

Letter from the President



Toiling in the Tax Reporting Vineyards: Hidden Value for the Clients of IIAC Member Firms

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Often, some of the most important services you provide for a client are the least dramatic – and therefore the most taken for granted. Looking out for the tax implications of financial investments is a good example.

At a time of meager investment returns from stocks, bonds, and managed investment funds, investment dealer commissions and fees have come under greater scrutiny from the media and from the securities regulators. Moreover, the full disclosure of advisor compensation under the new Client Relationship Model (CRM) rules, including compensation in embedded trailer fees, will prompt greater dialogue with clients about the value proposition. Clearly, the direct financial advice provided by the advisor is the obvious source of value for clients. This advisory role has evolved beyond specific advice related to the purchase and sale of suitable investments in managed funds and individual stocks and bonds, consistent with client risk tolerance and financial goals, towards building an engaged relationship placing the advisor at the center of client financial decision-making.

IIAC client surveys and independent surveys of investors with advisors confirm that clients have a high level of trust and confidence in their investment advisors, and place high value on extensive engagement in their financial affairs. These survey results give assurance and recognition of the good job advisors are doing for their clients, and point in the strategic direction of meeting the growing expectation for deeper engagement in client financial affairs, across the generations of the client’s family.

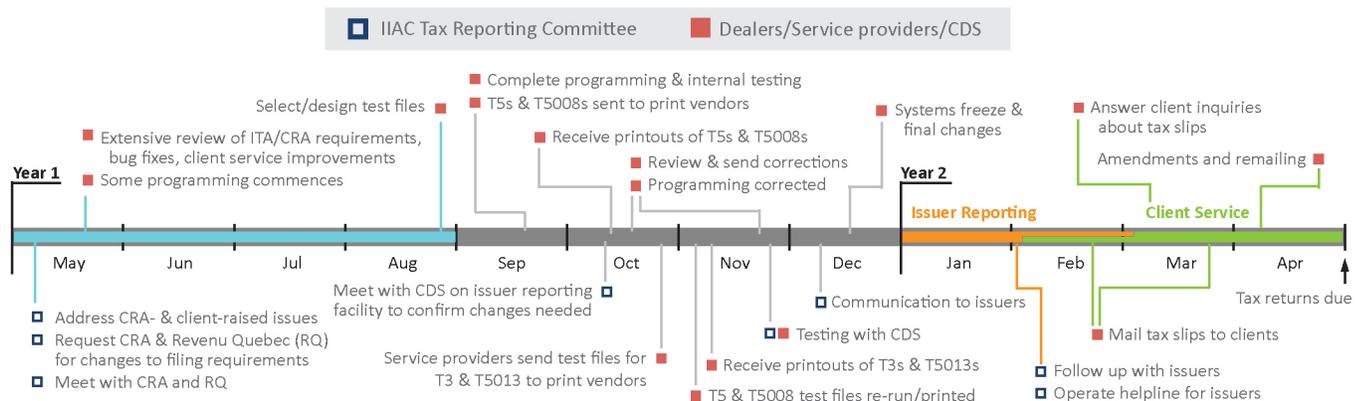
But advisors and firms should also articulate the less conventional and less understood values also generated on behalf of the client. Among the more important is the effective management of the tax implications of financial investments. The advice that ensures client investments with different tax consequences are managed in a tax-efficient manner is critical to maximizing after-tax returns.

Evidence indicates that Canadians without advisors use tax-efficient savings vehicles *less* efficiently. Assets placed in the

Tax Reporting Process for Trust Units and Limited Partnerships

Interest and dividends earned in Year 1 and reported in Year 2

Under the Income Tax Act (ITA) and Canada Revenue Agency (CRA) administrative rules



Source: IIAC

right registered plan results in an after-tax yield improvement of about 1.5%, compared with the same assets in non-registered form according to Finance Canada. Further, Ipsos Reid studies in 2010 and 2011 on the value of advice reported that households with a financial advisor are *twice* as likely as non-advised households to hold assets in tax-advantaged (registered) plans. Finally, advisors are increasingly called on for tax advice related to estate planning and other life-changing events.

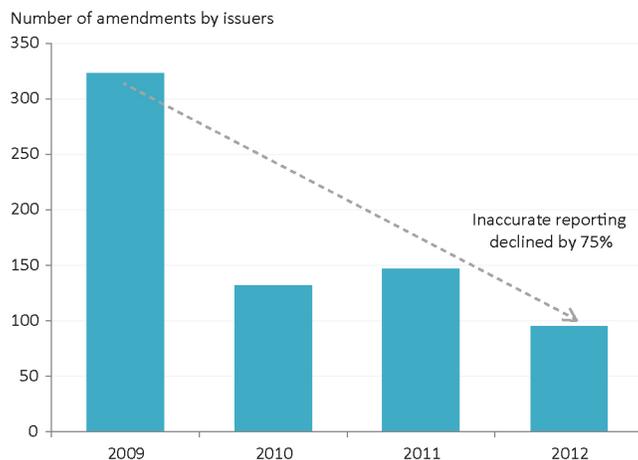
Financial institutions are mandated under legislative statute to produce tax slips for over 10 million of their clients to enable completion of individual annual tax returns. The tax reporting efforts of the member firms and advisors, with the assistance of the IIAC Tax Reporting Committee, have gone well beyond a simple tax reporting exercise. Advisors and their firms have undertaken a wide range of initiatives to ensure timely and accurate tax reporting for their clients.

