



INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Bill C-13 Recommendations – RRSP/RRIF Anti-Avoidance and Other Rules

Remarks to
the Chair and Members
Senate Standing Committee on National Finance

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It is an honour to appear before you on behalf of the Investment Industry Association of Canada (IIAC) and our 180 members to provide comments regarding Bill C-13's proposed anti-avoidance and related rules with respect to RRSPs and RRIFs (the new rules). Je m'appelle Barbara Amsden et je suis directrice à l'ACCVM. Je suis accompagnée de Debbie Pearl-Weinberg qui est avocate générale en droit fiscal à la CIBC. Debbie is here representing the IIAC's tax committee. My comments reflect our members' experience with Canadians' and Canadian companies' needs and concerns with respect to retirement savings.

Our members agree with Department of Finance (Finance) and Canada Revenue Agency (CRA) concerns with past use of registered plans in a way that the Government did not intend and agree with the need for anti-avoidance rules to address these cases. We believe, however, that measures taken to prevent those who deliberately try to take advantage of the tax laws beyond what was intended should not be implemented at the expense of honest taxpayers – the millions of Canadians who hold RRSPs and RRIFs that are approaching \$700 billion in value.

Before going into specifics, I'd like to correct a possible misconception that may have arisen from earlier testimony on Bill C-13. Last week, Senator Runciman asked whether there was anything that could be done to deal with the inappropriate tax results that the legislation was to address “in a retroactive way” and the reply was: “Certainly the rules that are in Bill C-13 apply on a prospective basis in the sense that they will apply to income going forward.”

- First, in the past, the CRA has re-assessed some of these inappropriate transactions. The 2011 Budget said that the Government had “successfully challenged a number of these schemes under existing rules in the Income Tax Act.”
- Second, certain measures embodied in Bill C-13, which took effect as of March 23, 2011, will have an impact on people with certain holdings acquired *before* that time. In addition, some investors will view other changes as *retroactive* to March 22, 2011 due to delays in finalizing and publicizing the new requirements

While there are transitional rules, they are not enough, as was echoed in a recent submission to Finance by the Joint Committee of the Canadian Bar Association and the Canadian Institute of Chartered Accountants. One of the new rules' transition periods was almost over by the time the Budget passed in June and, as of yet, while we have been working with Finance and CRA, there still has been no public communication by the Government that we are aware of regarding the implications of the anti-avoidance proposals that are affecting or will affect Canadians. As will be appreciated, there are public relations issues associated not only with RRSP- and RRIF-holders to be dealt with, but also with companies relying on private placement (and even public) funding.

We have three areas of concern:

- **First, prohibited investments.**

Some of the qualified investments that Canadians held in their RRSPs and RRIFs became, as of March 23, 2011, “prohibited investments”. While the harsh penalty tax on the acquisition of a prohibited investment only applies to assets acquired *after* March 22, 2011, the tax on income and gains earned on prohibited investments applies even to assets held *prior* to this date.

This will affect, in certain cases, shares of small businesses, whose owners risked their savings to fund their company from their RRSPs under a longstanding government-sponsored tax initiative to encourage investment in small businesses that are the job-creation engine in this country. Some of these individuals now find themselves subject to tax on the income and gains earned on those investments inside their RRSPs. Although transitional rules may reduce the rate of such tax for a period of time, that is not a satisfactory result for someone saving for their retirement.

And some RRSP- and RRIF-holders have no reasonable method to get prohibited investments out of their RRSP without incurring a large tax liability, as they do not have sufficient assets outside the registered plan to conduct a swap, and there may not be a willing

buyer. Where they are personally involved in these companies, they may not wish to find an outside buyer or be forced by a sudden change in tax policy to re-arrange their long-term plans for the success, development and succession-planning of the businesses.

Bill C-13 will also affect some mutual fund investors. In some situations, it will be impossible for RRSP- and RRIF-holders to know if they are offside the new rules or not as they can become offside and go back onside as individuals purchase and sell the units or shares. While income tax regulations may help in the start-up phase of certain mutual funds, as currently drafted these regulations will not help in all situations and investors are unsure, without seeing the final version of such regulations, if they should be redeeming units at this time.

- **Second, with respect to non-qualified investments...**

Bill C-13 changes the penalty tax regime applicable to non-qualified investments in a registered plan. One change impacts investments that were qualified investments when purchased and become non-qualified at a later date (such as those becoming delisted). Where this occurred prior to March 23, 2011, a 1% per month tax applies until the security is removed. Under Bill C-13, where this occurs after March 22, 2011, the RRSP- or RRIF-holder will be subject to a one-time (refundable) tax equal to 50% of the value of assets acquired after March 22, 2011.

