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*For distribution to relevant parties within your
firm*

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Department of Finance Decision on the Tax Treatment of Securities Lending Transactions

Last July we were advised that Revenue Canada may be unwilling to consider a transaction with a partnership as a "securities lending arrangement" (Section 260 of the Income Tax Act (Canada)) for the purposes of qualifying for the exemption from withholding tax where the partnership is a foreign partnership. The Investment Dealers Association petitioned the Department of Finance to eliminate the uncertainty overhanging capital markets in respect of securities lending and borrowing transactions and to introduce an appropriate amendment to the definition of securities lending arrangement.

This morning the Association received a response from the Department of Finance to our request for an amendment to the Income Tax Act. The Department acknowledges that the uncertainty about the tax treatment of partnerships in securities lending arrangements may adversely affect the market. Accordingly, the Department will amend Section 260 of the Income Tax Act to state explicitly that defined transactions include those transactions with partnerships. The Department has also stated that the anti-avoidance rules applicable to dividend rental arrangements (Sub-Section 248(1)) will be amended to apply to partnerships. The exchange of correspondence between the Department of Finance and the Association is attached.

These amendments will be tabled on the next occasion that legislation incorporating general technical amendments to the Income Tax Act is tabled in Parliament. We expect to have discussions with Department officials in the near future regarding their effective date. Members should seek guidance from counsel in carrying out securities lending and borrowing transactions in the intervening period.

For general background on this matter, member firms should contact Ian CW Russell, Senior Vice President, Investment Dealers Association.

Lyn M. Gilchrist
Association Secretary