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Alternative Investment Funds 2020

A practical cross-border insight into alternative investment funds work

Eighth Edition

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Expert Chapters

1 The Rise of ESG Investing
Mikhaelle Schiappacasse, Dechert LLP

8 The Global Subscription Credit Facility and Fund Finance Markets – Key Trends and Forecasts
Wesley A. Misson & Joseph P. Zeidner, Cadwalader, Wickersham & Taft LLP

12 Bringing Foreign Investment Funds into Japan
Yasuzo Takeno & Fumiharu Hiromoto, Mori Hamada & Matsumoto

17 Private Fund Management Issues Arising From COVID-19
Sam Kay, Travers Smith LLP

Q&A Chapters

22 Andorra
Cases & Lacambra: Miguel Cases Nabau & Laura Nieto

29 Angola
VdA: Pedro Simões Coelho, Ricardo Seabra Moura, Carlos Couto & Inês Moreira dos Santos

36 Bermuda
Walkers (Bermuda) Limited: Sarah Demerling & Melanie Fullerton

45 Canada
McCarthy Tétrault LLP: Sean D. Sadler, Nigel P.J. Johnston & Cristian O. Blidariu

54 Cayman Islands
Maples Group: Grant Dixon & Andrew Keast

62 England & Wales
Travers Smith LLP: Jeremy Elmore & Emily Clark

74 Germany
Flick Gocke Schaumburg: Christian Schatz

80 Hong Kong
Vivien Teu & Co LLP: Vivien Teu & Sarah He

92 India
IC Universal Legal: Tejesh Chitlangi & Sushreet Pattanayak

101 Ireland
Dillon Eustace: Brian Kelliher & Richard Lacken

113 Japan
Anderson Mori & Tomotsune: Koichi Miyamoto & Takahiko Yamada

122 Jersey
Collas Crill LLP: Dilmun Leach & David Walters

128 Luxembourg
Bonn & Schmitt: Amélie Thévenart

136 Mexico
Deloitte Legal: Martín Cortina Camargo, Ramón Bravo Herrera, Héctor Alejandro Cuevas González & Eduardo Michán Escobar

143 Mozambique
VdA: Pedro Simões Coelho, Ricardo Seabra Moura, Carlos Couto & Inês Moreira dos Santos

150 Portugal
VdA: Pedro Simões Coelho, Ricardo Seabra Moura, Carlos Couto & Inês Moreira dos Santos

161 Scotland
Brodies LLP: Andrew Akintewe

170 Spain
Cases & Lacambra: Miguel Cases Nabau & Toni Barios Asensio

179 Switzerland
Bär & Karrer Ltd.: Rashid Bahar & Martin Peyer

189 USA
Dechert LLP: Karen L. Anderberg & Adrienne M. Baker

Canada

Sean D. Sadler

Nigel P.J. Johnston

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Securities Laws

Canada has a federal system of government whereby the authority to enact legislation is divided between Canada's federal and its provincial and territorial governments. The Canadian securities laws applicable to Alternative Investment Funds ("**AIFs**") are currently regulated solely by the provincial and territorial governments. As a result, each of Canada's 10 provinces and three territories has its own legislative scheme for regulating the formation and operations of AIFs within its own provincial or territorial jurisdiction and its own securities commission or regulatory authority ("**Securities Regulator**") for administering and enforcing such legislation. Securities regulatory requirements therefore vary from jurisdiction to jurisdiction in Canada. In an effort to harmonise Canadian securities laws, the 13 Securities Regulators have, under rule-making authority granted by the provincial and territorial governments, established numerous rules, referred to as national instruments, that operate in a substantially identical manner in each province and territory.

Canadian securities legislation generally regulates the activities of an AIF within a province or territory by requiring:

(a) those who act as an investment fund manager of an AIF to become registered as such with the relevant Securities Regulator (the "**Investment Fund Manager Registration Requirement**");

(b) those who engage in, or hold themselves out as being engaged in, the business of trading in securities of the AIF to prospective investors to become registered or licensed as a dealer (the "**Dealer Registration Requirement**");

(c) those who engage in, or hold themselves out as being engaged in, the business of managing the investment portfolio of the AIF to become registered or licensed as an adviser (the "**Adviser Registration Requirement**"); and

(d) the AIF that distributes securities to investors to file a prospectus with, and obtain a receipt therefor from, the applicable Securities Regulator(s) (the "**Prospectus Requirement**"),

unless:

- the securities legislation provides for an express statutory exemption from the relevant requirement; or
- an order or ruling can be obtained from the applicable Securities Regulator which exempts a trade, a security or a person or company from the relevant requirement.

