2 Queen Street East, Twentieth Floor
Toronto, Ontario M5C 3G7
www.ci.com

Telephone: 416-364-1145
Toll Free: 1-800-268-9374
Facsimile: 416-364-6299

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The HST and Investment Funds

Starting July 1, 2010, Ontario and British Columbia will combine the provincial sales tax with the federal goods and services tax to create a single harmonized sales tax (HST).

This means that most items subject to the GST, which is 5%, will be subject to HST, which will be 12% in British Columbia and 13% in Ontario. Many items that were not subject to provincial sales tax will face a tax increase because of the HST. This includes investment funds.

At the same time, the federal government has issued new rules that change the way GST and HST are calculated and collected from investment funds. These new rules are contained in a Backgrounder published May 19 by the Department of Finance and are expected to become formal regulations. These new rules are national in scope and take into account the fact that several other provinces already have an HST: Newfoundland and Labrador, Nova Scotia, and New Brunswick. Quebec has aligned its Quebec Sales Tax (QST) with the GST but has not adopted a fully harmonized tax.

As of July 1, management fees and administration fees paid by investment funds, including those offered by CI Investments, will be subject to HST. Currently, management and administration fees are subject only to the 5% GST. The application of the HST will lead to a higher management expense ratio (MER) for investment funds because the MER includes taxes.

The federal government has changed the "place of supply" rules so that the applicable GST/HST rate is calculated based on the location of the clients, rather than that of the fund company. Under the rules, investment funds with clients across Canada will calculate the HST payable using a "blended rate" based on the residency of a fund's investors and the value of their holdings in the funds.

The blended rate is based on the following tax rates by province:

- British Columbia: 12%
- Ontario, Newfoundland and Labrador, and New Brunswick: 13%
- Nova Scotia: 15%
- All other provinces and territories: 5%

The following example is based on a fund with 45% of unitholders in Ontario, 20% in B.C., 2% in Nova Scotia, and 33% in non-HST provinces. This results in an effective HST rate of 10.2%.

	GST at 5%	HST at 10.2%
Management fee	1.70%	1.70%
Administration fee	0.20%	0.20%
GST / HST	0.10%	0.19%
MER (including taxes)	2.00%	2.09%

Segregated funds

For segregated funds, management and administration fees, as well as any insurance fees paid by the fund will be taxed as described above.

Other fees that are paid directly by the client and which are considered insurance premiums are not subject to GST or HST. These include fees for these optional benefits: the Guaranteed Minimum Withdrawal Benefit, the Annual Automatic Death Benefit, and the Earnings Enhancement Benefit.

Fee-based accounts

In selected investment programs, investors pay some management fees directly (rather than indirectly, through the fund). When a fee is paid directly by the client, the applicable GST or HST rate for that fee depends on the province of residency of the client. Please note that Quebec has adopted its own place of supply rules so that clients resident in Quebec will pay QST at an effective rate of 7.875% (in addition to GST) on fees that they pay directly.

For example, with CI's Class F units, or fee-based funds, the funds are charged a reduced management fee. Investors pay a separate advisor fee, which they negotiate with their advisor. The fund management and administration fees will be subject to a blended HST rate, whereas the advisor fee will be subject to the HST or GST rate of the investor's province of residency (or GST and QST in Quebec).

FAQs

Q. Will I have to pay HST on my funds if I live in a province that doesn't charge HST?

A. It's important to remember that the tax is charged to the fund, though investors end up bearing the cost. The HST will result in an increase in taxes paid by all CI investment funds, and their unitholders will be affected regardless of where they live. The actual HST rate paid by each fund will depend on the mix of residency of the investors in the funds. This will also be the case for investment funds offered by other companies.

The exception will be if you are in a fee-based program. In that case, residents of a non-HST province will continue to pay GST on the management fee or portion of the fee they pay directly (outside of the fund).

Q. Why are you using the blended rate?

A. The blended rate was established by the federal government as a method of calculating the tax and was set out in the Backgrounder published in May.

Q. How will the HST be charged?

A. The HST will be charged to the fund in the same way as management fees, which are charged to the fund and deducted from its assets daily. The HST will be calculated and charged to a fund at the series level.

Q. How will the HST affect the fund's returns?

A. The MER of investment funds are calculated after taxes. The HST will lead to a slight increase in the funds' MERs and a decrease in their returns by the same amount.

Q. Doesn't the HST make your funds less competitive?

A. All investment funds across Canada are subject to the same rules regarding the implementation of the HST.

CI has long been an industry leader in operating its funds efficiently and controlling costs. CI was the first fund company to introduce a fixed administration fee, which replaced the funds' operating expenses. The fee ensures the expenses charged to the funds remained fixed at a low level.

In general, CI's investment funds continue to offer excellent value for investors, providing some of the best portfolio management expertise in Canada, along with diversification, convenience in investing, ease of administration, and a broad selection of products and platforms, including mutual funds, tax-efficient funds, and segregated funds with principal and income guarantees.

If you have any questions, please contact CI Client Services at 1-800-563-5181.