



Canadian Association of Income Funds

Economics Society of Calgary
Luncheon Meeting – Calgary Chamber of
Commerce

January 26, 2006

George Kesteven, President CAIF

Agenda

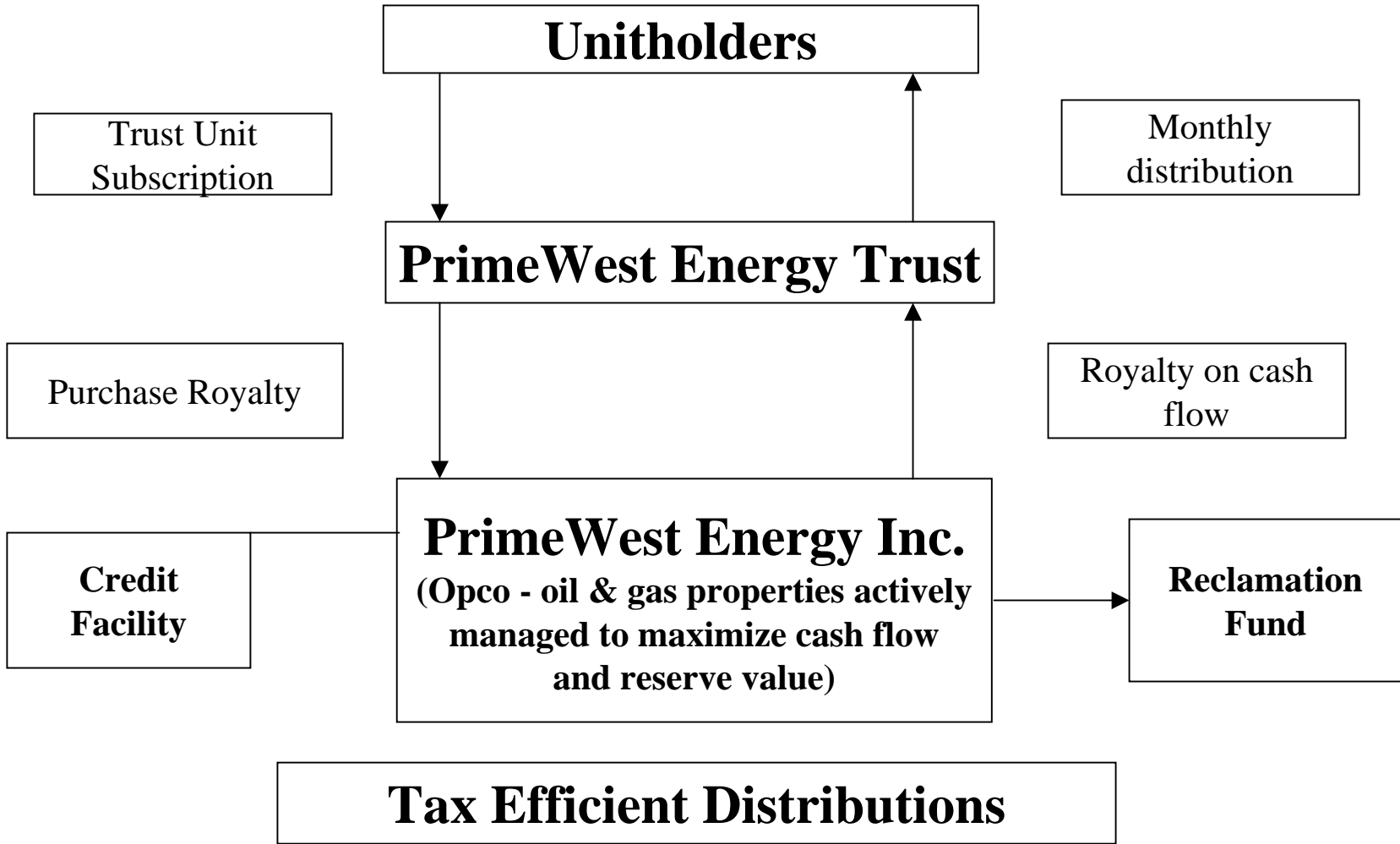


- What is an income fund? (royalty, business, LPs, REITs, FoF, FTE's all)
- Growth of income funds (and flowthrough entities in general)
- Performance of income funds
- Some familiar (and perhaps surprising) income fund names
- The role and benefits of energy income funds
- What and who is CAIF?
- Who owns income funds?
- Recent Government of Canada challenges (round #1 and round #2)
- Future issues and challenges for the income fund sector

What is an income fund?