Other Laws

In contrast to securities laws, tax laws applicable to AIFs apply at both the federal and provincial levels. Securities and tax laws will always be engaged in the formation and operation of AIFs. It is also typical that corporation law, limited partnership law, anti-money laundering law, terrorist financing law and privacy law will apply.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

The manager of an AIF is the entity responsible for administering the day-to-day operations of the AIF and is generally considered to be the "operating mind" of the AIF. In several Canadian provinces, a manager of an AIF is subject to a duty of care of a fiduciary nature. AIF managers are subject to the Investment Fund Manager Registration Requirement.

An entity providing portfolio management services to an AIF is subject to the Adviser Registration Requirement and is also subject to a fiduciary duty of care. If the advice to be provided by the adviser would include advice in respect of exchange-traded commodity futures contracts and options, registration as an adviser under commodity futures legislation may also be required, depending on the province in which the AIF is established.

An entity in the business of trading securities of the AIF to prospective investors is subject to the Dealer Registration Requirement.

For purposes of the Dealer Registration and Prospectus Requirements of Canadian securities legislation, the term "trade" is broadly defined to include any sale or disposition of a security for valuable consideration, any receipt by a registrant of an order to buy or sell a security and any act, advertisement, solicitation, conduct or registration directly or indirectly in furtherance thereof. The term "distribution" is defined, with reference to the term "trade", to include a trade in the securities of an issuer that have not been previously issued.

For AIFs that operate as private equity funds, it may be possible under current law to structure the AIF in such a way

that the Investment Fund Manager Registration Requirement, Adviser Registration Requirement and Dealer Registration Requirement do not apply to the AIF and the offering of its securities.

If the AIF is formed outside Canada and the investment fund manager and adviser provide services to the AIF from outside Canada, the Investment Fund Manager Registration Requirement and Dealer Registration Requirement may be avoided by relying on exemptions available to non-residents. Ordinarily, the Adviser Registration Requirement will not apply to an adviser resident outside Canada who provides portfolio management services to an AIF domiciled outside Canada but offered to Canadian investors.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

The AIF is not itself licensed or registered but, as a market participant, an AIF is regulated by the applicable Securities Regulator(s).

AIFs that distribute their securities in Canada must either qualify the distribution pursuant to a prospectus prepared and filed in accordance with applicable Canadian securities laws or conduct the distribution in reliance upon a prospectus exemption. AIFs do not usually qualify their securities for distribution in Canada pursuant to a prospectus because the prospectus clearing process would require the AIF to adhere to rules that would materially restrict the ability to engage in numerous activities that AIFs ordinarily engage in, such as short selling, leveraging and investing in illiquid positions. Accordingly, AIFs typically distribute their securities to investors in reliance upon one of two private placement exemptions from the Prospectus Requirement described below.

Canadian securities laws provide an exemption from the Prospectus Requirement where a security is distributed to an accredited investor who acquires the AIF security as principal (the "Accredited Investor Exemption"). Accredited investors are purchasers who are considered to be sophisticated because of their status or financial well-being. Like the US version, Canadian accredited investors include: financial institutions; governments; pension funds; securities dealers and advisers; corporations, partnerships and trusts with net assets of $5 million; individuals who, alone or with a spouse, have net assets of at least $5 million; and individuals who meet a financial net worth test of $1 million or an income test of $200,000 in each of the last two years (or, together with their spouse, of $300,000) and a reasonable expectation of exceeding that amount in the current year.

Another exemption from the Prospectus Requirement is available where a purchaser is not an individual and purchases an AIF security as principal and the AIF security has an acquisition cost to the purchaser (other than individuals) of not less than $150,000 paid in cash at the time of the trade (the "Minimum Investment Exemption").

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity *vs.* hedge)) and, if so, how?

