The Joint Committee on Taxation of
The Canadian Bar Association
and
The Canadian Institute of Chartered Accountants

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Mr. Gérard Lalonde
Director
Tax Legislative Division
Tax Policy Branch
Department of Finance
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140 O'Connor Street
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Dear Mr. Lalonde:

Specified Investment Flow-through ("SIFT") Conversion

On February 21, 2007, we provided you with our submission on the December 15, 2006 Department of Finance guidance on "normal growth." In our submission, we also commented on a number of matters relating to the conversion of a SIFT to a corporation. We are writing to provide further comments on measures to facilitate the conversion of a SIFT trust to a corporation.

We recommend that a provision that parallels subsection 85(3) of the Income Tax Act should be considered. Generally, such a provision would provide rollover treatment to a SIFT trust and its unitholders where the SIFT trust transfers common shares of a taxable Canadian corporation to its unitholders upon the redemption of their units. The provision could be applied successively to eliminate both a SIFT trust and any of its underlying subsidiary trusts. In this letter, we will refer to this provision as the SIFT Conversion Rule. As discussed below, we also recommend a separate provision to facilitate the elimination of subsidiary trusts of SIFTs, which would be accomplished by an amendment to the definition of "disposition" in subsection 248(1) of the Act.

SIFT Conversion Rule

The SIFT Conversion Rule (which could be included as new subsection 85(4)) would apply on an elective basis to a (i) a trust that would be a SIFT trust if the definition of SIFT trust in 122.1(1) were read without reference to the words "(other that a trust that is a real estate investment trust for the taxation year)", (ii) a trust that would have been a trust referred to in (i) on October 31, 2006 had the SIFT trust definition been in force and applied as of that date or (iii) a trust all of the beneficial interests in which (determined without regard to subsection 248(25)) are held by a trust described in (i) or (ii), where

(a) at any time, all or substantially all of the property of such a trust (the "transferor") is comprised of shares of a taxable Canadian corporation (the "subject corporation"),

(b) all or substantially all of the income and capital interests in the transferor outstanding at that time are disposed of to the transferor within 60 days after that time, and

(c) no person disposing of an income or capital interest in the transferor to the transferor within that 60 days period (otherwise than pursuant to the exercise of a statutory or other right of dissent) receives any consideration for the interest other than common shares of the subject corporation.

The SIFT Conversion Rule could be applied by a transferor that transfers its property (under subsection 85(1) of the Act or otherwise) to either an existing or a newly formed subject corporation that is controlled by the transferor or to an unrelated corporation. Alternatively, the trust could acquire the shares of the subject corporation on a rollover basis on the winding up of an intermediate partnership or trust. As a result, a trust could convert to a corporation through an internal reorganization or in connection with an acquisition or other transaction involving an unrelated corporation. We think it is reasonable to allow SIFT trust conversions involving corporations unrelated to the trust. Otherwise, taxpayers wishing to effectively do so would have to incur the costs involved in a two step transaction. The first step would involve a SIFT trust conversion with a wholly-owned corporate subsidiary which would then amalgamate with the unrelated corporation.

Elimination of "Subsidiary" Trusts

Many publicly-traded trusts hold interests in one or more subsidiary trusts which it would be desirable to eliminate, either in connection with a SIFT conversion or, if necessary, to satisfy the exception from the application of the SIFT provisions to real estate investment trusts. In order to facilitate the elimination of a subsidiary trust, we recommend that the definition of "disposition" in subsection 248(1) of the Act be amended to add that the following are not a disposition:

> (o) where the property is property of a trust all the beneficial interests in which (determined without regard to subsection 248(25)) are held by a taxpayer that is

(i) a trust that would be a SIFT trust if the definition of SIFT trust in 122.1(1) were read without reference to the words "(other that a trust that is a real estate investment trust for the taxation year)",or

(ii) a trust that would have been a trust referred to in (i) on October 31, 2006 had the SIFT trust definition been in force and applied as of that date,

a transfer of the property by the trust to the taxpayer on the winding-up of the trust,

(p) where the property is a capital interest of a taxpayer in a trust all the beneficial interests in which (determined without regard to subsection 248(25)) are held by the taxpayer and the taxpayer is referred to in either of subparagraphs (o)(i) or (ii), the extinguishment of the taxpayer's interest in the trust as a result of a transaction in which paragraph (o) applies

In conjunction with the above subparagraph 248(25.1) should be amended to provide that the taxpayer referred to in paragraph (o) is deemed to be the same trust as, and a continuation of, the trust referred to in paragraph (o).

Acquisition of Control

Although there is no Canadian tax law dealing specifically with the question of who controls a corporation where all of its shares are held by an income trust, the case law dealing with corporate control in the trust context more generally indicates that control lies with a trust's trustees, and the CRA has adopted this view in the income trust context.