- Flowthrough entities (tax consequences)
 - Royalty (oil and gas)
 - LP (pipeline and power)
 - Business (numerous sectors/numerous sub-structures)
 - REIT's (real estate investment trusts) [REALPAC]
 - Fund-of-funds (FTE's holding FTE's)
- Distribute cash flow to unitholders
- Capital reinvestment decision[↑]

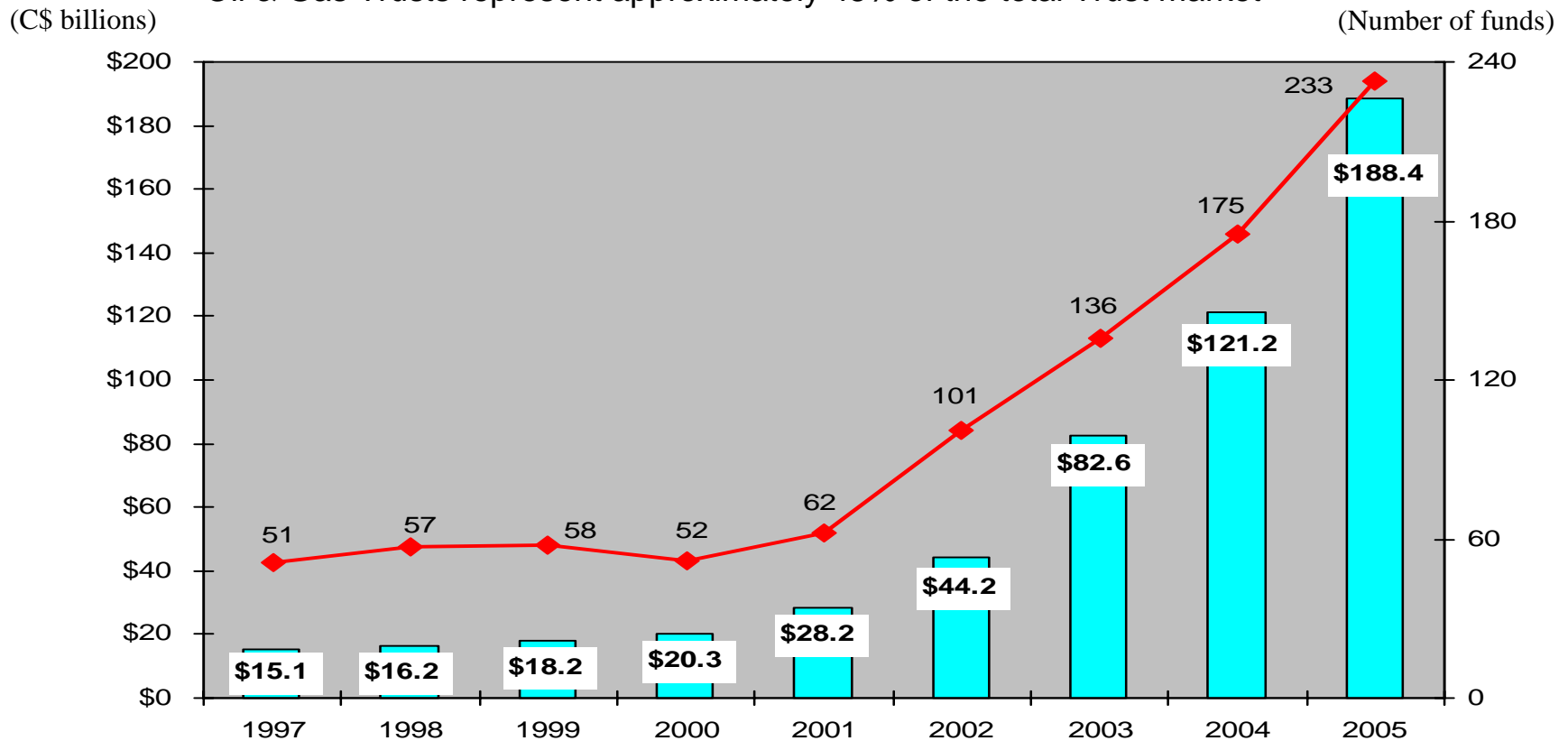
