

TOP TIPS FOR MANAGING MICs

EVERYTHING FROM THE INCOME TAX ACT TO INVESTOR COMPLIANCE

With recent changes in the traditional Canadian banking regulations, growth of MICs and Canadian Private Lenders has been expanding exponentially. For those creating a MIC or would like to grow their MIC, having an effective administration system can provide ease for management of daily tasks as well as an effective system for growth.

In addition to duties required to manage any corporation, MIC management requires managing a conduit of capital. MIC Managers need to manage investments into the MIC in terms of share purchases, the allocation of capital into mortgages, payments back into the MIC (in terms of mortgage payments) while also maintaining a system of reporting and financial accounting.

WHAT ARE MICs

MICs are unique in that they can raise capital through individual investors as well as able to lend money for mortgages outside the Canadian traditional banking system. MICs are also unique in that as a Corporation they are exempt from corporate taxes. In order to meet MIC status, MICs must comply with regulatory bodies including the Mortgage Brokers Act, Provincial Security Commissions as well as the Income Tax Act.

INCOME TAX ACT

MICs are defined under section 130.1 of the Income Tax Act as a tax-exempt Corporation and all income (minus fees, expenses etc.) must be distributed to shareholders. For a MIC to maintain its exempt status the administrators need to comply with the rules on the Act such as and not limited to 50% of the MIC assets must be invested in Residential Properties, minimum of 20 shareholders and no such one group of investors can invest 25% or more of the MIC assets. In order to comply to the Act, MIC Managers will periodically review their portfolio with corporate analytical and accounting reports, particularly at corporate year end.

Income Tax Act,[1] Section 130.1: Salient Rules

1. A MIC must have at least 20 shareholders.
2. A MIC is generally widely held. No shareholder may hold more than 25% of the MIC's total share capital. Shareholders whose MIC holding are held in registered accounts (RRSP, TFSA, etc.) are limited to 10% due to regulations restricting ownership in those accounts. capital.
3. At least 50% of a MIC's assets must be residential mortgages, and/or cash and insured deposits at Canada Deposit Insurance Corporation member financial institutions.
4. A MIC may invest up to 25% of its assets directly in real estate, but may not develop land or engage in construction. This ceiling on real estate holdings does not include real estate acquired as a result of mortgage default.
5. A MIC is a flow-through investment vehicle, and distributes 100% of its net income to its shareholders.
6. All MIC investments must be in Canada, but a MIC may accept investment capital from outside of Canada.
7. A MIC is a tax-exempt corporation as its income is instead taxed in the hands of its shareholders.
8. Dividends received with respect to directly held shares, not held within RRSPs or RRIFs, are taxed as interest income in the shareholder's hands. Dividends may be received in the form of cash, or additional shares.
9. MIC shares are qualified RRSP and RRIF investments.
10. A MIC may distribute income dividends, typically interest from mortgages and revenue from property holdings, as well as capital gain dividends, typically from the disposition of its real estate investments.
11. A MIC's annual financial statements must be audited.
12. A MIC may employ financial leverage by using debt to partially fund assets.

AUDITED FINANCIALS

Rule 11: MICs annual financial statements must be audited. MICs need to maintain accurate financial records as well as an accounting system. Creating and managing your MIC using a Chart of Accounts for real time accounting will provide a strong financial system for corporate analysis. Furthermore, managing your MIC using an accurate and updated Chart of Accounts will allow MIC managers to view their finances at a glance such as Interest Receivable balances and Share Capital under management. Cash Management for the MIC is the backbone of MIC administration thus having a real time true accounting package is essential for strong MIC management.

INVESTOR COMPLIANCE

MICs acquire their capital to lend by offering individual investors an opportunity to purchase shares in the MIC. The investment of the MIC is regulated strictly by each of the Provincial Security Commissions. Understanding and applying these rules are vital to administering a MIC. (please refer to a lawyer for maintaining SEC Provincial Compliance)

Similarly, MICs may need to comply to the National Instrument 31-103 CRM2 Compliance. In order to comply to 31-103 and the new CRM2 regulations, MICs will need to produce Compliance reports including Form 45 106F1, Investor Statement of Holdings, Quarterly Statements, Confirmation of Transactions, Transaction History (Trade Blotters) and recently implemented Annual Charges and Compensation report. Another recently implemented and frequently used Compliance report is the new Investor Performance Report with money weighted rate of return.

REGISTERED INVESTMENTS

Upon approval, MICs can accept investment from registered funds such as RRSP and RRIF. When MICs are managing registered funds, they will need to comply with requirements to report to the Trustees. For instance, Olympia Trust requires a physical share certificate for initial investment and to reflect any accrued dividends from the MIC. Similarly, Trustees can instruct MICs certain format for reports if MICs send cheques or cash payments to Trustees. Having a system in house to automate the creation of certificates and reports for new purchases as well as accrued dividends is recommended for managing registered funds.

DIVIDENDS

Investors in a MIC receive return in their investment through dividends. MIC Managers will distribute dividends either monthly, quarterly or annually. Dividends are usually calculated on a daily basis (365 days) based on their proportional investment. Investors might have many different investments (shares) with varying amounts and purchase dates as well as registered or non-registered. Effective MIC Management will use an automated dividend calculation and ideally an electronic (eft) distribution system which will save days of administration time while similarly great reducing investor errors.

ON-LINE PRESENCE

Having an online system in place to report to investors and borrowers will make the entire administration of the MIC less time

consuming. Investors will likely periodically call regarding their investment and having a handy report also available online will greatly reduce administration time as well as provide a professional online presence.

UNDERWRITE GOOD LOANS

In order to manage a MIC, managers will also need to successfully underwrite and fund loans. Most MICs will have a dedicated person(s) who are experienced underwriters able to mitigate risk by making prudent lending decisions. MIC Managers generally underwrite their loans using objective decisions and could even physically visit the properties. Many MICs will also have a credit committee with very strict lending policies based on such factors as loan to value ratios and the sale or value of the property itself. Having a very strong and experienced underwriter in your MIC will likely reduce defaults on properties thereby greatly reducing the timely and costly administration of foreclosure and loss of funds.

SYSTEMS

Creating an integrated transaction based system for Mortgages, Shares and Accounting will provide a good administration for a majority of MIC Management. With recent changes in Compliance rules such as 31-103 Investor Performance Report, having an ability to maintain compliance through the generation of reports will reduce chances of errors and maintain good regulatory compliance. Similarly, having a system that reports and provides corporate analysis will provide opportunity for growth for aid in corporate decisions including Underwriting decisions. Managing your MIC with a real time accounting system will provide MIC Managers with a system to generate financial reports for audit as well as quickly grow through corporate analysis.

MICs are an excellent vehicle for investment - provide a terrific source for funding - as well as a fantastic business to manage and run. Just ensure, as MIC Managers, you have good systems in place.



Shannon Dolphin is CEO of Dolphin Enterprises Ltd. and has been working with MICs for over 14 years. Dolphin and its new Underwriting and MIC Manager software solution is the only software to provide administration for MICs from the application of the loan to the back-end transaction based Chart of Accounts/Accounting system.

For information about MICs or MIC Manager please contact info@dolphinent.com or 604-685-6721 or visit www.dolphinent.com

MIC Manager
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