

Institute Calls for Factual Hearings on Income Trusts

The non-partisan research and education organization, iTrust Institute cautions that the pending hearings about income trust taxes are of significant importance to all Canadians. But it is not clear that a full depth and range of useful data is being invited for consideration.

Institute President, Leslie Hayman, said that, "It is in our shared interest and within our constitution that taxes are imposed in a fair and effective manner for the benefit and social security of all Canadians."

With limited time for hearings, it is crucial that participants have access to the best possible information. Meaningful questions and answers depend on facts being considered in the context of broad, deep and accurate data.

Ms. Hayman noted that, "Hearings will waste time and potentially result in harmful recommendations without due consideration of facts in appropriate context. Few know whose briefs are being invited to lay that factual ground"

Support for Canadian Finance Committee Objectives

Tax on cash distributions from Canadian income trusts, excluding passive REITs with Canadian holdings, and new rules to inhibit new equity issues by trusts were brought to life in a "*Tax Fairness Plan*" based on clearly stated and implied objectives:

1. Abolish unfair tax status for income trust equities;
 - a. Reduce tax leakage;
 - b. Eliminate tax-only incentives for existing public equities and private companies from going public as an income trust;
2. Strengthen Canadian financial markets;
3. Focus investment on and retain Canadian ownership in growing and productive Canadian companies.

The iTrust Institute embraces these objectives in general and seeks to help inform the hearings to achieve beneficial goals.

A brief from the Institute would, however, provide a range of data that gives evidence that new trust taxes and rules actually create and exacerbate the risks that the rules are supposed to address, rather than solving problems.

Seeking Clarity through Pre-hearing Confusion

To address Canadian objectives, it is incumbent upon members of the Finance Committee and Parliament, as well as government administrators to establish an inquiry process that avoids focus on special interests.

Canadians face tax rules of enormous consequence, not small questions about whether a 4-year tax grace is long enough or whether special exemptions are justifiable for trust issuers in some sectors, like oil and gas or REITs, versus others.

Members of the Finance Committee need to be cognizant of pre-hearing rhetoric and self-justifying news reports from analysts who confuse the factual context within which upcoming presentations need to be heard, to ensure that facts are not obscured in favor of political preference.

We note below, for example only, how important it is to obtain data taken with a comprehensive perspective. The example is not intended to dismiss the expertise of a study author, but may be helpful in appreciating the limited and skewed information with which policy positions are being taken in the current political environment in which trust hearings will occur.

EXAMPLE: Misinformation Due to Data Limitations

A respected financial expert, Diane Urquhart, took the press podium in October 2006 beside the NDP finance critic, Judy Wasylycia-Leis, to present an “independent” study “*Income Trusts: Heads I Win, Tails You Lose*”.

In lead-up to public hearings, that expert is now reinforcing the study conclusion that suggests that reductions in income trust distributions reflect a problematic structure inherent in trust securities. Ms. Urquhart is quoted (Toronto Star, January 23, 2007) as saying that a key concern for investors is that trusts fail to report the difference in source of cash for distribution in terms of return of capital or net operating gains.

The study and follow-up public commentary gives the public, including Finance Committee members and politicians, the misimpression that such distribution and structure problems are significant and generic among trusts.

Such expert opinion fails, however, to measure the extent to which the relatively few securities cited for study reflect the way flow-through entities generate net earnings or growth. Neither pre-hearing media commentary nor expert original study observes a full data set for the income trust market.

As a result, the expert comments are irresponsible and misleading when presented as fact, particularly when published without comparative measure and out of context. The distribution-oriented propositions are as offensive to good Canadian managers as the statements are inappropriately generic.

Through use of comprehensive market-tracking data, the iTrust Institute can show that:

- ✓ During 2006, there were more than three times as many distribution increases as decreases by income trusts. There is little difference in statistics when REITs are excluded;
- ✓ Approximately three quarters of income trusts and flow-through entities have not had a reduction in distribution in the past two years and, furthermore, pay cash returns to investors that are less than operating cash from continuing operations;
- ✓ The high frequency of cash distributions unique to Canadian income trusts generally increases returns relative to market-related risk for investors. This kind of cash return to investors offers such informative and economic value to investors seeking transparency in managerial practice that there is increasing demand by sophisticated foreign investors to own Canadian flow-through securities. There is demand to own Canadian income trusts despite the economic dampening impact of new taxes on recipients of distributions from income trusts.

Comprehensive factual studies show very different findings with significant implications compared to those presented in the expert independent study that was publicized as if part of the NDP Finance Critic's position on income trusts and the Party's stated reason to support Conservative tax policies.