Typical Income Fund Structure



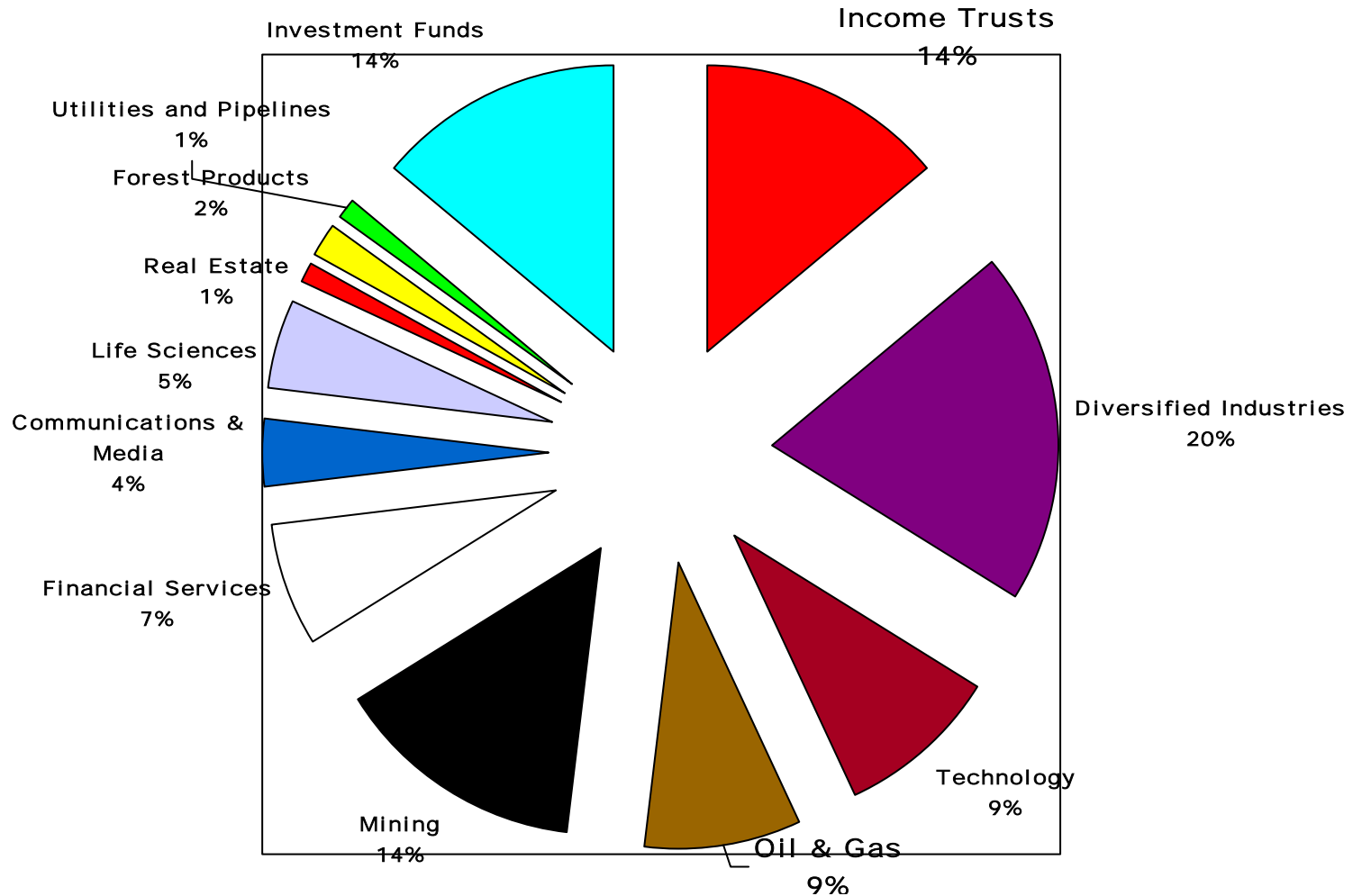
Canadian Income Fund Growth



- The Trust sector has grown by over 400% in the last 5 years
- With a market capitalization of over \$180 billion Trusts comprise around 14% of the TSX
- Oil & Gas Trusts represent approximately 45% of the total Trust market