Now nearly nine months after the Budget, with the tax year-end less than a month away, we believe that neither financial institutions nor the CRA are ready for some of the changes required by Bill C-13 due to outstanding questions concerning complicated rules, hoped-for amendments to the proposals, and the extent of required systems and procedural changes. For instance, financial institutions essentially have continued to charge the 1% tax even when a security became non-qualified after March 22, 2011 as the draft legislation was not introduced until August, and systems and operational changes could not reasonably be made without clarifications from Finance and/or the CRA. How can reimbursing the 1% charged,

advising the CRA who has such investments and having the CRA charge the penalty tax of 50% of the non-qualified investments' fair market value be rectified efficiently?

- **A third issue is swaps – transfers of securities between the registered plan and its owner (or related party), for example, between an RRSP and a non-registered or open account.**

Proposed changes to the existing rules will subject RRSP- or RRIF-holders to a penalty tax equal to 100% of the fair market value of any future increase in value of assets swapped or income from such assets.

We believe, and understand that Finance staff would agree, that the majority of swaps would not be considered offensive from a policy perspective. Finance and CRA are concerned, however, with the ability to identify and stop *unacceptable* swap transactions from occurring. In our view, as the vast majority of swaps are likely to be legitimate, preventing them altogether will be problematic for many Canadian investors. For example, it will no longer be possible for a senior to swap to get emergency cash from an RRSP or to make the minimum required cash payments from a RRIF – both of which are immediately taxable transactions – without selling a security that has dropped significantly in value. It won't be possible for a small business owner to use a swap so that he or she doesn't have to sell a share of a private business that is not a prohibited investment.

Conclusion

We understand it is very late in the process to make changes to the Bill. We have been and are continuing to work with Finance for some changes by regulation and with the CRA for administrative relief, however, this is not enough. If the recommendations included in an attachment to my remarks cannot be made at this stage in the legislative process, we respectfully request that the Committee, as a minimum, seek Finance's immediate public notification of retroactive relieving changes that can be shown to be in the interests of honest taxpayers. Changes could be added to draft technical legislation issued on October 31, 2011.

Why we believe the intended changes – and in particular reasonable grandfathering periods – need to be announced quickly is simple: it will be confusing and costly for investors, the CRA and financial institutions to be subject to unnecessary or stop-gap systems and operational changes, and for investors and the CRA to have to deal with numerous refund requests, if Bill C-13's RRSP and RRIF provisions are implemented as drafted.

During this additional transition or grandfathered period, the CRA can challenge – as it has done successfully – transactions inconsistent with the intent of RRSPs and RRIFs, while the CRA and our industry develop the necessary systems and procedures to apply the new rules as amended. At a time of considerable pessimism about the global economy, the changes proposed will be welcomed by Canadians looking for good news this holiday season.

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RECOMMENDATIONS

Prohibited Investments

We request that the Committee recommend two amendments to Bill C-13 to address the fact that some securities, which are now prohibited investments, cannot quickly be removed from an RRSP or RRIF:

- i. Provide an additional grandfathering period, at least until December 31, 2021, during which the income and gains on assets held in RRSPs/RRIFs before March 23, 2011, which became prohibited investments as of March 23, 2011, are not subject to tax,
- ii. Exempt National Instrument (NI) 81-102 funds, and
- iii. Grandfather other assets acquired up to October 4, 2011 from the prohibited investment rules, at least until 2021.

Non-qualified investments

We request that the Committee recommend, as not being a risk of tax avoidance, continuing application of the rate of 1% on the fair market value of non-qualified investments until the end of 2012, followed by the application of a special tax at one rate on all non-qualified assets as of January 1, 2013.

Swaps

We request that the Committee recommend two amendments to Bill C-13:

- i. Provide an additional transition period for legitimate swaps (i.e., those that are not part of a series of transactions, or swap-ins with a fair market value that is readily verifiable) to be permitted until December 31, 2012 to allow taxpayers to restructure their holdings before the freeze on swaps is implemented, and
- ii. Exclude swap-outs from the definition of advantage, i.e., allow property to be swapped out of a registered plan for cash, even if property cannot be swapped into a registered plan, thereby:
 - a. preventing abuse through frequent in-and-out transfers and over-contributions where fair market value may not reflect real value (thus addressing both of the major stated concerns of Finance), and
 - b. allowing access to cash for minimum RRIF amount and emergency cash withdrawal purposes without forcing a sale at an inopportune time.

Options

Recognizing the need for many parts of Bill C-13 to proceed, we recommend that relevant provisions not apply through some mechanism such as severance for further work and re-introduction in legislation accompanying Budget 2012, provision for the prescription of certain effective dates in regulation, or assignment of an effective date of January 1, 2013, by which time the policy, implementation and other issues for Canadian seniors, small business owners, CRA and financial institutions can be addressed.