

## Frequently Asked Questions Regarding PFICs

***U.S. Holders (as defined below) should consult their own tax advisors for advice regarding the application of the U.S. federal income tax rules governing PFICs***

### **Q. What is a PFIC?**

A. PFIC stands for “passive foreign investment company.” A PFIC is generally defined as a foreign (non-U.S.) corporation that meets one of the following two tests: (1) 75% or more of its gross income is passive income; or (2) 50% or more of the foreign corporation’s assets produce, or are held to produce, passive income. Canadian mutual fund trusts are considered to be PFICs for U.S. income tax purposes.

### **Q. What are the U.S. reporting requirements for U.S. persons holding interests in PFICs?**

A. Effective for 2013 and subsequent years, U.S. persons (for U.S. tax purposes) holding investments in Canadian mutual fund trusts (“U.S. Holders”) are required to file Internal Revenue Service (“IRS”) Form 8621 to report their investment in a PFIC.

The following discussion is for informational purposes only and does not provide financial, legal, tax or investment advice. Other U.S. reporting requirements may apply. U.S. persons that intend to purchase or hold PFIC units should consult their tax advisors to determine the U.S. federal, state, local and other tax consequences of an investment in the PFIC. Additionally, see the IRS’s “Form 8621, *Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*” for further information.

### **Q. Who are U.S. persons?**

A. For U.S. tax purposes, U.S. persons generally include U.S. citizens, U.S. residents (“Green Card” holders), partnerships and corporations formed under U.S. state or territorial laws, any estate other than a foreign estate, certain U.S. trusts, and any other person that is not a foreign person, as defined by U.S. law. U.S. persons may also include individuals who meet the “Substantial Presence” test under the United States Internal Revenue Code (and do not qualify for the “Closer Connection Exception”).

**Q. How are U.S. Holders in a PFIC taxed?**

A. U.S. Holders with ownership interest in a PFIC are required file IRS Form 8621 for each tax year under the following five circumstances if the U.S. person:

1. Receives certain direct or indirect distributions from a PFIC,
2. Recognizes gain on a direct or indirect disposition of PFIC units,
3. Is reporting information with respect to a Qualified Electing Fund ("QEF") or mark-to-market election,
4. Is making an election reportable in Part II of Form 8621, or
5. Is required to file an annual report pursuant to section 1298(f) of the U.S. Internal Revenue Code.

Absent a QEF or Mark-to-Market Election:

Generally: Unless a U.S. Holder makes a Qualified Electing Fund ("QEF") QEF election or a mark-to-market election as defined, respectively, in sections 1295 and 1296 of the Internal Revenue Code, the U.S. Holder may generally: (1) be subject to tax in the year that distributions of earnings and profits from a PFIC is received and (2) be ineligible to treat such distributions as "qualified dividend income". In addition, a U.S. Holder may be subject to special rules with respect to (1) any "excess distributions" or (2) any gain realized on the sale or other disposition of their ownership interest in a PFIC.

Excess Distributions: "Excess distributions" are the part of the distribution received by a U.S. Holder of a PFIC in the current tax year that are greater than 125% of the average annual distributions received by such U.S. Holder in the three preceding taxable years, or, if the U.S. Holder's holding period is less than three taxable years, the U.S. Holder's holding period before the current tax year. If there is an excess distribution, the excess distribution amount is allocated pro rata to each day the U.S. Holder owned the investment in the PFIC. No part of a distribution received or deemed received during the first tax year of the shareholder's holding period of the PFIC units will be treated as an excess distribution.

Portions of an excess distribution are treated differently. The amount allocated to the days in the current tax year and the shareholder's tax years in its holding period before the foreign corporation qualified as a PFIC are taxed as ordinary income. The portions allocated to the days in the shareholder's tax years (other than the current tax year) in its holding period when the foreign corporation was a PFIC are not included in income, but are subject to the separate tax and interest charge set forth in section 1291(c) of the U.S. Internal Revenue Code.

Gain on Sale or Other Disposition: If a U.S. Holder disposes of their ownership interest in a PFIC, any gain resulting from the disposition generally is treated as an excess distribution and would be subject to the rules set forth above.

QEF Elections:

Generally: By making a QEF election, a U.S. Holder may not be subject to the tax treatment discussed above under "Absent a QEF or Mark-to-Market Election".