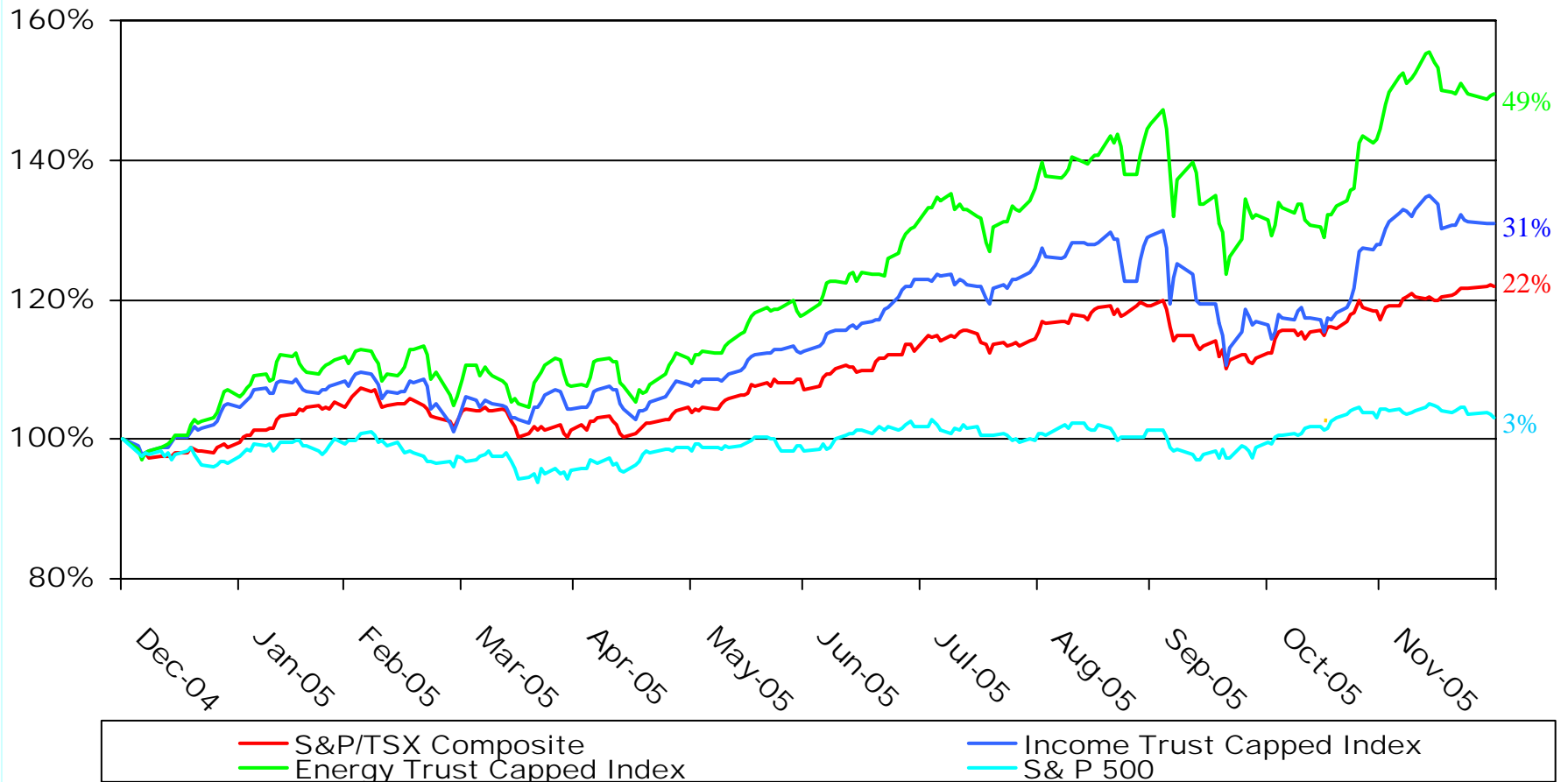
TSX Issuers by Sector



Source: TSX

Income Trust Performance

S&P/TSX Income Trust Indices vs. Broader Market Indices ⁽¹⁾



Large Calgary based Income Trusts



- Canadian Oil Sands (\$11.4 billion)
- Enerplus Resources (\$5.8 billion)
- Fording Canadian Coal Trust (\$7.1 billion)
- Canetic Energy (\$5.2 billion)
- ARC Energy (\$4.1 billion)
- Harvest [& Viking] (\$3.7 billion)
- Pengrowth Energy (\$3.2 billion)
- Peyto Energy (\$3.0 billion)
- Superior Plus Income Fund (\$2.1 billion)
- Bonavista Energy (\$3.4 billion)
- PrimeWest Energy (\$2.7 billion)
- Petrofund Energy (\$2.3 billion)
- Provident Energy (\$2.2 billion)
- Interpipeline Fund (\$1.9 billion)
- Pembina Pipeline (\$1.5 billion)
- Vermilion Energy (\$1.8 billion)
- Fort Chicago Energy (\$1.6 billion)

Household name Income Trusts



- Yellow Pages Income Fund (\$6.6 billion)
- BFI Canada income Fund (\$1.4 billion)
- Labrador Iron Ore (\$0.9 billion)
- Connors Brothers (\$0.7 billion)
- Davis & Henderson (\$0.8 billion)
- TransAlta Power L.P. (\$0.7 billion)
- Calpine Power Income (\$0.6 billion)
- Newalta Income Fund (\$0.7 billion)
- UE Waterheater Fund (\$0.6 billion)
