

## >: Canada Goes Chavez on Global Investors

Friday, November 3, 2006 / Teeka Tiwari

The sheer blind, unadulterated stupidity of some government officials is truly stupefying. I mean diaper wearing, crash helmet, padded room, chin drooling savants are geniuses when compared to some of the world's bureaucrats. I am referring directly to the action taken this week by the Canadian tax authority and their decision to start taxing Canadian Income Trusts.

In particular I am pointing to that financial giant of a man (**NOT!**

), Jim Flaherty, Canada's Finance Minister. This misanthropic, blinkered rocket scientist of a human being unilaterally decided it would be a good idea to slap a tax on all Canadian Income Trusts. True, the taxes will not take effect for another four years but in the interim Mr. Flaherty essentially went third world dictator on every investor that has their money in Canadian Trusts.

I would expect this type of political risk if I were invested in South America, China, India or Africa. But to have the rug pulled out from under me by a 'first world' country like Canada is horrifying. It's like the 1970's all over again where western governments all over Europe started nationalizing private industry assets. There is a very ugly anti business trend talking place in the Western world and it scares me to death.

Apparently our good friend Mr. Flaherty pulled out his trusty (*and rusty*) slide rule and figured that Canada was losing (*losing* is a very subjective word) about \$800 million per year in tax revenues from income trusts. So Mr. Flaherty (with zero notice to the finance community) decided to impose a 26.5% tax on non-Canadian investors.

The Canadian Income trust market is 200 billion dollars big and is populated by many non-Canadian holders. In fact, trusts account for more than 10% of the Toronto Stock Exchange's entire market capitalization. Hardly a backwater product, the trust market is a very important source of investment dollars for Canadian companies.

The Finance Ministers move has already wiped away between 10%-15% of market cap off the entire sector as investors reevaluate the tax efficiency of their trust investments. In addition markets were so spooked that the Canadian dollar took almost a 1% hit in a day!

BMO Nesbitt Burns analyst Gordon Tait commented dryly ?

*We would point out to the Minister that a potential 10% correction in the capitalization of the trust market equates to an approximate \$25 billion destruction of wealth. A \$25 billion hammer to fix a \$500 million to \$800 million problem does not look like a very equitable solution?*

I'd like to applaud Mr. Tait for having the guts to say what needed to be said. It was a bold move, bravo Mr. Tait, bravo.

Ok, I've vented my anger, so what do we do now?

Well a couple of weeks ago I wrote an article on the Canadian Royalty Trusts (CANROY's) and recommended two stocks. Baytex Energy (BTE) at \$21.50 and Provident Energy (PVX) at \$12, as of Thursday BTE was quoted at \$17 and PVX was quoted at \$9.50. In that article (you can access it here [http://www.thetycoonreport.com/tycoon\\_report/20061020.html](http://www.thetycoonreport.com/tycoon_report/20061020.html))

I stated that you want to spread your bets around and not get overly concentrated in one issue when it comes to investing in equities for yield to protect yourself from the unexpected. Hopefully you followed that a

As a yield investor the first thing to do is to ascertain if the yield you are receiving under the new tax structure still makes sense for you. If it does not and your tax advisor recommends selling then the smart thing to do would be to wait for a bounce. There's a lot of raw emotions out there right now and these stocks have become extremely oversold and in all likelihood will experience a bounce.

If however the trusts still make sense for you from an investment and tax perspective then you may want to consider buying more down here at these prices because this is a tax issue not a company issue. Meaning that these companies will still carry on churning out cash and their core businesses will remain unaffected.

The important thing to remember is that the new taxes won't kick in for another 4 years so this could be quite a buying opportunity. Once again you must consult your tax professional to get a clearer idea of your own personal tax ramifications. The yield on BTE now stands at over 11% and PVX is at over 13%. If you work under the assumption that all the bad news is out and their respective business remain the same then even with a 26% tax on dividends both of these stocks may be compelling buys for you based on your current tax bracket. Once again you need to talk to your tax professional to make that determination.

For Canadian investors it's more of a no brainer because Canadian residents can take advantage of the dividend tax credit, which will allow distributions from income trusts to be taxed as income as they are now.

The key lesson here is that you can do everything right and a government can change the rules on you and make you wrong. Even a well developed western government like Canada. The key is to not get too concentrated in one area where a move like this wipes you out and to also not miss the opportunity afforded by the chaos that follows an announcement such as this one. Remember where there are lemons, there is lemonade to be made!

Enjoy Your Weekend!



Teeka Tiwari

Chief Investment Officer

≥