Yes, there are significant differences between the regulation of open-ended and closed-ended funds. Closed-ended funds are usually publicly offered funds that have qualified their securities by prospectus and are traded over a stock exchange and available to retail investors. Accordingly, closed-ended funds tend to be much more regulated by securities laws and stock exchange requirements than open-ended funds unless the open-ended funds are also qualified by prospectus and available to retail investors, which is not usually the case for an AIF.

Closed-ended funds that operate as private equity funds typically do not engage the Investment Fund Manager Registration Requirement or the Adviser Registration Requirement.

1.5 What does the authorisation process involve and how long does the process typically take?

The authorisation process differs for the registration of each of the investment fund manager, adviser and dealer. However, each category of registration involves the filing of a Form 33-109F6 for the firm and a Form 33-109F4 for applicable individuals. There are minimum capital, financial statement, insurance and proficiency requirements associated with the authorisation process. The Securities Regulator reviews the filed materials and provides comments or questions on the applications for registration that usually take between eight and 12 weeks to resolve.

1.6 Are there local residence or other local qualification or substance requirements?

Each of the investment fund manager, adviser and dealer categories of registration is available to non-residents of Canada. Non-residents are usually required to satisfy Canadian proficiency requirements and will have to submit to the jurisdiction of the Securities Regulator. Some categories of registration such as investment dealer require (pursuant to the rules of the Investment Industry Regulatory Organization of Canada – the Canadian equivalent of FINRA) the applicant to be incorporated pursuant to Canadian law but are not otherwise required to be resident in Canada.

1.7 What service providers are required?

Most AIFs will utilise the services of an investment fund manager, adviser, dealer or prime broker, registrar and transfer agent, fund accountant, custodian, auditor and lawyer.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

For investment fund managers, advisers and broker-dealers located outside Canada, there are exemptions from the applicable registration requirements that permit these firms to do business with Canadian clients that qualify as "permitted clients", which is a category of client that is similar to, but slightly more restricted than, the accredited investor category of client discussed above.

1.9 What relevant co-operation or information sharing agreements have been entered into with other governments or regulators?

The Securities Regulator has, for many years, entered into different forms of reciprocal regulatory oversight arrangements with foreign

securities regulatory bodies. These arrangements, frequently called memoranda of understanding or "**MOUs**", are intended to facilitate the sharing of information about firms and individuals under common regulatory oversight, support collaboration on investigation and enforcement matters, and generally assist in the global integration of securities regulatory oversight. The pace of entering into, and the general interest in, MOUs has increased considerably since the onset of the 2008 financial crises. Today, the Securities Regulator has approximately 20 MOUs in place with foreign regulators including the United States Securities and Exchange Commission ("**SEC**"), Commodity Futures Trading Commission ("**CFTC**"), Financial Industry Regulatory Authority ("**FINRA**"), United Kingdom Financial Conduct Authority and Bank of England, European Union, International Organization of Securities Commissions ("**IOSCO**") and securities regulators in Australia, China, France, Hong Kong and Italy.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

The principal legal structures used in the formation of AIFs are limited partnerships, unit trusts and corporations.

2.2 Please describe the limited liability of investors in respect of different legal structures and fund types (e.g. PE funds and LPACs).

Investors in a corporation have liability limited to the value of their investment. Investors in a limited partnership also have liability limited to the value of their investment, provided they do not take part in the control of the business of the partnership. Investors in a trust are likely to have limited liability but there may be some uncertainty which may be addressed by providing where possible, in contracts of the trust, that no recourse is to be had to the personal assets of investors. Some provinces have adopted a statutory limited liability regime for investors in certain public trusts.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Managers and advisers of Canadian AIFs are usually organised as corporations but are sometimes organised as partnerships.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Provided the AIF is not offered by prospectus, there are usually no limits on the manager (other than, in certain cases, for tax reasons) to restrict redemptions in open-ended funds or transfers in closed-end funds.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

Yes, most investors acquire AIF securities pursuant to exemptions from the Prospectus Requirement. Any resale of the AIF security would also have to comply with an exemption from the Prospectus Requirement such as the Accredited Investor Exemption or the Minimum Investment Exemption (these exemptions are discussed above).

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

If the adviser is registered in Canada or the AIF is formed in Canada, there are several legislative restrictions that pertain to self-dealing and conflicts of interest. If the adviser is not registered in Canada and the AIF is not formed under Canadian law, there are no legislative restrictions on how the manager/adviser manages the AIF.