- Bell Nordiq Income (\$1.5 billion)
- The Brick Group (\$545 million)
- Sleep Country Canada (\$250 million)
- Clearwater Seafoods (\$254 million)
- Boston Pizza (\$190 million)
- Keg Restaurants (\$135 million)
- A & W Restaurants (\$165 million)

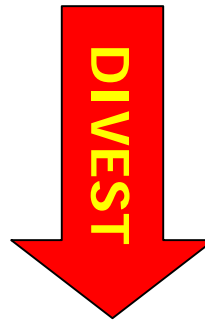
The Benefits of Energy Trusts



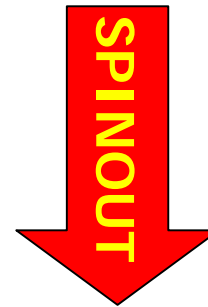
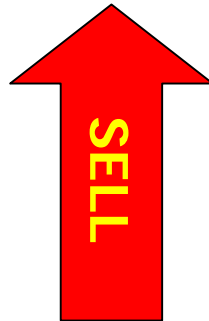
- Oil & gas trusts purchase many Canadian assets from foreign companies thus transferring mind and management of these assets back into Canada
- Trusts have been able to re-enter mature areas of the Western Canadian Sedimentary Basin that have had little or no recent development activity stimulating incremental production and reserves growth and fueling local economies
- The increased drilling activity brought about by Trusts has created numerous jobs and helped boost Canada's oil and gas exports to record levels
- Trusts are now starting to purchase assets outside of Canada and are importing cash flows from other countries into Canada
- Trusts are increasing the amount of investment in secondary and tertiary recovery schemes of mature Canadian oil and natural gas fields