Institute findings can support some of the conclusions of that same study by Ms. Urquhart in so far as there is common recognition of the need to protect Canadians from false claims and incomplete attention to risk during promotional efforts by financial product and broker sales personnel.

There is clear evidence of need to improve the accuracy of information provided to investors by sellers when they advise or promote purchase of units or shares, particularly for initial public offerings. This perspective is not new or isolated to income trusts, however, and has been featured as a conclusion of reports commissioned by authorities like the Bank of Canada.

Focus on key financial considerations in the context of comprehensive and factual context is necessary for the Finance Committee to ensure that its time serves Parliament and Canadian interests.

Potential Brief Contribution by iTrust Institute

The Institute has been studying income trusts and their market in a broad context as a non-partisan organization for more than a year now including both collection of research published by a full range of experts and through our own original studies.

From this perspective, it is nearly certain that information being presented to the Finance Committee, members of Parliament and the public by some

experts and independent analysts is based on a narrow set of data and calculations made without comprehensive context. Without context and the kind of perspective that we can and have offered to the Finance Committee, it may be misled or mistaken in its conclusions.

The Institute was formed to ask the question and explore the extent to which “Equities managed and structured like income trusts to flow net gains through to owners by way of frequent and regular distributions of cash can offer superior rates of overall return, support market growth, enhance economic productivity and contribute to growth of the tax base with less risk than other equities given honest managers and a fully competitive market supported by open communications.”

Our group was given the name iTrust Institute, not to advocate or lobby for income trusts. But rather, our founding members saw need and potential to test the real benefits and risks for investors and Canadians to place their trust in public financial securities in general. We saw opportunity to obtain great insight by focusing on flow-through and trust structures in particular.

As inquisitive members of the public with public interests, we asked if income trust securities were trustworthy investments, wanting to understand if they are simply a tax avoidance or Ponzi scheme as proposed by a few analysts.

As Canadians and investors of all political stripes, we need to understand how business returns to public investors align with the productive capabilities and operating practices of the enterprises they own, and if those enterprises are structured and managed in such a way that growth is possible and pays returns aligned with surrounding interests in growing the Canadian economy.

By looking at a comprehensive set of facts, the Institute found that:

- ✓ **Income trusts are like common public equities and not generically good investments.** If they were, then the financial services professionals and their allies, who joined with members of various other trade lobby groups to fund the recent upstart lobby group, CAITI, would not have opportunity to sell quality-differentiating services to investors.
- ✓ **Not all company managers with investors and lenders, in and outside, the income trust market are honest people or working in the interest of owners.** If they were, then the public wouldn't need public securities regulators nor place such responsibility to articulate risks on the shoulders of otherwise self-regulating financial market participants.
- ✓ **A narrow focus on cash yield as a unique feature of income trusts, by analysts and now the government in order to impose new taxes, fails to address the full risk, returns and growth potential available to Canadian investors.** Such a yield focus is not only misleading in the process of selling new issues of securities and fund products to Canadian investors and seniors, but it cripples Canadian policy makers to the extent that it misinforms economic and tax policy.

To many members of the public, it appears that the Finance Committee is especially at risk of setting up a debate between pro and anti-trust lobby groups and experts. A few relevant observations might be made in the course of that process. But on balance, such debate would be an unnecessary waste of time and an egregious waste of taxpayer dollars.

The Committee need not work with a limited set of data or to accept at face value data that is skewed to justify political interests.

It is increasingly prudent for the Committee to include in its hearings the best possible depth and range of factual data.

To that end, the Institute has offered to attend and report on its non-partisan findings in hearings by the Finance Committee.

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ABOUT THE INSTITUTE

The iTrust Institute is an independent, non-partisan organization that provides research and education services to members and others.

The Institute was born in early 2006 from the interests of members in TrustInvestor, a leading independent information resource for more than 3993 members including investors, advisors, brokers, bankers, traders, financial professionals, market makers & issuers. That number now approaches 5000 as Liberal tax policy and Conservative election promises helped popularize income trusts in early 2005.

The iTrust Institute was incorporated as a federal not-for-profit organization as a means to address the information needs of a public and government divided during the Department of Finance Consultation of 2005. At that time, we assembled a Round Table to address questions still unanswered today. Many sensed growing need for specialized education and objective information in regard to the securities and their market.

With surprise imposition of new taxes and rules on flow-through entities in 2006, the Canadian government increased the urgency for good information in order to ensure policy has positive impact on Canadians and our economy, today and tomorrow.