

September 22, 2004**CAIF Backgrounder on HLB Study****Budget 2004 Measures**

The following measures were announced in the 2004 Federal Budget:

- The definition of Taxable Canadian Property would be changed so that resource and timber based Trusts would be subject to foreign ownership restrictions.
- All Trust distributions paid to non-residents would be subject to a 15% withholding tax, including return of capital distributions that are currently exempt.
- Restrictions on pension funds on ownership in business trusts. (Currently suspended pending further consultations by the Federal Department of Finance).

Government Concern – Tax Leakage

It is our understanding that the 2004 Budget measures came as a result of government concerns over tax leakage through non-resident ownership. To address this concern, CAIF commissioned a study by HLB Decision Economics Inc. to analyze the proposed Budget measures related to non-resident taxation.

The key findings of the HLB Study were:

- Increased withholding taxes on the otherwise non-taxable portion of foreign distributions that were announced in Budget 2004 would increase government revenues by \$83 million in 2004.
- Tax losses due to increased foreign ownership are relatively minimal – the Budget 2004 measure to increase withholding taxes would more than compensate for that reduction.
- Withholding taxes on foreign owned trust units resulted in a net increase in tax revenue where non-resident investment shifted from oil and gas corporations to Trusts.

Access to Capital Is Key

Energy is one of Canada's most important resources. Maximizing the extraction of our oil and natural gas resources benefits all Canadians. Today increasing amounts of capital are needed to develop Canada's oil and natural gas reserves and large-scale projects such as Oil Sands, primary, secondary and tertiary recovery schemes. Oil and gas Trusts also purchase many Canadian assets from foreign companies thus transferring the mind and management of these assets back into Canada.



However accessing capital is a key challenge:

- The reality today is that Canadian capital markets can only absorb finite quantities of Trust resource product and cannot supply the capital needed to fully exploit our reserves over the long term. The needed capital must therefore come from foreign investors.
- The Canadian resource sector has a long history of foreign investment.
- Foreign investments in Canadian resources ultimately create employment and produce revenues to government at the Provincial and Federal levels.

Conclusion

The Canadian Association of Income Funds respectfully suggests the Federal Government did not have the benefit of comparable data to that contained in the HLB Study when putting forward the 2004 budget proposals impacting Trusts.

The HLB study shows that any issue related to tax leakage is addressed by the withholding tax on non-resident Unitholders of Canadian resource trusts (a large portion of which are oil and gas royalty trusts). This measure is entirely sufficient to address Government concerns about not disadvantaging Canadian investors relative to foreign investors when it comes to taxation.

The Budget measure to restrict non-resident ownership is an unnecessary measure that will severely hamper Canadian trust access to equity capital. It imposes dramatic and negative consequences on the ability of oil and gas players to raise new capital and keep investing in oil and gas development especially in Western Canada.

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