3 Marketing

3.1 What legislation governs the production and use of marketing materials?

All marketing activities intended to solicit purchase orders of an AIF security would likely be considered an act in furtherance of a trade of a previously unissued security under applicable securities laws and would therefore be subject to the Prospectus Requirement and the Dealer Registration Requirement. The exemptions from the Dealer Registration Requirement are not generally available to intermediaries in the business of selling AIF securities. Accordingly, the marketing intermediary must ordinarily become registered in one of the three dealer categories: investment dealer; exempt market dealer; or mutual fund dealer (if the AIF is an open-ended mutual fund).

Generally, securities law of the provinces and territories of Canada does not differentiate between oral, electronic or documentary communication. As matter of procedure, electronic and documentary communication is to be preferred and oral communications are to be made only in a manner entirely consistent with the electronic and documentary materials.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

If an offering document is to be used to solicit sales of AIF securities that are to be distributed in Canada in reliance upon either the Accredited Investor Exemption or the Minimum Investment Exemption, the offering document will probably be considered an offering memorandum under Canadian securities laws. Generally speaking, any material prepared in connection with such a private placement, other than a "term sheet" that is limited to describing the terms of the securities being issued rather than describing the business and affairs of the issuer, will be considered an offering memorandum. Purchasers who receive an offering memorandum have a statutory right of action for rescission or damages for any misrepresentation in the offering memorandum. The statutory right of action must be described in the offering memorandum. The term "misrepresentation" is broadly defined to mean: (a) an untrue statement of material fact; or (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

The offering memorandum must be delivered to the relevant Securities Regulator within 10 days of the distribution of an AIF security. If a foreign prospectus is used as an offering

memorandum, it is common to attach a stand-alone Canadian "wrapper" to describe the statutory rights of action and to address other related disclosure requirements. The Securities Regulator does not review or approve the offering memorandum.

If the securities of an AIF are distributed into a province or territory of Canada in reliance upon certain prospectus exemptions, including the Accredited Investor Exemption or the Minimum Investment Exemption, the AIF must file a completed Form 45-106F1 exempt trade report with the applicable Securities Regulator within 30 days of the end of the calendar year in which the distribution occurred, and the filing of the report must be accompanied by the payment of a prescribed filing fee that varies from jurisdiction to jurisdiction.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Provided the marketing of the AIF is done pursuant to an offering memorandum in accordance with the Accredited Investment Exemption or Minimum Investment Exemption through registered dealers, there are no other material restrictions applicable to the marketing of AIFs.

3.5 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

In Canada, the term "pre-marketing" is used with reference to certain types of prospectus qualified offerings of securities and does not have application to the offering of AIF securities in Canada.

3.6 Can Alternative Investment Funds be marketed to retail investors?

Retail offerings in Canada are usually made by way of prospectus. Most AIFs are offered pursuant to exemptions from the Prospectus Requirement. Some AIFs are offered to high-net-worth individual clients in reliance upon the Accredited Investor Exemption. If an AIF is offered to certain categories of such high-net-worth individuals, the AIF must provide standard form risk disclosure as prescribed by Form 45-106F9.

3.7 What qualification requirements must be met in relation to prospective investors?

When relying on the Accredited Investor Exemption, AIFs and intermediaries should take reasonable steps to ensure that the terms of the Accredited Investor Exemption are met, including requiring prospective investors to certify that they are accredited investors.

3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

Some institutional investors such as regulated pension funds have internal and statutory restrictions that restrict the level of investment in, and control over, an AIF.

3.9 Are there any restrictions on the participation in Alternative Investments Funds by particular types of investors (whether as sponsors or investors)?

Intending to restrict the role of financial institutions in AIFs, like most jurisdictions around the world, Canadian regulators have responded to the financial crisis with numerous macro-prudential and micro-prudential initiatives and measures designed to address various systemic risks revealed as a result of the financial crisis. In particular, in Canada, we have seen a mixture of federal and provincial initiatives, that have resulted in, for example, designation of domestically significant financial institutions, new bank capital rules, higher bank capital thresholds, proposed requirements relating to the clearing and reporting of OTC derivatives, new residential mortgage insurance rules, new regulation of the government mortgage insurer and proposed bail-in policies.

