Finance introduces relief for ETFs from Share Buyback Tax

November 28, 2023

On November 28, 2023, the federal government tabled the Notice of Ways and Means Motion to introduce the *Fall Economic Statement Implementation Act, 2023*. This legislation will amend the *Income Tax Act* (the ITA) in order to implement various measures previously announced in earlier economic statements and federal budgets, including to introduce the new tax on the repurchase of equity (referred to as the "share buyback tax" or SBT) that was first announced in the 2022 Fall Economic Statement and re-confirmed in the 2023 Federal Budget.

Based on the draft legislation of the SBT that was released on August 4, 2023, there were concerns that the SBT could apply to Canadian exchange-traded funds (ETFs) when units of the ETF are redeemed by authorized participants, contrary to the stated policy objective of the SBT.

The government announced today, likely as a response to submissions from the investment funds industry regarding the August 4, 2023 draft legislation, that the SBT will not apply to redemptions of ETF units in two circumstances that are described below.

Complete Exemption from SBT for Most ETFs that are Mutual Fund Trusts

An ETF is entirely exempt from SBT on the redemption of ETF units if it meets the following 3 requirements:

- It is a "mutual fund trust" for purposes of the ITA (MFT Status) that has at least one class of units in continuous distribution;
- It is not a "real estate investment trust" for purposes of the ITA (REIT); and
- It is not a "specified investment flow-through trust" for purposes of the ITA.

For ETFs that qualify under this complete exemption, they are not subject to SBT on any redemptions of its units.

Partial Exemption from SBT for All Other ETFs

An ETF that does not meet the requirements for the complete exemption (such as an ETF that does not meet MTF Status) may rely on the partial exemption.

In order to benefit from the partial exemption, an ETF must meet the “open-ended” unit trust requirements in paragraph 108(2)(a) of the ITA. Where this requirement is met by the ETF, the ETF will be exempt from the SBT on a redemption of its units where the redemption price does not exceed the fair market value of the units at the time of redemption. Accordingly, the partial exemption from SBT may not apply in limited situations where, at the time of redemption, the units were trading at more than their intrinsic value.

Please contact the authors of this bulletin for more information.

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