Investment Cycle

MAJORS



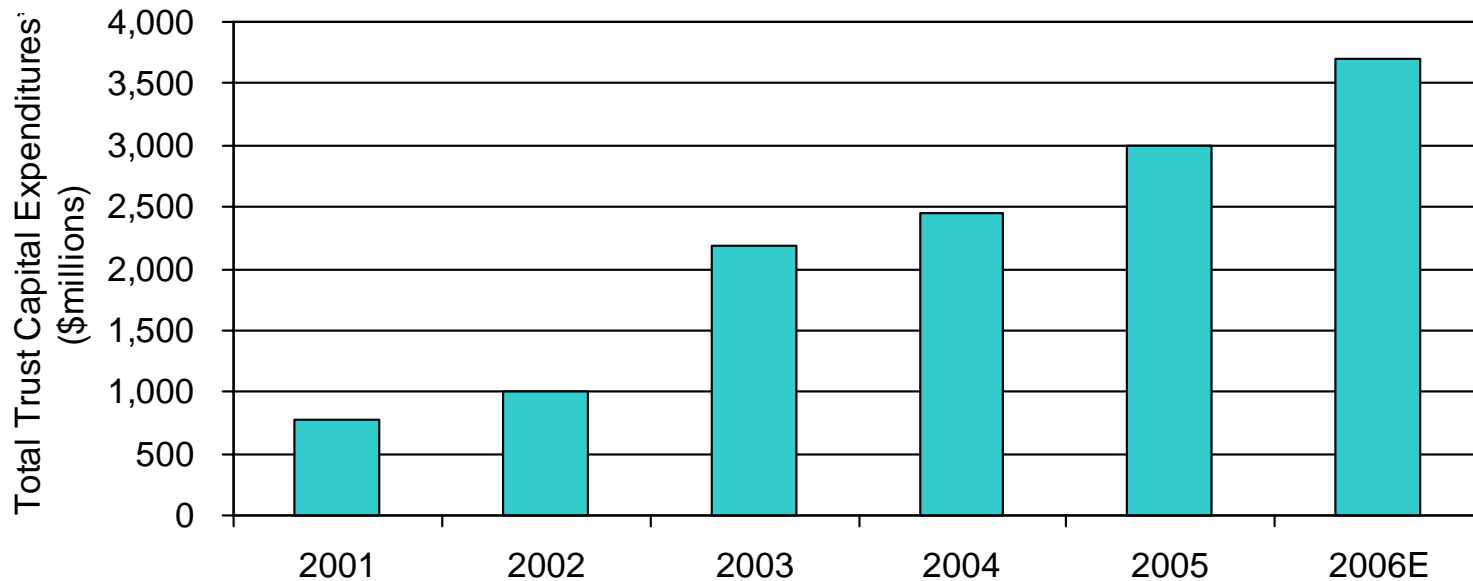
Income and Royalty Trusts



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The Need for Foreign Capital by the Energy Trusts

- Increasing amounts of capital are needed to develop Canada's oil and natural gas reserves and large scale projects such as Oil Sands, SAGD, primary, secondary and tertiary recovery schemes
- Canadian Trusts, by virtue of their distribution model, pay out more cash flow to investors and have an increasing need for access to capital for re-investment



* Excludes acquisitions

Source: FirstEnergy

- Formed in March of 2003, the Canadian Association of Income Funds (“CAIF”) represents over 70 Trusts from various sectors with a combined market capitalization of approximately \$100 billion (www.caif.ca)
- Major recent CAIF initiatives:
 - Limited liability legislation (Alberta, Ontario, Manitoba, B.C and Nova Scotia pending)
 - Taxation Issues - non-residency limitations, CICA reporting issues, T3 filing revisions, taxation of trusts
 - S & P /TSX composite index inclusion
 - Corporate Governance
 - Consultations with CAPP, REALPAC, and PIAC on issues of mutual concern
- Calgary-based oil and gas trusts (36 at last count!) represent approximately 20% of the current production in the Western Canada Sedimentary Basin
- These energy trusts produce, in aggregate, over 450,000 BOE per day of oil and natural gas and directly employ approximately 4,000 personnel throughout western Canada

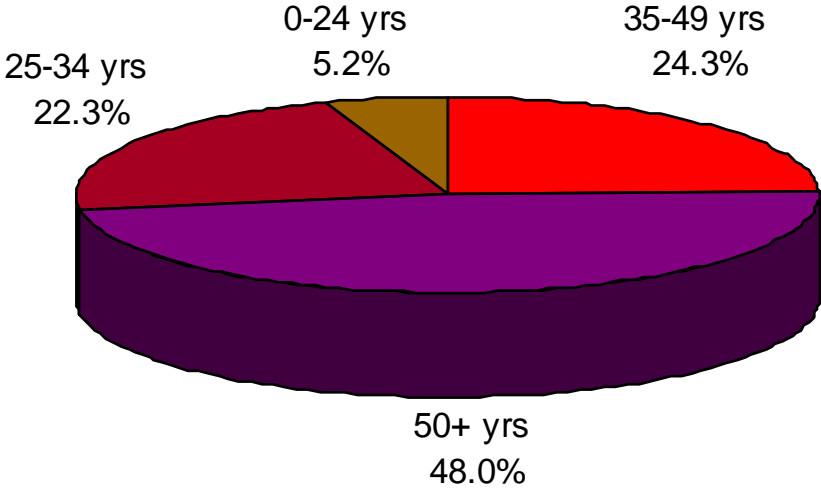
Who leads CAIF?