3.10 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Intermediaries assisting in the fundraising process will usually be subject to the Dealer Registration Requirement.

4 Investments

4.1 Are there any restrictions on the types of investment activities that can be performed by Alternative Investment Funds?

Provided the AIF is not offered by way of prospectus and the adviser is properly licensed, there are no restrictions on the types of activities that can be performed by the AIF other than, in certain cases, to comply with tax requirements.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio, whether for diversification reasons or otherwise?

Provided the AIF is not offered by way of prospectus and the adviser is properly licensed, there are no restrictions on the types of investments that can be included in the AIF's investment portfolio other than, in certain cases, to comply with tax requirements.

4.3 Are there any local regulatory requirements which apply to investing in particular investments (e.g. derivatives or loans)?

Regulatory requirements applicable to AIF investments are largely harmonised across Canadian jurisdictions. The Province of Quebec has in place a legislative regime that governs licensing, trading and advising activities by participants in that province's derivatives market.

4.4 Are there any restrictions on borrowing by the Alternative Investment Fund?

Provided the AIF is not offered by way of prospectus and the adviser is properly licensed, there are no restrictions on borrowing by the AIF.

5 Disclosure of Information

5.1 What disclosure must the Alternative Investment Fund or its manager make to prospective investors, investors, regulators or other parties?

Provided the AIF is not offered by way of prospectus, the only public disclosure that an AIF must make is annual audited financial statements and semi-annual unaudited financial statements. It is possible to obtain an exemption from the requirement to file these financial statements with the Securities Regulator provided that the financial statements are delivered to investors. If the AIF is not formed in Canada, there are no public disclosures other than the Form 45-106F1 discussed in question 3.3 above.

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

Yes, the Form 45-106F1 requires disclosure to the relevant Securities Regulator of the investors in the AIF securities. The investor information provided to the Securities Regulator in Form 45-106F1 is not placed on the public file of the Securities Regulator. However, freedom of information legislation ("**FOI**") may require the Securities Regulator to make this information available if requested. Securities Regulators have given guidance that an FOI request for investor information contained in a Form 45-106F1 would be opposed by Securities Regulators. Where a Form 45-106F1 identifies an Ontario purchaser, the Securities Regulator in Ontario places on the public file a monthly summary of the following information contained in the Form 45-106F1: the name of the issuer; the date the Form 45-106F1 was submitted; the first distribution date; the dollar amount raised in Ontario; and the number of Ontario purchasers. FOI legislation varies from jurisdiction to jurisdiction in Canada.

5.3 What are the reporting requirements to investors or regulators in relation to Alternative Investment Funds or their managers?

Provided the AIF is not offered by way of prospectus, the key reporting requirements in relation to AIFs are:

- audited annual and unaudited semi-annual financial statements of the AIF discussed above;
- Form 45-106F1 trade reports to the Securities Regulator by the AIF discussed in question 3.3;
- trade confirms from the dealer to the investor reporting on the trade of the AIF security to the investor;
- alternative monthly reports (the "**AMR System**") from the adviser and an AIF (if it is an open-end investment fund) to the Securities Regulator where the adviser exercises control or direction over 10% or more of a class of securities of a Canadian public company and subsequent reports when investment goes above or below 10%, 12.5%, 15% or 17.5%;
- early warning reports (the "**EWR System**") from the AIF (if it is not an open-end investment fund) to the Securities Regulator where the AIF acquires 10% or more of a class of securities of a Canadian public company and subsequent reports in respect of any 2% increases or decreases thereafter; and
- insider reports to the Securities Regulator where the AIF acquires 10% or more of a class of securities of a Canadian public company.

5.4 Is the use of side letters restricted?

There are no prescriptive restrictions on the use of side letters, but investment fund managers and advisers are subject to a fiduciary duty of care and side letters must be examined carefully to ensure that the arrangements contemplated thereby do not breach the fiduciary duty of care owed to all investors. The Securities Regulator has been known to focus on the use of side letters and take action when it is evident that the fiduciary duty of care has been compromised.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

Canada imposes tax on the worldwide income of persons that are resident in Canada.