**Impact of QEF Election:** A U.S. Holder who has made a QEF election must include in gross income, as ordinary income, its pro rata share of the QEF's ordinary earnings, and as long-term capital gain, its pro rata share of the net capital gain of the QEF. No portion of such inclusions of ordinary earnings would qualify as "qualified dividend income". The U.S. Holder would increase the tax basis in its PFIC ownership interest to reflect the U.S. Holder's pro rata share of the PFIC's ordinary earnings and net capital gain. Any distribution earnings with respect to which the U.S. Holder has already been taxed would be excluded from income upon receipt by such U.S. Holder, and such U.S. Holder would decrease the tax basis of its ownership interest by such distribution. Gain or loss realized on a sale or exchange of the PFIC units will be a capital gain or loss.

**PFIC Losses:** A U.S. Holder would not be entitled to a deduction for its pro rata share of any losses incurred by the PFIC for such year.

**Timing Considerations:** The QEF election is effective for the taxable year in which the election is made and all subsequent taxable years of the PFIC in which an investor holds an ownership interest. Generally, a U.S. Holder must make the election to be treated as a QEF by the due date, including extensions and subject to exceptions, for filing the U.S. Holder's income tax return for the first tax year to which the QEF election will apply.

#### Mark-to-Market Elections:

Generally: By making a mark-to-market election, the U.S. Holder is treated as if the PFIC units were sold on the last day of the tax year for fair market value and then repurchased at the same fair market value. Any gain is treated as ordinary income rather than a capital gain, and any losses are disallowed.

#### **Q. How does a U.S. Holder make a QEF election?**

A. A U.S. Holder of a PFIC can make an election to treat the PFIC as a QEF by completing and attaching IRS Form 8621 to the U.S. Holder's federal income tax return, which must be filed by the due date of the return, including extensions and subject to exceptions. A separate election must be made for each PFIC that the U.S. Holder wants to treat as a QEF.

#### **Q. If a U.S. Holder doesn't make a QEF election in the first year, can one be made in the future?**

A. Yes, but complicated rules apply to U.S. Holders that have not made a QEF election in the first year of the U.S. Holder's holding period in the PFIC. Each U.S. Holder should consult their own tax advisor with respect to the U.S. federal, state, local and other tax consequences of making such a QEF election.

#### **Q. What if a U.S. Holder owned PFIC units in a year prior to the year of the QEF election?**

A. If the QEF election is not made in the first year of the U.S. Holder's holding period in the PFIC, the U.S. Holder may be able to make a deemed sale election, if eligible. A deemed sale election requires the U.S. Holder to recognize any gain from the deemed sale of the PFIC units as of the first day of the PFIC's first

tax year as a QEF (the qualification date) for its fair market value. The gain from the deemed sale is taxed as an excess distribution received on the qualification date. A U.S. Holder that makes the deemed sale election increases its adjusted basis of the PFIC units owned directly by the amount of gain recognized on the deemed sale. If there is no gain, then the U.S. Holder will not have to pay any taxes as a result of making the deemed sale election, but any loss realized on the deemed sale is not recognized.

**Q. What are the potential benefits of a QEF election?**

A. If a U.S. Holder elects to treat a PFIC as a QEF, then any future gain from the sale of PFIC units will qualify for capital gain treatment (assuming the U.S. Holder holds the unit as a capital asset) and will be subject to tax at capital gains rates. In contrast, without a QEF election, the U.S. Holder would generally be subject to tax at ordinary income rates on distributions from the QEF.

**Q. What are the potential consequences of a QEF election?**

A. A U.S. Holder who makes a QEF election is required to annually include in gross income, as ordinary income, the U.S. Holder's pro rata share of the ordinary earnings of the QEF and as long-term capital gain, its pro rata share of the net capital gain of the QEF. Other consequences in the year of the election will depend on whether the U.S. Holder owned units of the PFIC in a year prior to the year in which the QEF election is made.

**Q. What is the PFIC Annual Information Statement?**

A. The PFIC Annual Information Statement enables U.S. Holders who have made a QEF election to compute their taxable income, if any, attributable to their investment in the PFIC.

**Q. What information will be included in the PFIC Annual Information Statement?**

A. The PFIC Annual Information Statement will include the U.S. Holder's pro rata share of the PFIC's ordinary income and net capital gains, if any, for that tax year, as well as the amount of any distributions to the U.S. Holder during the tax year of the PFIC. Alternatively, the PFIC Annual Information Statement will include sufficient information to enable the U.S. Holder to calculate its pro rata share of the PFIC's ordinary earnings and net capital gain for that tax year.

The information contained in this document (including any attachments) is for information purposes only and has been drawn from sources believed to be reliable. The information is not intended to promote, market or recommend to another party any transaction or matter addressed herein. Investors should consult their own tax advisors concerning the overall tax consequences of their ownership of securities based on their particular circumstances under U.S. federal, state, local or foreign law.