

Naked investing

Why do so many Canadian investors continue to ignore the bare facts about income trusts?

Ever since Finance Minister Jim Flaherty clamped down on income trusts, Canadians have been inundated with some truly outrageous and self-serving lobbying. The Canadian Association of Income Funds (CAIF), that public-spirited group of 90 income funds, three accounting firms, 10 law firms and seven investment dealers, wants to galvanize public opinion—misinformed seniors, mostly—and get Ottawa to recant. The 42-member Coalition of Canadian Energy Trusts (more than two-thirds of which are, by coincidence, members of CAIF) has orchestrated a \$10-million advertising campaign, noting, among other howlers, that energy trusts are not only one of the keystones of Canadian economic sovereignty, but are also “green.”

Actually, the colour that more aptly describes income trusts is red. As in the red ink that some trusts produce by handing out more money in distributions than they record as profits from their business.

The Coalition of Canadian Energy Trusts makes the claim that they pay more taxes per dollar of revenue than non-trust energy companies. Nevertheless, they love being trusts. In fact, they love being trusts so much they are screaming mad that Flaherty is going to make them pay less tax. Yes, that's right. They must convert back to regular corporations over the next few years, and presumably—according to their own research, anyway—will end up paying much less tax. How dare you, Mr. Flaherty!

Naturally, this means that there must be some other advantages to being a trust that outweigh the extra tax they claim to pay. These advantages are not mentioned in the Coalition's recent 85-page report. But, I'm guessing that one of the big attractions is the ability to trade at several more times their reported earnings than regular energy companies. You can thank the abuse of distributable cash reporting and deceptive investment yield comparisons for that.

Essentially, investors have been cajoled into focusing on cash distributions, instead of normal profitability. Most investors would worry if a regular corporation is consistently paying out dividends in excess of earnings.

Not so with income trusts. Thus, there's a certain leap of faith that income trust investors are willing to make. Trusts love this kind of mentality. Investors are willing to bid up the price of trust units above their fundamental profitability. The trusts crave this backward investment philosophy so much they even have a name for it—“access to capital”—a phrase sprinkled liberally throughout the coalition's report.

Of course, the coalition is not alone in its less-than-complete view of the merits of income trust investing. It has been aided by its paid lawyers, accountants and underwriters, all of whom have made a small fortune off the explosion of income trusts over the past five years.

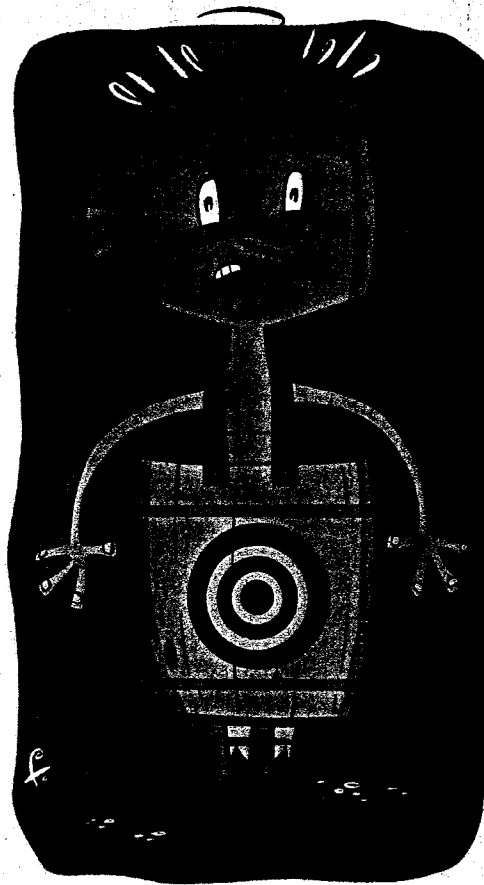
However, the screeching from those secondary parties has

reached a crescendo and is fading quickly. The accountants, lawyers, underwriters and opposition political parties were mostly looking to score some quick points, in the hopes of making the blame stick to someone else. They have already moved on to other profitable work, some of which will include undoing the income trust mess that they helped create.

Investors still have to endure the last-gasp advertising blitz of the trust associations, with all its attendant distortions. Discerning truth in all this flak will take a lot more than blind faith. It will take skepticism and common sense, starting with the realization that the income trust sector, replete with failures as it's been, is not viable in the long run. Equally, the government's Oct. 31 income trust measures did nothing to address the abundant deficiencies in investor protection. Investors are as naked and alone as they were on Oct. 30.

But hopefully, not without their wits. They should, as the old wisdom goes, act as investors rather than speculators, objectively buying sound equities that have value and the prospect of enduring growth. Tax or no tax, income trusts that eat themselves alive wouldn't seem to qualify. **CB**

Red, not green, is the colour that more aptly describes many income trusts



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