Only 50% of capital gains are taxable and 50% of capital losses are deductible but only against the taxable portion of capital gains. Dividends received from a Canadian corporation are subject to special tax treatment to reflect the fact that they are paid out of after-tax income of the corporation. Such dividends received by a Canadian corporation are generally deductible in computing taxable income, while those received by an individual are "grossed up" and a dividend tax credit is given. Other forms of income (interest, income/loss from transactions in derivatives that are not considered to be hedges of capital property, etc.) are taxed at regular rates. Income or loss must generally be computed in Canadian dollars.

An AIF that is a partnership is generally fiscally transparent for Canadian tax purposes. Canadian-resident partners should be entitled to treaty benefits on a look-through basis.

An AIF that is a Canadian-resident trust is treated as a taxpayer but, in computing its income, is generally entitled to deduct that portion of its income that is payable in the year to its investors who are required to include such amounts in income. A special tax may be payable by a Canadian-resident trust (other than a "mutual fund trust" for tax purposes which, among other conditions, requires that its activities be limited to investing its funds in property) if it has non-resident investors and "designated income" (comprised of income from Canadian real property, resource property and businesses carried on in Canada and capital gains from the disposition of "taxable Canadian property" (see below)). While a trust should be treated as a resident of Canada for the purposes of Canada's tax treaties, subject to limitation on benefits provisions, some countries in the past have denied treaty benefits.

An AIF that is a Canadian corporation is treated as a taxpayer and pays tax on its taxable income. If it qualifies as a "mutual fund corporation" for tax purposes which, among other conditions, requires that its activities be limited to investing its funds in property (but which, in practice, is given a broad meaning), tax on capital gains is refundable to the corporation. Dividends from Canadian corporations received by a mutual fund corporation are subject to a 38⅓% tax which is refundable when the corporation pays taxable dividends to its investors. An AIF that is a Canadian corporation will generally be treated as a resident of Canada and beneficial owner of income for the purposes of Canada's tax treaties, subject to limitation on benefits provisions.

Canada also imposes tax on non-residents that carry on business in Canada, that dispose of certain capital properties referred to as "taxable Canadian property" (generally Canadian real property and resource property and certain securities that derive more than 50% of their value from such properties) or that derive certain income from Canadian sources (dividends, rents, royalties, etc.). A non-resident AIF that engages a Canadian investment adviser with authority to trade on its behalf would be considered to carry on business in Canada unless the requirements of a safe-harbour rule are satisfied.

6.2 What is the tax treatment of the principal forms of investment manager/adviser identified in question 2.3?

A manager that is a Canadian corporation is treated as a taxpayer and pays tax on its taxable income. Management fees and performance fees will be treated as ordinary business income.

A manager that is a partnership must calculate its income or loss as if it were a separate person resident in Canada. Management fees and performance fees will be treated as ordinary business income. Income or loss of the partnership is allocated in accordance with the partnership agreement to its partners, who include or deduct the relevant amounts as if they earned them directly.

If the AIF is a partnership, the manager or an affiliate of the manager may be a partner of the partnership in order to be entitled to a carried interest. In such case, a share of income and gains of the partnership would be allocated to the manager or affiliate and the character of the allocated amount as ordinary income or capital gain is expected to be respected for tax purposes under current tax rules.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

No establishment or transfer taxes are imposed on investors. The disposition of an investor's interest may give rise to a capital gain or capital loss (or to ordinary income/loss if not capital property) that must be taken into account in computing income. See below regarding the treatment of a disposition of an interest in an AIF.

6.4 What is the local tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors (or any other common investor type) in Alternative Investment Funds?

(a) A resident investor in an AIF that is treated as a partnership for Canadian tax purposes, whether established in Canada or a foreign jurisdiction, must take into account its share of the income or loss of the partnership that is allocated to it in accordance with the partnership agreement. The partnership must calculate its income or loss as if it were a separate person resident in Canada. The "at-risk" rules restrict the deductibility of losses from a business or property allocated to a limited partner to the limited partner's "at-risk amount". In determining how an AIF established in a foreign jurisdiction should be treated for Canadian tax purposes, the primary attributes of the AIF under the foreign law are determined and compared with the primary attributes of a partnership, trust or corporation under Canadian law.

