Securing & Sustaining
"Mutual Fund Trust" Status – Tips & Traps

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Part II

Navigating the New RRSP/RRIF Anti-Avoidance Rules

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Agenda – *RRSP/RRIF Anti-Avoidance Rules*

I. Historical Developments and Overview

II. Old RRSP Eligibility Standards

III. New RRSP Anti-Avoidance Rules

- **“Prohibited Investments”**
- **“Advantages”**
- **Tax Waivers**
- **Grandfathering Relief**
- **Special Considerations**

Historical Developments

- Proposed RRSP Anti-Avoidance Rules (the "**Proposed Rules**") were first introduced in the March 22, 2011 federal Budget
- Proposed Rules re-introduced in June 6, 2011 federal Budget
- Draft legislation released on August 16, 2011
- "Technical Notes" released on September 1, 2011

Overview of Proposed Rules

- Based on rules governing tax-free savings accounts
- Reflect desire of the Department of Finance to address certain planning involving registered plans
- Introduce concepts of “prohibited investments” and “advantages”
- Establish new penalty tax regime

Old RRSP Eligibility Standards

- Section 146 of the Tax Act / Regulation 4900
- “Qualified investment” status critical
- Relatively broad array of property could be held by an RRSP, including shares of certain private corporations

“Prohibited Investments”

- Additional restriction on RRSP property holdings
- Captures property that is:

a) a debt of the annuitant of the RRSP;

b) a share of the capital stock of, an interest in, or a debt of

i. a corporation, partnership or trust in which the RRSP annuitant has a “significant interest”, or

ii. a person or partnership that does not deal at “arm’s length” with (1) the RRSP annuitant, or (2) a person or partnership described in subparagraph i. above;

"Prohibited Investments"

c) an interest in, or a right to acquire, a share, interest or debt described above; or

d) a "prescribed property".

- Certain "excluded prescribed property" carved out of the definition of a "prohibited investment"

“Prohibited Investments”

“Significant Interest” [ss. 207.01(4)]

- Incorporates “specified shareholder” definition
- Frequently captures 10% + holdings
- Various look-through, deeming, and aggregation rules

“Arm’s Length” [s.251]

- Related party and factual tests

“Prohibited Investments”

“Prescribed Property” [Proposed Reg. 5001]

- Captures certain small business, venture capital, specified cooperative corporation shares
- Introduces potential traps

“Prescribed Excluded Property” [Proposed Reg. 5000]

- Certain insured mortgages [Reg. 4900(1)(j.1)]
- Certain shares/units of relatively new mutual fund corporations/trusts
  - Exclusion more complicated/restrictive than it first appears

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"Prohibited Investments" – Tax

- Tax payable by RRSP annuitant if property acquired is, or becomes, a "prohibited investment" or a "non-qualified investment" [ss. 207.04(1)]
- Tax = 50% of fair market value of property at time of acquisition/status change [ss. 207.04(2)]

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“Prohibited Investments” – Tax

- Refund of tax potentially available in year RRSP disposes of “prohibited investment”.
- Refund equal to:
  1) the amount of tax paid, **UNLESS**
  2) it is reasonable to consider that the RRSP annuitant knew, or ought to have known, at the time the property was “acquired” by the RRSP, that it was, or would become a “prohibited investment”, or
  3) the property is not disposed of by the RRSP before the end of the calendar year following the calendar year in which the tax arose (or any later time the Minister considers reasonable in the circumstances).

“Prohibited Investments” – Tax

- If 2) or 3) above apply, no refund will generally be granted
- The new tax applies in respect of investments “acquired” after March 22, 2011
  - Several events could trigger the “acquisition” of an investment by an RRSP, including certain deemed dispositions/acquisitions
  - Note the Canada Revenue Agency’s published position regarding transfers of property between RRSPs

“Advantages”

- Lengthy statutory definition captures many types of benefits and potentially advantageous transactions, including:
  - certain benefits associated with transactions that would not have occurred on the open market
  - “swap transactions”
  - a benefit that is income (including a capital gain) that is reasonably attributable, directly or indirectly, to a “prohibited investment”
  - an “RRSP strip” [ss. 207.01(1)]

“Advantages”

- Proposed amended definition of an “advantage” applies to transactions occurring, income earned, capital gains accruing and investments acquired after March 22, 2011, except for certain grandfathering in respect of “swap transactions”

“Advantages” – Tax

- A tax is generally payable by the annuitant of an RRSP in the year an “advantage” in relation to the RRSP is extended to, or is received or receivable by, (1) the annuitant, (2) the RRSP, or (3) any other person that does not deal at “arm’s length” with the annuitant.
- However, an issuer of an RRSP can instead be liable for the tax alone if the advantage is extended by the issuer or a person with whom the issuer is not dealing at “arm’s length”. [s. 207.05]

“Advantages” – Tax

- The amount of the tax equals:
  - in the case of a benefit, the fair market value of the benefit
  - in the case of a loan or an indebtedness, the amount of the loan or indebtedness
  - in the case of an “RRSP strip”, the amount of the “RRSP strip
- Certain limited grandfathering relief may be claimed, subject to certain conditions

Tax Waivers

- The Minister may waive/cancel a tax liability where the Minister considers it just and equitable to do so, having regard to all the circumstances, including whether the tax arose as a consequence of reasonable error. [ss. 207.06(2)]
- The Minister may not waive/cancel a tax in respect of an “advantage” unless payments are made, without delay, by the RRSP to the annuitant equal to the tax liability. [ss. 207.06(3)]

Grandfathering Relief

- Limited exclusion from “prohibited investment” tax provisions
- Until end of 2012, an annuitant may execute a “swap transaction” to remove property from an RRSP without triggering an “advantage” in respect of the “swap transaction” *if it is reasonable to conclude that the retention of the property in the RRSP would result in tax being payable under the Proposed Rules.*

Grandfathering Relief

- “Transitional prohibited investment benefit” relief
  - Limited ability to reduce “advantage” tax from 100% to 42.9%, provided certain conditions are satisfied. Among other things, access to such transitional relief requires:
    - subject property to have been a “prohibited investment” on March 23, 2011
    - subject income to have been paid to the annuitant by the RRSP within 90 days after the end of the taxation year
    - an election to have been made before July, 2012

Special Considerations

- Duty of care requirement for issuer of an RRSP
  - Issuer must exercise the care, diligence and skill of a reasonably prudent person to minimize the possibility that an RRSP holds a “non-qualified investment”.
  - Potential penalty for contravention [ss. 207.01(5)]
- Special return requirement [s. 207.07]
- Grandfathering relief traps
- New “prohibited investment” compliance burdens
- “Swap transactions”

Questions

Cautionary Note

The foregoing commentary is summary in nature and does not address all of the issues and considerations that may be relevant under any particular set of circumstances.

The statements and material presented herein do not represent legal or tax advice.

No transactions should be executed on the basis of the foregoing statements, diagrams, and commentary. Formal legal, tax, and accounting advice should be obtained prior to making any investment or executing any transaction.

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