Getting the information – early and accurately

The interest and dividends paid on debt and equity securities issued by governments and corporations are reported through CDS, and can easily be accessed by dealers and the public for tax reporting purposes. However, for special investment vehicles such as publicly traded trust units, closed-end mutual funds, limited partnerships and split share corporations, only aggregate payment flows from these instruments are reported through CDS, requiring further breakdown of these payments into interest, dividends and return of capital (ROC) by the issuer. In recent years, these special investment vehicles have provided formal statements of tax factors to dealers with insufficient time for dealers to compile the required T3, T5 and T5013 forms for their clients in order to complete income tax returns by April 30. Moreover, these statements have often contained inaccuracies that necessitate a re-filing of the forms after the client has submitted his or her annual tax return to the Canada Revenue Agency.

The IIAC and its Tax Reporting Committee have taken a number of steps to improve the reporting of financial information by these special investment vehicles. First, IIAC staff and the Committee have been engaged in educating these issuers of the priority for timely and accurate reporting, and have lobbied the CRA to mandate the filing of the interest and dividend streams online within a defined and reasonable deadline, leaving sufficient time to complete and mail T3, T5 and T5013 forms in time for filing individual tax returns by April 30. Further, the industry has designed an online reporting facility to facilitate reporting income breakdowns (interest payments, dividends, capital gains) for distribution to the issuers of trusts, limited partnerships and split share corporations. This information can then be accessed readily by IIAC member firms and others to complete the requisite T3, T5 and T5013 tax slips for client tax reporting. The filing spreadsheet on the CDS website, developed by the IIAC Tax Reporting Committee, coupled with the mandated filing deadline and ongoing discussions with issuers, have markedly improved the timeliness and accuracy of financial information.

Amendments by Issuers to Investment Dealers For preparation of T3, T5 and T5013 tax forms



Sources: CDS, IIAC

Keeping up with tax changes

The industry also takes steps to build systems infrastructure to manage new tax programs, accommodate tax changes and deal with differing tax treatment for different types of securities. Industry representatives consult continuously with CRA staff throughout the year to identify and implement improvements in the tax reporting process. These consultations usually intensify once new federal budgets announce tax changes, sometimes with limited lead time to prepare for the upcoming tax year. For example, the new Tax-Free Savings Accounts (TFSA) registered accounts were announced in the May 2008 Federal Budget effective for the 2009 tax year. The industry moved quickly, in consultation with the CRA, to design technical systems to capture the required contributions and withdrawals to the new TFSA registered plans for the 2009 tax year.

Another example relates to helping clients obtain appropriate withholding tax treatment as client investments shift between foreign securities eligible for withholding tax relief from tax protocol agreements, and those securities not subject to such relief. This is invisible to the client. More apparent to clients, investment dealers can help investors who move to a lower-withholding jurisdiction and do not notify their dealer to get refunds more easily. Clients previously had to file a separate form to reclaim each tax overpayment. The IIAC has argued successfully for a single reporting form to claim back cumulative withholding tax paid in error.

Making the most of registered plans

Investment dealers can tell clients if it is better to invest in an RRSP or TFSA, when it is best to start taking Canada Pension Plan payments, and how to get the best tax treatment as they draw down on registered plans. Investment dealers also monitor investments in RRSP and RRIF accounts to the extent possible to ensure only eligible investments are held in the account. This is, of course, in addition to making the case for larger annual contributions to RRSPs, smaller mandatory withdrawals from RRIFs and wider eligibility of investments in these registered

plans, to improve the effectiveness of these popular retirement savings vehicles.

For the 2008 tax year, the IIAC was successful in advocating a one-time special reduction in the minimum annual withdrawal from RRIF accounts to avoid the unnecessary selling of equity shares when these shares were at abnormally low values during the trough of the 2008 financial crisis.

Total RRSPs and RRIFs Outstanding



Source: Investor Economics

The Association continues to argue aggressively for a capital gains tax incentive to encourage capital-raising by small and mid-sized companies, and for equitable tax treatment between employee and employer contributions to Group RRSPs and such contributions to pension plans. At present, these RRSP contributions are not exempt from payroll taxes, as defined benefit and defined contribution plan payments are, even though Group RRSPs are a popular retirement vehicle for small businesses to offer their employees.

Conclusion: Meeting the duty of client tax reporting – and then some

The IIAC Tax Reporting Committee and individual member firms engage in extensive efforts to meet tax reporting obligations on behalf of the clients of IIAC member firms. While tax reporting is mandated for all financial institutions, and these institutions are liable for the accuracy of these reports, the high standard of accuracy, timeliness and effectiveness – the product of technology, active oversight and consultation – goes beyond the call of duty. It is also important to recognize that firms large and small meet these same high standards. Clients have come to expect these high standards and take them for granted, despite the complexity of the investment business and constant change in tax regulations. Clients often fail to appreciate the value embedded in this important service. It is yet another service IIAC members provide – one that needs to be articulated and explained to the investing public.

Special recognition to the IIAC's Barbara Amsden and Eon Song for their analytical and technical support.

Yours sincerely,

Ian C. W. Russell, FCSI
President & CEO, IIAC
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