- Stephen Probyn – Chair (Clean Power) - Toronto
 - George Kesteven – President (PrimeWest) – Calgary
 - Don McCutcheon – Past President (Gowlings) - Toronto
 - Hume Kyle – Vice President (Fort Chicago) - Calgary
 - Steve Rotz – Vice President (Davis & Henderson) – Toronto
 - Francois Ramsay – Vice President (Yellow Pages) – Montreal
 - Paul Hollands – Vice President (A & W) – Vancouver
 - Vacant – Vice President (Oil & Gas Trusts) – Calgary
 - Stephen Pincus – Board Member (Goodmans) - Toronto
 - Tyron Cotie – Advisor (Clearwater Seafoods) – Bedford, N.S.
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- Margaret Lefebvre – Executive Director – Montreal
 - Peter Carayiannis – Director – Legal & Government Affairs - Toronto
 - Ruth Abrahamson – Secretariat – Toronto
 - Matthew Behan – Advisor – Hill & Knowlton - Ottawa

Income Trusts Provide Cash Flow to Canadians

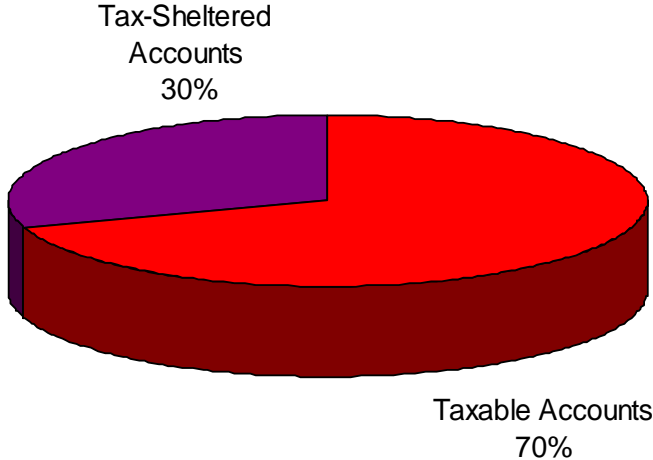
- Retail investors represent approximately 80% of income trust holders
- Units of trusts are held in taxable accounts and used as an income supplement in the present low interest environment – during 2005 approximately \$12 billion was distributed to Canadians

ESTIMATED AGE OF UNITHOLDERS



Source: Estimations based upon results of Canada Newswire survey of investors seeking information on PrimeWest Energy Trust and Enerplus Resources Fund

ACCOUNT TYPE



Source: BMO Nesbitt Burns, CIBC World Markets and RBC Capital Markets

Why Mobilize Retail Unitholders?

- According to Harry Levant, a research analyst with IncomeTrustResearch.com, there are nine million Canadian voters over the age of 50, and research conducted by CAIF indicates the majority of income trust holders are also over 50.
- The average turnout rate for an election is 60 percent, which means there are up to 5.4 million votes at stake from this age demographic.

Legislative Changes in 2004 Federal Budget (Round #1)



- The Federal government announced changes to the Canadian Income Tax Act on December 6th, 2004 affecting Income Trusts in Canada:
 - The proposed change to the definition of Taxable Canadian Property (TCP) such that resource and timber based Trusts would be subject to foreign ownership restrictions was suspended subject to consultation
 - All Trust distributions paid to non-residents would be subject to a flat 15%, non-refundable withholding tax, applicable to previously tax-exempt (i.e. IRA's) account as well

Note - Restrictions on ownership of certain types of trusts by Pension Funds, announced March 23rd, 2004 were suspended pending further discussion on May 18th, 2004.