We submit that control of a corporation should not be considered to be acquired, solely by virtue of a change in the trustees of the transferor or the wind-up of the transferor. Instead, we recommend the SIFT Conversion Rule should specify that, for purposes of determining whether control of a corporation has been acquired as a result of transactions to which either the SIFT Conversion Rule or the exceptions to the definition of "disposition" applies, the shares of a corporation held by a transferor should be deemed to be owned by the transferor's unitholders, *pro rata* based on the fair market value of the transferor units held by each unitholder, immediately before the transferor transfers those shares as part of such transactions.

SIFT Debt

We recommend the SIFT Conversion Rule include a rollover for holders of transferor debt obligations that are assumed by the transferee in the course of a SIFT trust conversion or exchanged for transferee debt. Such provision might be analogous to subsections 87(7) and 87(6).

We also recommend an amendment to address potential debt forgiveness issues that could arise where debt of a corporation (which is owned by a SIFT trust or subsidiary trust) is capitalized, or debt of a subsidiary trust is extinguished, or repaid in trust units as part of a SIFT conversion or elimination of a subsidiary trust. In such circumstances, an

election similar in effect to subsection 80.01(3) or 80.01(4), or a provision similar to subsection 80(2)(g), could be available as the case maybe.

Securities Exchangeable for SIFT Units

We also recommend an automatic rollover analogous to subsection 85.1(1) of the Act for holders of securities exchangeable for trust units. Many income trust structures indirectly hold interests in a limited partnership of which other partners hold interests exchangeable for trust units. Given the administrative complexity involved in cases where the elections must be filed for a large number of taxpayers, we submit that a taxpayer holding exchangeable interests should be permitted to exchange those interests for common shares of a subject corporation as part of a SIFT trust conversion on a tax-deferred basis without the need to file a section 85 election.

Section 7 Stock Options

We considered how taxpayers holding section 7 options to acquire income trust units might be affected by a SIFT trust conversion. If the transferor trust transfers its property to a subject corporation of which it holds a majority of the shares (and which for purposes of section 7 should mean that the trust controls the subject corporation), subsection 7(1.4) could apply where a taxpayer exchanges it options to acquire units of the transferor for options to acquire shares of the subject corporation. Subsection 7(1.4) may not apply, however, where the subject corporation is unrelated to the transferor. To provide a rollover in this case, paragraph 7(1.4)(b) could be amended to add new subparagraph (vi) to refer to a subject corporation to which the particular person (being the transferor trust) has transferred property in circumstances to which the SIFT Conversion Rule applied.

Part XIII.2 Tax

We submit that, in general, Part XIII.2 tax should not apply in respect of a redemption of a trust's units held by a non-resident. We recommend that an exemption from the application of Part XIII.2 tax should be introduced for all redemptions of units. At a minimum, we submit that it would not be appropriate for non-resident trust unitholders to be subject to Part XIII.2 tax as a result of a SIFT trust conversion.

Period of Availability

We understand that you contemplate that a SIFT trust conversion rule might be available for a limited period of time only, as a transitional measure related to the transitional delay in the taxation of SIFTs.

Given that the SIFT rules generally tax SIFT trusts as corporations, we recommend that the above provisions be available indefinitely to be consistent with the existing rollover and reorganization provisions in the Act that apply to corporations. Situations may arise in 2011 and subsequent years in which a SIFT trust wishes to convert to corporate form. For example, for a variety of reasons, some trusts that are currently subject to the grandfathering provisions may continue in existence after 2010 and exist as SIFT trusts for some period of years before converting to corporate form. Further, some trusts that satisfy the "REIT Exception" in or after the transitional delay may subsequently fail to so qualify and may determine at that point that conversion to corporate form is in the best

interests of unitholders. Lastly, unless the broad meanings of investment and security under the SIFT rules are changed (as we have previously recommended), we think it is reasonable to expect that a trust might inadvertently become a SIFT trust and in such a circumstance the above provisions should be available even if this circumstance arises after 2011.

SIFT partnerships

Our comments above address measures that parallel subsection 85(3) to facilitate the conversion of a SIFT trust to a corporation. Under subsections 85(2) and 85(3), a tax deferred conversion of a partnership to a corporation may not be available for publicly traded SIFT partnerships. This is because a SIFT partnership whose units are publicly traded will not be able to determine whether it qualifies as a "Canadian partnership" at the time of disposition. Under subparagraph 85(2)(a)(i), real property of a partnership that is not a Canadian partnership, including real property that is used in a business carried on in Canada by the partnership, cannot be transferred to a corporation on a tax deferred basis. Accordingly, subsection 85(3) would be unavailable to facilitate the conversion of a SIFT partnership to a corporation in such cases.

We recommend that subsection 85(2) be expanded to apply to a partnership that is, at the time of disposition of partnership property, a SIFT partnership or a partnership that would have been a SIFT partnership on October 31, 2006 had the SIFT partnership definition been in force and applied as of that date, where the affairs of the partnership are wound-up within 60 days after the disposition.

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We look forward to discussing our submission with you.

Yours truly,

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cc: Brian Ernewein – Department of Finance