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February 18, 2015

Mr. Ted Gallivan
Deputy Assistant Commissioner
Canada Revenue Agency (CRA)
344 Slater Street
Ottawa, ON K1A 0L5
(613) 946-9684/ted.gallivan@cra-arc.gc.ca

Dear Ted:

Re: Request for Confirmation of CRA Policy re Holding Trustees/Financial Institutions Liable for Taxes Assessed on a TFSA for Carrying on a Business, Audit Position on TFSAs with Accidental Overdrafts, and TFSA Taxpayer Alert

The Investment Industry Association of Canada (IIAC) represents securities dealers regulated by the Investment Industry Regulatory Organization of Canada (IIROC) that act on behalf of Canadians holding about one third of investor financial assets in this country. Its members are in many respects natural partners to the CRA in achieving compliance with the *Income Tax Act* and CRA policies. We would appreciate your help in addressing tax-free savings account (TFSA) matters that first arose two years ago in an area reporting to you, but that we learned cross different parts of the CRA. While affecting a proportionally very small number of taxpayers directly, it has the potential to affect many more taxpayers and the CRA, in addition to IIROC-regulated dealers.

Background

TFSAs are being assessed penalty taxes on the basis that the TFSA has carried on business. We believe that it is understood that it is not possible for TFSA trustees and issuers to determine if a TFSA has carried on a business. The IIAC's concerns are that there is insufficient information from the CRA in place for TFSA holders to know that they may be carrying on business, that the CRA is looking to TFSA trustees to cover any shortfall should assets within the TFSA be insufficient to cover the penalty taxes (and the trustee will recover such amounts from IIROC dealers), and that taxpayer TFSAs are being deregistered on the basis that the TFSA has borrowed money, when this was the result of an inadvertent overdraft that occurred for a short period of time (and potentially for very small amounts).

Our members, as regulated dealers, take their regulatory and tax compliance requirements, as well as their client service commitment, very seriously. The IIAC would like to better understand the specific nature of the CRA's concerns so that we can work on appropriate solutions that meet the needs of the tax authorities as well as those of clients/taxpayers and dealers. We would also like to discuss whether the combined needs of the government, taxpayers and IIROC-regulated dealers can be addressed by the CRA by:

- Providing comfort through the exercise of an administrative policy that TFSA trustees would not be liable for any shortfall in taxes should funds within a TFSA be insufficient to cover the tax liability arising by virtue of a TFSA being found to have carried on a business (in some cases, the TFSA could have been closed by the time the assessment from the CRA is issued)
- Exercising administrative tolerance in the cases of accidental overdrafts within TFSAs, so that such accounts are not deregistered
- Providing a tax alert/factsheet (sample attached that was included with the IIAC's December 8, 2014 letter to the CRA) so that TFSA holders, when placing trades within TFSAs, have the basic information necessary so that they are materially less likely to be considered by the CRA to be carrying on a business, e.g., they should be made aware that trading frequently, investing in less typical investments, etc. may bring their TFSA under CRA scrutiny.

The IIAC has requested the Department of Finance to amend the *Income Tax Act* to remove the possibility that TFSA trustees could be liable for taxes arising should a TFSA be found to have carried on a business and to ensure that inadvertent overdrafts are not contrary to the prohibition on leverage. We believe that the three proposed CRA steps above are also reasonable and necessary to avoid the risk brought by a very small number of taxpayers that could affect many more Canadians as securities dealers try to mitigate inappropriate TFSA trustee and issuer liability for assessed TFSA holder taxes that may not be recoverable due to withdrawals or transfers from TFSAs. We would like to arrange a meeting with you and appropriate CRA officials as soon as your calendar permits to discuss the CRA's concerns, elaborate on the impacts we are seeing, and identify a productive way forward. I hope to call shortly to find a convenient time to meet.

Yours sincerely,



Points to Consider for a Tax Alert/Fact Sheet for Taxpayers Possibly “Carrying on a Business”

Do you enjoy trading securities in your spare time?

Learn about possible tax implications ...

If you trade a lot, and especially if you trade frequently in your Tax-Free Savings Account (TFSA), this information is for you.

- Most Canadians believe if they make a gain when they sell a stock or bond, they pay tax on the gain at a more favourable rate than they do on the same amount earned from their job. While usually the case, this is not always true. If someone spends a lot of time buying and selling securities, it can be considered a business and tax will apply at the higher rate of tax on ordinary income. As an example, Canadian financial institutions usually can't claim capital gains treatment because they 'carry on the business' of buying and selling stocks, bonds, mutual funds and other investments.
- Even typical Canadians may have to pay tax at the higher rate applicable to ordinary income, for example, in the case of the "short sale" of shares or if there is no, or a below-market, interest rate on a debt security. Other examples include cases when people are considered to be a "trader or dealer in securities". Sometimes they are "day traders", and pay the full rate of tax on earnings, including gains, from trading.

Are you carrying on a business?

The CRA looks at your trading pattern to see if you are acting like a trader. Factors include:

- High transaction frequency – Do you buy and sell securities often?
- Brief ownership period – Do you own securities only for a short time?
- Good knowledge of securities markets – Do you have knowledge of or experience in capital markets?
- Part of ordinary business – Are securities transactions part of your ordinary work?
- Extended time spent – Do you spend a lot of time studying the securities markets and researching potential purchases?
- Leveraged financing – Do you buy securities primarily on margin or finance them via other forms of debt?
- Advertising – Do you advertise or otherwise make it known that you are willing to buy and sell securities?
- Speculation – Are the securities you buy considered speculative? Do they *not* pay dividends?

Although none of these factors may alone be enough to prove you are carrying on a business, evidence of several factors could be enough for the CRA to consider you to be doing so.

Why have I never heard of this before?

These rules have been in place for many years with no real changes. What has changed over the last 30 years is the financial marketplace, including improved technology that offers easier access to trading.

Should I be worried?

If you think your investing may meet more than one of the above criteria, you may be considered to be carrying on the business of trading, and therefore may be liable for a higher rate of tax. It is particularly important not to carry on the business of trading in your TFSA, as income earned from carrying on business in a TFSA is subject to tax [CRA to elaborate]. Talk to a tax professional if you need help.