



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

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Mr. Brian Ernewein  
General Director, Tax Legislation Division  
Finance Canada  
140 O'Connor Street, 17<sup>th</sup> Floor  
L'Esplanade Laurier, East Tower  
Ottawa, ON K1A 0G5

Dear Brian:

**Re: Extension in Definition of “qualified security” for purposes of securities lending**

On behalf of the Investment Industry Association of Canada (IIAC), I would like to request an amendment to the *Income Tax Act* (Canada) to extend the subsection 260(1) definition of “qualified security” to include exchange-listed units of non-Canadian trusts (that is, interests in certain non-Canadian trusts listed on foreign stock exchanges) through the addition to the qualified security” definition of words along the lines of the following:

- “(e) a qualified trust unit or
- (f) any other security issued by a trust (other than a debt obligation) that is listed on a stock exchange;”.

We believe that the proposed change would mean no loss of – and would likely lead to some small gain in – tax revenues for the government as little to no business in the above-mentioned area is undertaken in Canada at present since current tax provisions make the transactions tax-inefficient. In contrast, equivalent transactions are tax-effective in the U.S., meaning the benefits of the business and the related tax revenues from lending listed trust units accrue to tax authorities in the States. Our proposal will have a small gain in tax system efficiency as it will treat resident and non-resident trusts the same way. Also, capital markets efficiency will be enhanced, consistent with the goals of the Finance Minister’s capital markets strategy announced as part of *Advantage Canada* (Nov. 2006).

**Background**

We believe that there are two key factors to consider in reviewing our request: the business need for the amendment and ensuring no loss to government tax revenues.

**1. Business changes**

The IIAC, when previously part of the Investment Dealers Association of Canada, worked with Finance Canada in the 1980s, following growth in securities lending activity, on what became known as the section 260 securities lending rules. Securities lending promotes the liquidity of public capital markets by, for example, enabling short selling, to facilitate quick and efficient capital market transactions. The securities lending tax rules were introduced to enhance the confidence of market participants engaging in and volumes of securities lending by reducing tax uncertainty.

The security types included 20 years ago in section 260's definition of "qualified security" were the types then the object of growing securities lending activity, namely, shares and bonds of listed corporations, with no requirement in either case for the issuer to be resident in Canada. As capital markets and investment vehicles developed, so too did the need to update tax legislation and regulations to keep pace in an increasingly competitive global marketplace. Today, there is a demand for borrowing and lending of listed trust units as these instruments increasingly are used as an issuance vehicle. Recent changes expanded the definition of "qualified security" to mutual fund trust units. These are units of Canadian resident trusts, which meet the other mutual fund trust requirements. This proposal to broaden the definition of "qualified security" to include units or interests in trusts other than mutual fund trusts was consistent with the original objectives of fostering liquidity in Canadian securities markets as well as remove uncertainty regarding the tax treatment of securities loans.

**2. Preventing tax avoidance**

We recognize the need to avoid tax base erosion by preventing double access to preferred tax treatment (for example, by the borrower of a public company share claiming a deduction on a compensation payment with respect to a taxable dividend for which a tax credit is also claimed). The securities lending arrangement rules mitigate tax base erosion that could otherwise result from the extension of tax preferences associated with issuer payments on the loaned securities to borrower compensation payments. Exchange-listed units of non-Canadian trusts enjoy no special tax preferences associated with distributions if these securities were to be included in the definition of "qualified security".

**Conclusion**

Including exchange-traded trust units listed on foreign exchanges within the ambit of "qualified security" for purposes of subsection 260(1), as proposed in the preamble to this letter, would create a plain-language rule of general applicability that we believe is consistent with Finance Canada tax policy objectives, avoids erosion of the tax base and contributes to capital markets liquidity.

We would welcome the opportunity to discuss our proposal with you. Please let us know if you have any comments or we will contact you shortly to address any questions that you may have.

Yours sincerely,