Consequences of Foreign Restrictions (Round #1)



- Due to market size and product saturation, the Canadian capital markets can only support equity offerings of limited size
- By subjecting energy Trusts to foreign ownership restrictions, the Federal government would severely limited the ability of Trusts to participate in the development of large scale projects
- As foreign and Canadian companies sell larger assets, Trusts would be competitively challenged in situations where significant funds are required to compete for opportunities
- Several Trusts already have a majority of foreign ownership and would have to somehow repatriate hundreds of millions of dollars worth of Units at great cost to their existing Canadian Unitholders. This could result in significant market disruption and unwarranted economic losses in the Canadian retail market

Government Concerns - Tax Leakage (Round #1)



- We suspect the budgetary changes came as a result of government concerns over perceived tax leakage
- CAIF commissioned a study by HLB Decision Economics Inc. to analyze the proposed budgetary tax changes related to non-resident taxation,
- The key findings of the study were:
 - Increased withholding taxes on the otherwise non-taxable portion of foreign distributions would increase government revenues by \$83 million in 2004
 - Tax losses due to increased foreign ownership, however, are relatively minimal – post budget effects of changes to withholding taxes would more than compensate for that reduction
 - Where non-resident investment shifted from oil and gas corporations to Trusts, a net increase in tax revenue was seen in every case

Trust vs. Corporation Tax Snapshot



<u>Based on Industry Data</u>	<u>Income Trusts</u>		<u>Public Corporations</u>	
Distributions/Income	\$180.00	(1)	\$100.00	
Effective corporate tax rate	na		27.0%	(2)
Effective corporate taxes	na		\$27.00	
Taxable portion (Trust)	74.0%		na	
Net Income (Corp)	na		\$73.00	
Dividend payout ratio (Corp)	na		28.0%	(3)
Taxable distributions/dividends	\$133.20		\$20.44	
Effective tax rate distributions/divider	38.0%		22.5%	
Taxes on dividends	na		\$4.60	
Total Tax Collected	\$50.62		\$31.60	

Source: Gordon Tait, BMO Nesbitt Burns

- (1) Trust are taxed on distributions; CDPU average 1.8 X earnings (2004)
- (2) Corporate cash taxes average 27% (Stats Canada) of pre-tax earnings not 35%
- (3) Corporate dividend payout ratios average 28% on S&P/TSX not 100%

Summary: Department of Finance understates taxes on trust units and overstates taxes on corporate shares for taxable Canadian investors

Government of Canada (Round #2)



- September 8th – Government of Canada releases long awaited discussion paper (consultation process was to run to year-end)
- September 19th – Government of Canada suspends “advanced tax ruling” protocol
- September 28th – CAIF panel appears before the Senate Banking and Finance Committee
- November 18th - CAIF launches “Setting the Record Straight” campaign
- November 23rd – Minister Goodale truncates consultation process, revises dividend taxation
- November 28th/29th – Government falls/Election writ dropped

Potential Outstanding Tax Issues

- Capping the level of pension fund (tax exempt) ownership, thus limiting institutional popularity?
- Putting corporate dividends and income trust distributions on an equal footing from a tax perspective, lessening the attraction for corporations to convert to the income trust structure (November 23rd)
- Lowering corporate income tax rates, again diminishing the attraction to convert to a trust (Goodale tried!)
- Limiting non-resident ownership and/or increasing the level of tax withheld from non-residents
- Provincial tax issues
 - Province of unitholder residence issue
 - Dividend taxation change – conformity to the November 23rd announcement (Quebec has already said no!)

The Future . . .

- Post the November 23rd announcement
 - Not yet legislated – sent to the Ways and Means Committee
- Post the January 23rd election . . .

The Globe and Mail reports in its Thursday, Jan. 12, edition that a Conservative government would leave in place the Liberal income trust policy. A Canadian Press dispatch to The Globe reports the Conservatives's finance critic Monte Solberg said Wednesday the Tories, if elected, plan no real changes. "When the Liberals made their announcement, that's what we had been proposing," Mr. Solberg said. "So we're very supportive of that approach and we'll be explicit about it when we release our platform," later this week, he added. The minority Liberal government announced on Nov. 23 the tax treatment for income trusts would be left in place. The Liberals also said taxes on dividends would be lowered.

The Future (continued)

- Governance issues
 - Board of Director/Trustee issues
 - Corporations vs. income funds
- Disclosure issues
 - “Distributable cash” definition
- Institutional following
 - S&P/TSX index inclusion
- We are an elephant that can no longer hide under an umbrella – communication and education programs are now a top priority



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