducting Securities Related Activities using the relationship contemplated in By-law 39.3(b)(ii), the Member shall:

- (p) along with the sales company/agent, be responsible for ensuring *all arrangements between the Member and the sales company/agent comply with applicable tax laws* and for providing satisfactory evidence to the Association of such compliance. *(emphasis added)*

Having regard to the foregoing requirement, you have asked us to comment on the tax treatment of sales company/agents under the *Income Tax Act* (Canada) (the "ITA"). This letter is a follow-up to an earlier letter to you dated September 24, 2001 (the "First Letter") in which we advised you on the arrangements required to permit individual sales representatives of Canadian securities dealers to qualify as independent contractors for



various purposes.<sup>1</sup> In preparing this letter, we have reviewed the proposed amendments to the IDA by-laws in their entirety.

Where a sales company/agent enters into an agency agreement with a Member and complies with the requirements of proposed IDA By-law 39.5, employee source deductions should not be required in respect of payments by the Member to the sales company/agent. This is because a company cannot be an employee. The one possible exception to the conclusion that employee source deductions should not be required would be if the facts were such that the legal relationship with respect of the provision of services was actually between the Member and the shareholders and employees of the sales company/agent and the shareholders and employees were not independent contractors. This should not be the case where Members enter into properly documented contractual arrangements with sales company/agents to receive the services of the sales company/agents and the parties comply with the terms and conditions of those contractual arrangements and do not contradict or ignore those arrangements in their dealings with each other or third parties. In coming to this conclusion, we have assumed that the sales company/agent will carry on its business with a level of independence and economic risk similar to that of a representative operating as described in the First Letter.

A sales company/agent may also be required to consider from time to time the extent to which certain provisions of the ITA are applicable to the sales company/agent or an investment in the sales company/agent. These provisions include the "personal service business" provisions in section 125 of the ITA, the various provisions in the ITA relevant to the availability of "income splitting" and the provisions with respect of the entitlement of a shareholder to benefit from the \$500,000 lifetime capital gains exemption. However, these provisions will generally only be relevant to the sales company/agent and its shareholders and thus should not be considered an aspect of the "arrangements between the

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<sup>1</sup> A copy of the First Letter is attached to this letter. The copy does not include the extensive schedules and research and case law commentaries which accompanied the First Letter.

Member and the sales company/agent". Accordingly, these provisions should not normally result in any issues for the Member.

Please call me at your convenience if you wish us to further comment on any aspect of the foregoing.

Yours very truly,

A handwritten signature in cursive script that reads "Ronald Wilson". The signature is written in dark ink and is positioned above the typed name.

Ronald S. Wilson

RSW/mel