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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 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 Internal Revenue Service ("IRS") 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 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 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, only a U.S. person that is a direct or indirect shareholder of a PFIC must file IRS Form 8621. U.S. taxpayers that intend to purchase or hold PFIC Fund units should consult their tax advisors to determine the U.S. federal, state, local and other tax consequences of an investment in the PFIC Fund. The following discussion of PFIC status for U.S. taxpayers that hold PFIC Fund units is for informational purposes only.

Q. Who are U.S. persons?

A. U.S persons include U.S. citizens, U.S. residents ("Green Card" holders), a domestic partnership, a domestic corporation, any estate other than a foreign estate, certain U.S. trusts, and any other person that is not a foreign person. U.S. persons are also 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. 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, the U.S. Holder may: (1) generally 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 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 the part of the distribution received by a U.S. Holder in 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 Fund units will be treated as an excess distribution.

Portions of an excess distribution are treated differently. The amount allocated to the current year is included as ordinary income in the U.S. 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 would be 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 U.S. Holder must include in gross income as ordinary income 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 U.S. 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 U.S. Holder's gross 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 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 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 a U.S. Holder 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 PFIC Fund 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.

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

A. A U.S. Holder 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. What are the potential benefits of electing QEF?

A. If a U.S. Holder elects to treat a PFIC Fund as a QEF, then any future gain from the sale of PFIC Fund units will qualify for capital gain treatment (assuming the U.S. Holder 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 generally be distributed tax free. 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. Note there may be U.S. tax implications if a U.S. Holder held PFIC Fund units in a year prior to making the QEF election for the first time with respect to the PFIC Fund.

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 Fund.

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 for that tax year, as well as the amount of any distributions to the U.S. Holder during the tax year of the PFIC and the first and last days of the tax year of the PFIC to which the Annual Information Statement applies. 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.

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 income the U.S. Holder's pro rata share of the ordinary earnings and net capital gains of the PFIC Fund. Other consequences in the year of the election will depend on whether such U.S. Holder owned units of the PFIC 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 PFIC Fund units?

A. The U.S. investor can make a QEF election as of the date they buy PFIC Fund 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 have not made a QEF election with respect to the first year of the U.S. Holder's holding period in the PFIC. 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 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 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 IRS 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 basis. The deemed sale price is the fair market value of the PFIC Fund units on the first day of the PFIC Fund's year as a QEF (i.e., January 1 of the taxable year with respect to which the U.S. Holder makes the QEF election). The U.S. Holder's adjusted basis in the PFIC 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 a loss cannot be recognized. The U.S. Holder 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. A mark-to-market election to recognize a gain or loss in the value of the PFIC Fund units may be available. Under the mark-to-market regime, the U.S. Holder is treated as if the PFIC Fund units were sold on the last day of the tax year for fair market value and then repurchased. The gain or loss is treated as ordinary income and, therefore, the capital gain treatment is not available to the U.S. Holder. Each U.S. Holder should consult their tax advisors about eligibility for, procedures for, and appropriateness in making a mark-to-market election.

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