

BUDGET 2021: “REGISTERED INVESTMENT” TAXATION RULES RELAXED

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Budget 2021 announced legislative changes that will provide welcome relief to trusts and corporations that are “registered investments” for the purposes of the *Income Tax Act* (Canada) (the “**Tax Act**”).

Background

Registered plans, including registered retirement savings plans (“**RRSPs**”) and registered retirement income funds (“**RRIFs**”), are generally only permitted to hold “qualified investments”.

Shares or units of a “registered investment” are typically “qualified investments” for the purposes of the Tax Act.

Certain trusts and corporations are entitled to apply to the Minister of National Revenue to be accepted as “registered investments” for certain registered plans, including RRSPs and RRIFs. In addition to mutual fund trusts and mutual fund corporations, which each qualify as “registered investments”, trusts or corporations that would otherwise have been mutual fund trusts or mutual fund corporations had they satisfied the applicable ownership dispersal tests (e.g., the so-called 150 unitholder/shareholder test) may also qualify as “registered investments” so long as they only hold prescribed investments for the type of registered plan in respect of which they have applied for registration (the “**Prescribed Holding Requirement**”). Entities that fall within the latter registration category are commonly referred to as “quasi-mutual fund trusts” and “quasi-mutual fund corporations” (together, “**Quasi-Mutual Funds**”).

Quasi-Mutual Funds that fail to satisfy the Prescribed Holding Requirement may be subject to a special monthly tax equal to 1% of the fair market value of their impermissible property holdings (computed at the time of acquisition of such property) (“**Part X.2 Tax**”).

Potential Unfairness to Non-Registered Plan Investors

Stakeholders have raised concerns that, to the extent interests in a “registered investment” are not held by registered plans, Part X.2 Tax may place an unfair burden on non-registered plan investors. For instance, if 75% of the units of a Quasi-Mutual Fund are held by taxable individuals, it would seem unfair for the “registered investment” to pay Part X.2 Tax in respect of all of its non-permitted investments since 75% of its equity is held

by taxable investors to whom “registered investment” status is largely irrelevant.

The government has recognized the unfairness inherent in the Part X.2 Tax rules and has proposed to amend the Tax Act to effectively pro-rate Part X.2 Tax so that it only applies in respect of a fraction of the impermissible property holdings of a Quasi-Mutual Fund, with (i) the numerator of such fraction being equal to the number of issued and outstanding units/shares of the Quasi-Mutual Fund held at the end of the relevant month by RRSPs, deferred profit sharing plans, RRIFs and registered investments described in paragraphs 204.4(2)(b), (d) or (f) of the Tax Act, and (ii) the denominator of the fraction being equal to the total number of issued and outstanding shares/units of the registered investment at the end of the relevant month.

The new proposals are expected to reduce the Part X.2 Tax payable by “registered investments” by \$30 million over the next five years.

Implementation Timing

The Part X.2 Tax relieving measures are proposed to apply in respect of months ending after 2020. In addition, the relieving measures will also apply to a “registered investment” in respect of months before 2021 if, on or before April 19, 2021, (a) no notice of assessment in respect of an amount of Part X.2 Tax payable for the month has been sent to the “registered investment” in respect of the month, or (b) if such a notice of assessment has been sent to the “registered investment”, the “registered investment’s” right of objection or appeal in respect of the assessment has not expired.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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