

## FREQUENTLY ASKED QUESTIONS REGARDING PFICS

### U.S. HOLDERS SHOULD CONSULT THEIR OWN TAX ADVISORS FOR ADVICE REGARDING THE APPLICATION OF THE U.S. FEDERAL INCOME TAX RULES GOVERNING PFICS.

#### **Q. What are the new U.S. reporting requirements for U.S. persons holding interests in the Canadian Mutual Fund Trusts?**

A. Effective for 2013 and subsequent years, U.S. persons holding investments in Canadian Mutual Fund Trusts ("U.S. Holders") are required to file Form 8621 to report their investment in a Passive Foreign Investment Corporation (PFIC). Please see the IRS's 'Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund'.

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

A. PFIC stands for "passive foreign investment company." A PFIC is defined as a foreign (non-US) 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 corporation's assets produce, or are held to produce, passive income. Canadian Mutual Funds Trusts are considered to be PFICs for U.S. income tax purposes.

#### **Q. Does PFIC status affect persons who are not U.S. persons?**

A. Generally, the PFIC rules apply only to U.S. persons and should not apply to non-U.S. persons. U.S. Taxpayers that intend to purchase or hold Fund units should consult their tax advisors to determine the U.S. federal, state, local and other tax consequences of an investment in the Fund. The following discussion of PFIC status is intended to provide information to U.S. taxpayers that hold Fund units.

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

A. U.S. persons include U.S. citizens and "Green Card" holders, as well as individuals who meet the "Substantial Presence" test under the Internal Revenue Code (and do not qualify for the "Closer-Connection Exception").

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

A. *Absent a QEF Election:*

Generally: Unless a U.S. Holder makes a Qualified Electing Fund ("QEF") election or a mark-to-market election as defined, respectively, in Sections 1295 and 1296 of the Internal Revenue Code, (1) distributions of earnings and profits from a PFIC would generally be subject to tax in the year received and (2) such distributions would not be eligible to be treated as "qualified dividend income." In

addition, a U.S. Holder will be subject to special rules with respect to (1) any "excess distributions" and (2) any gain realized on the sale or other disposition of their ownership interest in a PFIC.

Excess Distributions: "Excess distributions" are distributions received by a U.S. Holder in a PFIC in a taxable year that are greater than 125% of the average annual distributions received by such Holder in the three preceding taxable years, or, such Holder's holding period, if the Holder's holding period is less than three taxable years. If there is an "excess distribution," the excess distribution amount is allocated pro rata to each day the Holder owned the investment in the PFIC. The amount allocated to the current year is included as ordinary income in the Holder's gross income for the current year. Any amounts allocated to prior years would be subject to tax at the highest rate of tax in effect for the applicable class of taxpayer for that year, and an interest charge would be imposed with respect to the resulting tax attributable to each such other taxable year (the "deferred amount.")

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 subject to the rules set forth above.

Termination of PFIC Status: If a foreign corporation is classified as a PFIC for any year during which a U.S. Holder has an ownership interest, the foreign corporation generally will continue to be treated as a PFIC in the case of such U.S. Holder for all succeeding years during which such U.S. Holder maintains an ownership interest regardless of whether the foreign corporation ceases to be classified as a PFIC for other U.S. Holders.

*If a QEF Election is made:*

Generally: By making a QEF election, a U.S. Holder will not be subject to the special rules discussed above under "Absent a QEF Election." Instead, such Holder will include its pro rata share of the PFIC's ordinary earnings and net capital gain for the taxable year in income, regardless of whether any amounts are distributed to such Holder during such taxable year.

Impact of QEF Election: A U.S. Holder who has made a QEF election includes its pro rata share of the PFIC's ordinary earnings and net capital gain in the Holder's income for each taxable year. 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 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 Holder, and such Holder would decrease the tax basis of its ownership interest by such distribution. Gain or loss realized on a sale or exchange of the Fund 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 may be made for the first year in which an investor holds Fund units. The QEF election is effective for the taxable year in which the election is made and all subsequent taxable years of the Fund in which an investor holds an ownership interest.

**Q. How does a US investor make a QEF election?**

- A. The QEF election is made by completing and attaching Form 8621 to the investor's federal income tax return filed by the due date of the return, including extensions.

**Q. What is the benefit of electing QEF?**

- A. If a U.S. Holder elects to treat a Fund as a QEF, then any future gain from the sale of Fund units will qualify for capital gain treatment (assuming the U.S. investor holds the unit as a capital asset). In addition, the U.S. Holder will be subject to tax at capital gains rates rather than ordinary income rates and distributions of amounts taxed to the shareholder will be distributed tax free. In contrast, without a QEF election, the U.S. Holder would be subject to tax at ordinary income rates on distributions from the QEF. Note there may be U.S. tax implications if a U.S. Holder held Fund units in a year prior to making the QEF election.

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

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

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

- A. The Annual Information Statement will include per unit information regarding ordinary income and capital gains that should be reported on U.S. Holder's U.S. tax return as well as the amount of any distributions to the shareholder during the taxable year of the PFIC and the first and last days of the taxable year of the PFIC to which the Annual Information Statement applies.

**Q. What is the consequence of a QEF election?**

- A. A U.S. Holder who makes a QEF election is required to annually include in income the U.S. Holder's pro rata share of the ordinary earnings and net capital gains of the Fund. Other consequences in the year of the election will depend on whether such U.S. Holder owned units of the Fund in a year prior to the year in which the QEF election is made.

**Q. What if the U.S. investor is a new U.S. Holder of the Fund units?**

- A. The U.S. investor can make a QEF election as of the date they buy units.

**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 do not have a QEF election in effect with respect to PFIC units throughout the period that they own such units. A U.S. Holder may make a QEF election in a subsequent year. The QEF regime will apply to the PFIC units for the subsequent taxable years. Each U.S. Holder should consult their own tax advisors 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 units in a year prior to the year of the QEF election?**

- A. If a U.S. holder makes a QEF election and owned units of the Fund prior to the effective date of the QEF election, then the U.S. Holder may also choose to make a deemed sale election. A deemed sale election will require the investor to recognize any gain from a "deemed sale" of the U.S. Holder's Fund units as of the first day of the QEF election year (January 1 of such year), and report the gain as ordinary income on Form 8621. Such gain will be allocated over the U.S. Holder's holding period up to the date of the deemed sale and taxed at ordinary income tax rates plus an interest charge. Gain, if any, is the difference between the "deemed sale price" and the U.S. Holder's adjusted cost basis. The deemed sale price to be used is the fair market value of the Fund units on the first day of the Fund's year as a QEF (i.e., January 1 of the taxable year with respect to which the U.S. investor makes the QEF election). The U.S. holder's adjusted basis in the Fund units will be increased by the gain on such deemed sale.

**Q. What if the U.S. Holder does not have a gain on the deemed sale?**

- A. 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 will still need to make the deemed sale election and a QEF election in order to avoid the application of the "excess distribution" rules, described above.

**Q. What if the U.S. Holder makes a mark-to-market election?**

- A. As a third alternative to the general rules and the QEF election mentioned above, a mark-to-market election to recognize a gain or loss annually to reflect changes in the value of the Fund units may be available. Each U.S. Holder should consult their own tax advisors about eligibility and procedures for, and appropriateness in such Holder's particular circumstances of making, this mark-to-market election.

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