

2011 BUDGET CHANGES RELATING TO FINANCIAL INSTITUTIONS' REPORTING AND REMITTANCE REQUIREMENTS AS REGISTERED RETIREMENT SAVINGS PLAN (RRSP) ISSUERS / REGISTERED RETIREMENT INCOME FUND (RRIF) CARRIERS

The 2011 federal budget included several measures to enhance the existing RRSP and RRIF anti-avoidance rules. Legislation to implement these measures was contained in Bill C-13, which received Royal Assent on December 15, 2011. The new rules largely adopt the existing TFSA rules for non-qualified investments, prohibited investments and advantages, with some modifications.

The following Questions and Answers have been prepared to assist RRSP issuers and RRIF carriers (generally referred to as "financial institutions") in better understanding when and how the new rules apply and to inform institutions of their responsibilities under the new rules.

Note: In this document, the word "Act" refers to the *Income Tax Act*.

NON-QUALIFIED INVESTMENTS

Q1. What is the new income tax treatment for non-qualified investments?

The new rules impose a 50% tax on the annuitant of an RRSP or RRIF if the RRSP or RRIF trust acquires a non-qualified investment or if an existing investment becomes non-qualified in the year. The tax is refundable in certain circumstances (generally inadvertent cases that are promptly resolved). The annuitant is also liable for the 100% advantage tax on specified non-qualified investment income if this income is not withdrawn promptly.

The annuitant must file *RC339, Individual Return for Certain Taxes for RRSPs or RRIFs for Tax Year 2011* if they owe tax for the year. The return must be filed with a payment for any balance due no later than June 30 of the following year. RC339 provides instructions on how to claim a refund.

Q2. When do these new rules apply?

The new rules apply to investments acquired after March 22, 2011. They also apply to pre-March 23, 2011 investments that first become non-qualified after March 22, 2011.

Q3. Do financial institutions have to remit this new tax?

No.

Q4. Will investment earnings on non-qualified investments still be taxable to the RRSP or RRIF trust?

Yes. There is generally no change to the existing tax treatment. Income earned and capital gains realized by an RRSP or RRIF trust on non-qualified investments will continue to be taxable to

the trust, regardless of when the investment was acquired. If an investment is both a non-qualified investment and a prohibited investment, it is treated as a prohibited investment only and the trust is not subject to tax on the investment earnings (see Q8 and Q12).

The trustee must file the *T3, Trust Income Tax and Information Return* for the trust and is liable to pay any tax owing. The return must be filed with a payment for any balance due no later than 90 days following the end of the calendar year.

Q5. Will financial institutions still have to report non-qualified investments under the new rules?

Yes. Financial institutions are required to report information to the CRA and the annuitant when an RRSP or RRIF trust begins or ceases to hold a non-qualified investment in a year (e.g., an existing investment becomes non-qualified or a non-qualified investment is sold). However, instead of reporting the information on a T4RSP or T4RIF (see Q7), the reporting is to be done as follows.

Similar to TFSAs, financial institutions must provide the annuitant with the following information by the end of February of the following year:

- A description of the non-qualified investment;
- The date that the non-qualified investment was acquired or disposed of (or became or ceased to be non-qualified), as applicable, and the fair market value of the investment at that date; and
- The RRSP or RRIF contract or account number.

Communication of non-qualified investment holdings to the annuitant on a timely basis will assist the annuitant in taking appropriate corrective action.

On an interim basis, for non-qualified investment transactions subject to the new rules that occurred in 2011, financial institutions are required to send the information on CD ROM by **May 31, 2012**. The required data elements and the applicable XML schema will be available soon on our website.

This information is to be sent to the following address:

Canada Revenue Agency
Pensions and Partnership Projects Section
25 McArthur Road, 3rd floor
Vanier Tower “C”
Ottawa, ON K1A 0L5

For 2012 and future years, the financial institutions must provide this information electronically to the CRA by the end of February of the following year.

Q6. What other responsibilities do financial institutions have under the new qualified investment rules?

Responsibility for compliance with the qualified investment rules is generally shared between the financial institution and the annuitant.

In addition to the reporting and tax filing obligations described above, financial institutions are required under subsection 207.01(5) of the Act to exercise the care, diligence and skill of a reasonably prudent person to minimize the possibility that the registered plan holds a non-qualified investment. Failure to comply with this obligation may result in the financial institution being liable for a penalty under subsection 162(7) of the Act.