A resident investor in an AIF that is a Canadian-resident corporation must include, in computing income, dividends received from the corporation. If the investor is a Canadian corporation, such dividends are generally deductible in computing taxable income. Dividends received by an individual are "grossed up" and a dividend tax credit is given. If the AIF is a "mutual fund corporation" for tax purposes, it may pay dividends that it elects to pay out of capital gains which are taxed as capital gains in the hands of investors.

A resident investor in an AIF that is a Canadian-resident trust must include in income its share of the trust's income that is payable in the year to the investor. The tax character of capital gains, dividends from Canadian corporations and income from foreign sources and related foreign tax credits will generally be preserved in the hands of the investor if appropriate tax designations are made by the trust.

A resident investor that invests in an AIF that is, or is treated for Canadian tax purposes, as a non-resident corporation will be required to include dividends received in income. If such an AIF is treated as a "foreign affiliate" of the investor (because the investor and/or certain connected persons own more than 10% of the shares of any class or series) and the AIF is a "controlled foreign affiliate" of the investor (because the AIF is controlled by the investor and/or certain specified persons with a connection to Canada), the investor must include in income, on an accrual basis, the investor's share of the AIF's "foreign accrual property income". Recent amendments to the Income Tax Act (Canada) (the "**ITA**") may extend this treatment to certain sub-funds within an umbrella investment company.

If this rule does not apply, it is necessary to consider whether the resident investor's investment in shares of the AIF is an "offshore investment fund property". In general, two conditions must be satisfied. First, the share must reasonably be considered to derive its value, *directly or indirectly*, primarily from portfolio investments of the corporation or any other non-resident entity in certain properties including shares, indebtedness, interests in one or more corporations, trusts, partnerships, organisations, funds or entities and real estate or any combination thereof. Secondly, it is necessary that it can reasonably be concluded, having regard to all the circumstances, that that one of the main reasons for the investor acquiring, holding or having the share was to derive a benefit from portfolio investments in such assets in such a manner that the taxes, if any, on the income, profits and gains from such assets for any particular year are significantly less than the tax that would have been applicable under Part I of the ITA if the income, profits and gains had been earned directly by the investor. If so, the investor must include a notional amount in income calculated with respect to the "designated cost" of its investment less dividends actually received.

Special rules apply in relation to investments by Canadian residents in non-resident trusts. Depending on the structure of the trust, the trust could be treated as a resident of Canada for certain purposes of the ITA and liable to tax in Canada. Alternatively, the trust could be an "exempt foreign trust" in which case the interest in the trust could be an "offshore investment fund property"; if not, the investor would generally be subject to tax on the income of the trust (calculated in accordance with the ITA) as is payable to the investor.

A resident investor must also take into account the gain or loss arising on a disposition of an interest in the AIF which, if the interest is a capital property, will be a capital gain or capital loss.

(b) A non-resident investor in an AIF that is a partnership will be liable to tax on the investor's share of the partnership's income from a business carried on in Canada and the investor's share of capital gains from the disposition by the partnership of "taxable Canadian property" (generally Canadian real property and resource property and certain securities that derive more than 50% of their value from such properties). By reason of having a non-resident investor, the partnership will be subject to a 25% withholding tax on certain income from Canadian sources (dividends, rents, royalties, etc.). Under the current administrative policy of the Canada Revenue Agency ("**CRA**"), the 25% withholding tax need only be applied in respect of the non-resident partner's share of the relevant income.

A non-resident investor in an AIF that is a Canadian-resident trust will be subject to a 25% withholding tax on distributions of income (including 50% of capital gains) by the trust. If the trust is a "mutual fund trust" for tax purposes, capital gains distributed by the trust will generally not be subject to withholding tax.

A non-resident investor in an AIF that is a Canadian-resident corporation will be subject to a 25% withholding tax on dividends paid or credited to the investor by the corporation (other than "capital gains dividends" paid by a mutual fund corporation).

A non-resident investor is liable to tax on the gain arising on a disposition of an interest in the AIF held as capital property if more than 50% of the value of the interest at any time in the 60-month period ending at the time of the disposition is derived from "taxable Canadian property" (see above). A tax clearance certificate may be required from the CRA in advance of the disposition in order that a purchaser does not withhold a prescribed amount (currently 25%) from the purchase price.

