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

11 King Street West, Suite 1600, Toronto ON M5H 4C7
T 416.364.2754 | F 416.364.4861

www.iiac.ca

Barbara Amsden
Managing Director
416.687.5488/bamsden@iiac.ca

December 23, 2014

Mr. Brian Ernewein
General Director, Tax Policy
Finance Canada (Finance)
140 O'Connor Street
Ottawa, Ontario K1A 0G5
Tel. (613) 992-3045/E-mail: brian.ernewein@fin.gc.ca

Dear Brian:

Re: Request to Amend *Income Tax Act* to Ensure Tax Liability Borne Appropriately re TFSAs

The Investment Industry Association of Canada (IIAC) continues to address an issue relating to Tax-Free Savings Accounts (TFSAs) with Finance Canada and the CRA. We appreciated teleconferencing with Grant Nash and Priceela Pursun of your office on October 30, 2014, and now better understand the Department of Finance's concerns with respect to issues raised in our July 3, 2014 letter on carrying on business in and incidental borrowing by a TFSA. Our discussions covered the following:

- The structure of a TFSA and interaction between the TFSA Trustee, the business sponsoring the TFSA (broker/issuer), and the TFSA Holder.

- The difficulty TFSA issuers would have in determining whether or not a client is carrying on a business within his or her TFSA: This is because, according to the tests in caselaw, it is a subjective test and there would be a need to understand the TFSA Holder's intention. We mentioned the Prochuk case as an example of the difficulty in making the determination. As well, even were the Department of Finance to insert a due diligence standard into the *Income Tax Act* (the Act), the situation would not be addressed as intention cannot be monitored by TFSA issuers.

- The comparable situation of the prohibited investment rules: It was recognized by the Department of Finance when these rules were introduced that TFSA issuers could not monitor for prohibited investment status. The penalty tax for prohibited investments falls on the TFSA Holder, as it should, and there is no monitoring or reporting done by the TFSA issuer. In the case of the "advantage" rules, the tax is levied on the TFSA Holder, unless an "advantage" is conferred by the TFSA issuer.

- A number of practical matters: We discussed, for example, whether the TFSA Trustee could file a Notice of Objection; how the TFSA Trustee could determine if an assessment is valid; whether the TFSA Holder could claim against the Trustee if no Objection is filed; who would cover the cost of the Objection; etc.

From a tax policy/fairness perspective, the IIAC strongly believes that the TFSA issuer should not be liable for any shortfall in penalty taxes beyond amounts CRA determines to be owing to a maximum value of the assets in the TFSA at the time the issuer receives a CRA assessment that the TFSA is carrying on business. From a public policy perspective, we discussed the practical ramifications of TFSA issuers deciding the risk was too great and starting to require section 159 clearance certificates prior to releasing funds from TFSAs. At the same time, charging back a TFSA Holder's unpaid penalties to the TFSA issuer would unacceptably place a chill on the issuance to – and the making available of funds from – TFSAs to honest taxpayers.

We appreciate and share Finance's concern that the government (and therefore the Canadian taxpayer) should not suffer the loss if a TFSA Holder's funds are no longer in the TFSA when funds have been withdrawn, assets have been transferred to another TFSA issuer, or in any other instance. Clearly, taxpayers will expect responsibility to lie with the TFSA Holder and that the CRA has or should have the administrative tools necessary to recover this money.

We also agreed to consider (1) what might form a legislative solution that would work from the IIAC perspective (no TFSA issuer liability other than funds in the TFSA at the time of the assessment) and (2) CRA concerns (getting access to funds that have moved to another TFSA issuer.)

1. Proposed legislative solution:

We believe that the best and most straightforward approach would be for the tax on the income earned in the TFSA from carrying on a business to be levied on the TFSA Holder, rather than the TFSA itself. The taxing provision is currently found in subsection 146.2(6) of the ITA. We would suggest that instead it be moved to Part XI.01 of the Act and be similar to subsection 207.04(1), which levies tax on a TFSA Holder should the TFSA hold a prohibited investment. We note that the CRA's enforcement provisions should permit the CRA to collect from any TFSA distributions, whether or not the funds continue to be held in the TFSA where they were held at the time that such TFSA was found to have carried on a business.

A second approach considered, but not recommended as it would be more difficult to enforce, is an exception to the liability provision in subsection 159(3) of the ITA. It would provide for an exception for a liability for taxes owing under subsection 146.2(6) of the Act, other than those within the control of the legal representative at the time of an assessment of tax by the Minister.

2. Addressing CRA Concerns:

We discussed ways to address problems from an administrative perspective, for example, a CRA mechanism for real-time monitoring and delivery of a warning to a TFSA issuer not to permit the withdrawal/transfer of funds. Also, we have sent the CRA an example of the type of one-page information sheet (attached) that we believe should help avoid honest errors in TFSAs where a taxpayer does not know about the "carrying on a business" rule. We will follow up with the CRA to discuss further ideas.

We also raised the second issue addressed in our July 3, 2014 letter, namely, incidental borrowing by a TFSA and discussion was deferred to another time. We have followed up to determine what possible dates might be convenient to continue joint work on this issue and hope to confirm a time soon. The purpose of a meeting with Finance would be for Finance to confirm that the policy objective in the TFSA provisions preventing a TFSA from borrowing were meant to capture true borrowings, and that it was not the policy objective to capture overdrafts occurring for short periods of time due to processing issues. We then would like to arrange a joint meeting with Finance and CRA staff so that the latter would be comfortable addressing the issue through administrative practice, unless there is evidence of the intention to deliberately take advantage of the rules contrary to their purpose.

In conclusion, we hope the legislative amendment to ensure liability for unpaid TFSA Holder taxes falls on the TFSA Holder will be included in the upcoming Budget Ways and Means Motion and look forward to closing the incidental borrowing issue as soon as possible.

We will call shortly to see what time may be convenient for you to discuss the matters raised here and we look forward to resolving both topics early in the New Year.

Yours sincerely,

Mr. Grant Nash <grant.nash@fin.gc.ca>
Ms. Priceela Pursun <priceela.pursun@fin.gc.ca>

Points for CRA to Consider for an Information Sheet for People 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, mutual fund 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 can rarely 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:

(a) High transaction frequency – Do you buy and sell securities often?
(b) Brief ownership period – Do you own securities only for a short time?
(c) Good knowledge of securities markets – Do you have knowledge of or experience in capital markets?
(d) Part of ordinary business – Are securities transactions part of your ordinary work?
(e) Extended time spent – Do you spend a lot of time studying the securities markets and researching potential purchases?
(f) Leveraged financing – Do you buy securities primarily on margin or finance them by way of other forms of debt?
(g) Advertising – Do you advertise or otherwise make it known that you are willing to buy and sell securities?
(h) 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.