It is common for financial institutions to have an agreement with an agent, such as an investment broker, that allows the agent to provide the institution with certain administrative and investment functions. As noted in paragraph 15 of IC 72-22R9 and paragraph 28 of IC 78-18R6, the ultimate responsibility for the administration of each RRSP or RRIF covered by the agency agreement remains with the financial institution.

Q7. Will pre-March 23, 2011 non-qualified investments continue to be subject to old rules?

Yes. An investment that was a non-qualified investment before March 23, 2011 will continue to be subject to the old rules that provided for either an income inclusion with an offsetting deduction or the 1% monthly tax.

- As in prior years, the following amounts are to be reported to the annuitant in Box 28 of the T4RSP slip or Box 22 of the T4RIF slip, as applicable:
 - If the trustee acquired a non-qualified investment prior to March 23, 2011, report (as a positive value) the FMV of a non-qualified investment at the time of its acquisition;
 - If the trustee disposed of a non-qualified investment that was acquired prior to March 23, 2011 and that was reported as income of the annuitant, report (as a negative value) the lesser of
 - The FMV of the non-qualified investment when it was acquired; and
 - The proceeds of disposition of the non-qualified investment.

Other T4RSP/T4RIF reporting instructions remain unchanged.

- Investments that were qualified when initially acquired but later became non-qualified before March 23, 2011, and non-qualified investments acquired before March 23, 2011 that were not reported as income of the annuitant, will continue to be subject to the 1% monthly tax for as long as the investment is held by the RRSP or RRIF trust. The trustee must report and remit the tax using the *T3GR, Group Income tax and Information Return for RRSP, RRIF, RESP, or RDSP Trusts*. The return must be filed with a payment for any balance due no later than 90 days following the end of the calendar year.
- Income earned and capital gains realized by an RRSP or RRIF trust on non-qualified investments will continue to be taxable to the trust, regardless of when the investment was acquired.

PROHIBITED INVESTMENTS

Q8. What is the income tax treatment for prohibited investments?

The new rules impose a 50% tax on the annuitant of an RRSP or RRIF if the RRSP or RRIF trust acquires a prohibited investment or if an existing investment becomes prohibited. The tax is refundable in certain circumstances (generally inadvertent cases that are promptly resolved). The annuitant is also liable for the 100% advantage tax on income earned and capital gains realized on prohibited investments.

The annuitant must file *RC339, Individual Return for Certain Taxes for RRSPs or RRIFs for Tax Year 2011* if they owe tax. The return must be filed with a payment for any balance due no later than June 30 of the following year. Transitional relief is available for prohibited investments held on March 23, 2011 (see Q12). RC339 provides instructions on how to claim a refund.

Q9. What is a prohibited investment?

A prohibited investment is an investment to which the RRSP or RRIF annuitant is closely connected. It includes:

- a debt of the annuitant;
- a debt or share of, or an interest in, a corporation, trust or partnership in which the annuitant has a significant interest (generally a 10% or greater interest); and
- a debt or share of, or an interest in, a corporation, trust or partnership with which the annuitant, or an entity described in the previous bullet, does not deal at arm's length.

A prohibited investment does not include a mortgage loan that is insured by the Canada Mortgage and Housing Corporation or by an approved private insurer. It also does not include certain regulated mutual funds.

Q10. When do these new rules apply?

The 50% tax on prohibited investments applies to investments acquired after March 22, 2011. The 50% tax also applies to pre-March 23, 2011 investments that first become prohibited after October 4, 2011. The transfer of a pre-March 23, 2011 prohibited investment between RRSPs or RRIFs of the same annuitant will not be treated as a post-March 22, 2011 acquisition and thus will not result in the investment being subject to the 50% tax.

The 100% advantage tax applies to income earned, and the portion of any realized capital gain that accrued, after March 22, 2011, regardless of when the prohibited investment generating the income or gain was acquired. Transitional relief is available for prohibited investments held on March 23, 2011 (see Q12).

Q11. Are investment earnings on prohibited investments taxable to the RRSP or RRIF trust?

No.

Q12. What transitional relief is available for prohibited investments held on March 23, 2011?

Transitional relief is available if an annuitant held one or more prohibited investments on March 23, 2011 in their RRSP or RRIF and continues to hold the investments in their RRSP or RRIF in the tax year. The transitional relief provides that any income earned and capital gains accrued after March 22, 2011 and before 2022 on these investments will not be subject to the 100% advantage tax, but instead will be included in the annuitant's regular income.