Canada's ability to impose tax on a non-resident may be affected by a bilateral tax treaty between Canada and the non-resident's country of residence. For example, a tax treaty may reduce the withholding rate from 25% to rates between 0% and 15%, depending upon the relevant income.

(c) A Canadian pension plan that is a "registered pension plan" under the ITA is generally exempt from income tax under the ITA on income derived from, and gains derived from the disposition of an interest in, an AIF.

In the case of non-resident pension investors, certain of Canada's tax treaties provide exemptions from Canadian withholding tax on interest and dividends. In such cases, dividends from a Canadian AIF structured as a corporation would not be subject to withholding tax. In the case of an AIF treated as a partnership, Canada would view the partnership as transparent and grant treaty benefits on a look-through basis. In the case of an AIF structured as a Canadian resident trust, there would be no relief from withholding tax on distributions of income to a non-resident pension plan even if the income were derived from Canadian-source interest and dividends.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

No. Rulings are generally not sought unless there is a specific tax concern.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the OECD's Common Reporting Standard?

Canada entered into an Intergovernmental Agreement ("**IGA**") with the United States relating to the implementation of FATCA which is substantially in the form of the Model 1 IGA, and the ITA was amended to provide for the due diligence and reporting regime contemplated by the IGA. The definition of "Canadian financial institution" in the ITA is narrower than that in the IGA. An AIF that is managed by a Canadian financial institution will generally itself be a Canadian financial institution. Canadian financial institutions (other than those that are treated as non-reporting Canadian financial institutions) will report information about US account holders to the CRA, which will exchange such information with the US Internal Revenue Service ("**IRS**"). Withholding agents will not be required to withhold the 30% tax on payments to reporting Canadian financial institutions (and certain "exempt beneficial owners" such as registered pension plans). A variety of registered accounts are excluded from the definition of "financial account" and do not have to be reported on. The rules in FATCA relating to recalcitrant accounts are suspended.

Canada also signed the Organisation for Economic Co-operation and Development ("**OECD**") Multilateral Competent Authority Agreement and Common Reporting Standard ("**CRS**"). The ITA has been amended to provide for the due diligence and reporting regime contemplated by the CRS.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 2 (hybrids) (for example ATAD I and II), 6 (prevention of treaty abuse) (for example, the MLI), and 7 (permanent establishments), insofar as they affect Alternative Investment Funds' operations?

Canada signed the MLI in June 2017 and listed 75 of its 93 tax treaties as Covered Tax Agreements. It originally adopted only the minimum standard provisions and the binding mandatory arbitration provision and registered reservations on all other optional provisions. As part of the ratification process, Canada announced that it would adopt a number of optional provisions including (i) imposing a 365-day holding period for shares of Canadian companies held by non-resident companies to access the lower treaty-based rate on dividends, and (ii) imposing a 365-day test period for non-residents who realise capital gains on the disposition of shares or other interests that derived their value from Canadian immovable property. The MLI was ratified in 2019 and entered into effect for Canada's tax treaties with many countries on January 1, 2020 for withholding taxes, and will enter into force for other taxes (including capital gains taxes), for tax years beginning on or after June 1, 2020 (which for calendar year taxpayers would be January 1, 2021).

Canada has amended the ITA to provide for country-by-country reporting for large multinational enterprises. The CRA is applying revisions to the OECD Transfer Pricing Guidelines recommended as part of the BEPS project.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

Generally, there are no tax-advantaged asset classes or structures available.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

Canada imposes a 5% Goods and Services Tax ("**GST**"); the provinces of Ontario, Nova Scotia, New Brunswick and Newfoundland and Labrador impose Harmonized Sales Tax ("**HST**") which varies from 8 to 10% and the province of Quebec imposes Quebec Sales Tax ("**QST**") at a rate of 9.975% (essentially value-added taxes) on certain supplies. Management and performance fees for services provided to a Canadian AIF will generally be subject to GST/HST/QST and no refund will be available to the AIF. An AIF that is a limited partnership may also be required to pay GST/HST/QST on the distribution, or a portion thereof, paid to the general partner.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months other than as set out at question 6.6 above?

It is expected that rules to limit interest deductibility as part of BEPs will be introduced.

7 Reforms

7.1 What reforms (if any) in the Alternative Investment Funds space are proposed?

There are currently no reforms proposed.

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