To take advantage of the transitional relief, the annuitant must file *RC341, Election on Transitional Prohibited Investment Benefit for RRSPs or RRIFs*. This election must be filed with CRA before July 2012. The annuitant will be required to withdraw from their RRSP or RRIF within 90 days after the end of the tax year in which the income or gains are earned or realized an amount equal to their "transitional prohibited investment benefit" for the year.

An individual's "transitional prohibited investment benefit" for a tax year is the total of any income earned and capital gains realized in the tax year on these prohibited investments held on March 23, 2011, less any capital losses realized on these investments in the tax year.

- The amount of a capital gain realized is the positive difference between the fair market value of the property when it is disposed of or when it ceases to be a prohibited investment (less reasonable costs of disposition, if any) and the fair market value of the property on March 22, 2011. The amount of a capital loss is the negative difference.
- Income is considered to be earned when it is recognized as income under general tax rules. For example, trust income is considered to be earned at the end of the tax year of the trust. Dividend income is considered to be earned when received (but for the purpose of the advantage rules the dividend gross-up amount is to be disregarded).

The amount of the withdrawal will be treated as a regular RRSP or RRIF withdrawal, to be reported by the financial institution on a T4RSP or T4RIF slip, as applicable, for the year of the withdrawal, and included in the annuitant's income on their income tax and benefit return.

Q13. What responsibilities do financial institutions have with respect to the prohibited investment rules?

Responsibility for compliance with the prohibited investment rules lies with the annuitant. Although RRSP issuers and RRIF carriers have no obligation under the Act to identify whether investments are prohibited, we would expect that financial institutions would not knowingly facilitate the holding of a prohibited investment in light of the serious tax consequences for the annuitant.

ADVANTAGES

Q14. What is the income tax treatment for advantages?

The new rules impose a 100% tax if an advantage is provided in relation to an RRSP or RRIF. The tax is payable by the RRSP or RRIF annuitant, unless the advantage is extended by the financial institution, in which case it is payable by the financial institution.

The annuitant is required to file *RC339, Individual Return for Certain Taxes for RRSPs or RRIFs for Tax Year 2011* if they owe tax. The return must be filed with a payment for any balance due no later than June 30 of the following year. The financial institution is required to file *T3GR, Group Income Tax and Information Return for RRSP, RRIF, RESP, or RDSP Trusts* if they owe tax. The return must be filed with a payment for any balance due no later than 90 days following the end of the calendar year.

Q15. What is an advantage?

An advantage in relation to an RRSP or RRIF is any benefit, loan or debt that depends on the existence of the RRSP or RRIF, other than distributions, administrative or investment services in connection with the RRSP or RRIF, loans on arm's length terms, and payments or allocations (such as bonus interest) to the RRSP or RRIF by the issuer or carrier.

An advantage also includes any benefit that is an increase in the total fair market value (FMV) of the property held in connection with the RRSP or RRIF that can reasonably be considered attributable, directly or indirectly, to one of the following:

- a transaction or event (or a series of transactions or events) that would not have occurred in an open market between arm's length parties acting prudently, knowledgeably and willingly and one of the main purpose of which is to enable the annuitant (or another person or partnership) to benefit from the tax-exempt status of the RRSP or RRIF;
- a payment received in substitution for either:
 - a payment for services provided by the annuitant (or another person not at arm's length with the annuitant); or
 - a payment of a return on investment, or proceeds of disposition, for property held outside of the RRSP or RRIF by the annuitant or a person not at arm's length with the annuitant;
- a swap transaction; or
- specified non-qualified investment income that has not been paid from the RRSP or RRIF within 90 days of the annuitant receiving a notice requiring them to remove the amount from the RRSP or RRIF.

An advantage also includes an RRSP strip or any benefit that is income (including a capital gain) that is reasonably attributable, directly or indirectly, to

- a prohibited investment in respect of the RRSP or RRIF or any other RRSP or RRIF of the annuitant; or
- an amount received by the annuitant of the RRSP or RRIF (or by a person not dealing at arm's length with the annuitant) if it is reasonable to consider that the amount was paid in relation to, or would not have been paid but for, property held in connection with the RRSP or RRIF, and the amount was paid in substitution for either a payment
 - for services provided by the annuitant (or another person not at arm's length with the annuitant); or
 - of a return on investment or proceeds of disposition.

An advantage does not include the principal of a mortgage loan that is insured by the Canada Mortgage and Housing Corporation or by an approved private insurer.

Q16. When do these new rules apply?

The 100% tax on advantages generally applies to transactions occurring, income earned and capital gains accruing after March 22, 2011. The rules apply later for swap transactions (see Q18).

Q17. What responsibilities do financial institutions have with respect to the advantage rules?

Responsibility for compliance with the advantage rules depends on the circumstances. Although financial institutions generally have no obligation under the Act to identify investments or transactions that may result in the annuitant being liable for the advantage tax, we would expect that financial institutions would not knowingly facilitate the holding of, or participate in, such investments or transactions in light of the serious tax consequences for the annuitant.

Q18. Are swap transactions prohibited under the new rules?

Yes. A swap transaction is expressly included in the list of transactions that are treated as an advantage, with effect from July 1, 2011. Swap transactions that are undertaken to remove an investment from an RRSP or RRIF that would otherwise result in tax under Part XI.01 if left in the plan are permitted to continue to occur until the end of 2021.

These rules strongly discourage individuals from undertaking any swap transaction with their registered plan by eliminating all current and future benefits associated with the transaction. Since this tax treatment serves, in effect, as a prohibition on swap transactions, we would expect that RRSP issuers and RRIF carriers will simply stop processing swap transactions, as was generally the case when these rules were first introduced for TFSA in October 2009.

Q. 19 What is a swap transaction?

A swap transaction is any transfer of property between the registered plan and the plan's controlling individual (i.e., annuitant or holder) or non-arm's length person, subject to certain exceptions. Contributions, distributions and purchase and sale transactions between an individual's two plans with the same tax attributes (i.e., TFSA to TFSA, or RRSP/RRIF to RRSP/RRIF) are not treated as a swap transaction.

An exception is also provided to allow individuals to "swap-out" a non-qualified or prohibited investment that was subject to the new 50% tax. To qualify under this exception, the individual must be entitled to a refund of the tax on disposition of the investment (generally inadvertent cases that are promptly resolved). In addition, the CRA will extend this exception, on an administrative basis, to cover swaps of non-qualified investments that were subject to the pre-March 23, 2011 rules, provided that the conditions applicable to a refund are met.

Q20. Are in-kind contributions and distributions now prohibited?

No. However, if a financial institution permits non-cash contributions or distributions, the institution is required to determine the fair market value of the property for reporting and source deduction purposes. Similarly, financial institutions are required to determine the fair market value of property held in connection with RRIFs for purposes of determining annual minimum amount payments. Failure to comply with these requirements may result in the financial institution being liable, depending on the circumstances, for the advantage tax or for a penalty under any of subsection 162(5), section 163.2 or subsections 215(6) or 227(8) of the Act.

OTHER ISSUES

Q21. How are RRSP or RRIF asset transfers of non-qualified or prohibited investments between institutions reported?

Form T2033 (or similar form by financial institutions) is currently completed between the transferor and transferee institutions, and will continue to be used to report the transfer of property between registered plans. However, in light of the new obligation in 207.01(5), we would not expect that financial institutions would knowingly accept transfers of non-qualified investments from other institutions.

Q22. The RRSP and RRIF income inclusion rules were amended to provide a new exception for amounts that are taxed under Part XI.01, unless the tax is waived, cancelled or refunded. How will financial institutions know how to adjust their reporting?

This change prevents an amount from being taxed both under Part XI.01 and again under Part I on withdrawal. However, because financial institutions will not normally know when this exception may apply, institutions should determine reporting and source deductions without regard to the exception unless the CRA has provided specific instructions. The CRA will deal

directly with the RRSP or RRIF annuitant to ensure that the RRSP or RRIF income is properly adjusted.

ADDITIONAL INFORMATION

Q23. Where can we get additional information on these rules?

The CRA is committed to providing taxpayers with up-to-date information. The CRA encourages taxpayers to check its Web pages often. All new forms, policies and guidelines will be posted as they become available.

Q.24. What recourses are available to the taxpayer when an amount is taxable under the new rules?

The new rules allow for the refund or a waiver in whole or in part of the tax under certain circumstances. For additional information, refer to the information page on the tax return, *RC339, Individual Return for Certain Taxes for RRSPs or RRIFs for Tax Year 2011*.

A taxpayer has the right to file an objection and to appeal the assessment of tax under the Income Tax Act. The publication *P148, Resolving Your Dispute: Objections and Appeal Rights Under the Income Tax Act* describes these rights in detail.