



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

IIAC COMMENTS ON TAX-FREE SAVINGS ACCOUNTS (TFSA_s)

IIAC recommendations with respect to Bill C-50

*An Act to implement certain provisions of the budget tabled in Parliament on
February 26, 2008 and to enact provisions to preserve the fiscal plan set out in that budget
(Budget Implementation Act, 2008)*

**Presentation by Ian Russell
President and CEO
Investment Industry Association of Canada
to the
House of Commons Standing Committee on Finance
May 26, 2008**

Bonjour, good afternoon, Mr. Chairman and ladies and gentleman of the House of Commons Standing Committee on Finance. I am Ian Russell – I have come before this Committee many times before, but it is my signal pleasure to come here today for the first time as President and CEO of the Investment Industry Association of Canada, or “IIAC,” on the important subject of tax-free savings accounts or “TFSA’s.” With me today is Barbara Amsden, IIAC Director of Capital Markets.

The IIAC is both one of Canada’s oldest, and one of its youngest associations. Founded in 1916 as the Investment Dealers Association of Canada or IDA – the IDA began as an industry association that over the next 90 years became increasingly a self-regulatory organization or SRO. From 1996 to 2006, the IDA grew rapidly on the SRO side, tripling in size until there was agreement that, in the interests of both the SRO and the IDA, the organization should formally separate, one part again becoming an industry association and the IDA remaining an SRO.

Within two short years, we have, as the IIAC, been able to more effectively advocate, than we could as part of the SRO, on our members’ behalf for regulatory and tax policy improvements to strengthen the capital markets and the Canadian economy. We have been better able to publicize what the securities industry does to promote the savings-investment process and encourage capital formation. We have increasingly been able to help our members deal operationally with the ever-changing environment in which they compete. Our members range from large national firms to small retail boutiques – indeed, over half of our members are small businesses, which is why I will speak mostly to operational and administrative issues rather than to points of principle with the TFSA concept.

L'Association canadienne du commerce des valeurs mobilières (ACCVM) est une association professionnelle qui a pour rôle de favoriser l'essor et le développement du secteur des valeurs mobilières au Canada. L'ACCVM représente d'une voix forte et proactive les intérêts du secteur des valeurs mobilières et de l'ensemble des participants du marché. Nos sociétés membres vont des sociétés régionales comptant peu d'employés jusqu'aux grandes entreprises comptant des milliers d'employés au Canada. Nos membres aident les investisseurs canadiens à augmenter et à protéger leur capital pour assurer leur avenir financier et celui de leur famille.

TFSA’s are part of a series of tax-assisted vehicles – including RRSPs, RESPs and RDSPs – that promote the savings and investment process in Canada. While the new registered product will have a small portfolio impact at inception and consequently be proportionally costly to administer in early years, TFSA’s will boost savings, over time slowly providing an effective vehicle to generate tax-sheltered dividend and interest income, and capital gains. TFSA’s both complement RRSPs as a means to encourage savings, and supplement RRSPs to help save for retirement – a critical objective for most Canadians.

We commend the Department of Finance and Canada Revenue Agency on having quickly moved to identify and tackle the issues that need to be addressed to create an effective design for TFSA’s so that Canadians can contribute to TFSA’s as efficiently and smoothly as possible at the start of next year.

For our members to be able to successfully begin offering TFSA’s and promote further savings among Canadians, we believe that it is in the best interests of investors, government and TFSA providers for TFSA’s to be as simple as possible to introduce and to manage and, to this end, in most respects as similar as possible to, and able to leverage, the current RRSP framework. A great deal of work needs to be done by our members between now and the January 1, 2009 TFSA start date – technology changes do not really occur at the push of a button. We hope to have your help with legislative changes, as well as the help of Finance and CRA on regulatory and administrative matters, to ensure a smooth launch. This would make an excellent good-news story for the front page of the first newspaper editions of the New Year.

First, there is one important exception to the need for TFSA operational similarity to RRSPs, that is, we believe that brokers should be able to offer TFSA's, and ultimately RRSPs, directly under account agreements. Bill C-50 limits TFSA offerings to a trust, annuity contract or deposit, and the February 26 budget did not identify brokers as entities that could provide TFSA's. We think that this ties back to the old "Four-Pillar" days, when lines between banks, trust companies, insurance companies and brokers were clearly delineated. However, many things have changed since the 1980s when the Four Pillars were dismantled. Interest rates have dropped, and more and more Canadians now rely on investments rather than just term deposits to finance their retirement or save for major purchases. What is certain is that still requiring brokers to resort to the trust structure through third-party trustees adds to cost and inefficiency and, we believe, is unnecessary.

Recommendation #1: Amend the legislation to enable brokers to offer TFSA's directly. Use of an account rather than trust structure will:

1. enable brokers to meet the needs of investors as flexibly and efficiently as other intermediaries can, as it should lower administrative costs for clients and intermediaries
2. establish a more level playing field both between brokers, deposit-taking firms and insurance companies, as well as between brokers with a trust company in their financial group and those that must use a third-party trust supplier
3. make reporting and tax withholding simpler when a TFSA-holder dies and help reduce U.S. documentation issues that trusts give rise to in the case of U.S.-born residents of Canada.

To this end, we think that paragraph (b) of the definition of "qualifying arrangement" in subsection 146.2(1) should be amended to extend the offering list to include wording along the lines of "an account offered by a dealer in securities or commodities resident in Canada, the business activities of which are subject by law to the supervision of a regulating authority of a province".

Second, we believe reporting should be as similar to RRSP reporting as possible for maximum efficiency for TFSA-holders, the CRA and intermediaries. The CRA is responsible for monitoring TFSA clients' contribution room and over-contributions as they do for RRSPs because, as with RRSPs, contributors can hold TFSA's in different institutions. For TFSA-holders to figure out their contributions annually is simple as compared to RRSPs – a flat \$5,000 rather than a percentage of income, complicated by PAR rules, in the case of defined-benefit RRSP-holders. If a client has withdrawn an amount and wants to re-contribute, he or she can confirm the amount withdrawn by reviewing their past TFSA account statements or, increasingly, by checking their accounts online. The CRA proposes more frequent reporting, which we believe, based on the RRSP example, is not cost-justified given that material over-contributions to RRSPs are proportionately small, excess amounts are usually low and penalties can be applied. As for RRSPs, an annual report with contributions and withdrawals will enable the CRA to identify over-contributions, even if withdrawn within the same year in an effort to unfairly take advantage of the tax system. Additional systems changes for different reporting would be costly and complex... for intermediaries and for the CRA... and we believe they are not necessary to protect the tax base.

Indeed, this government is committed to reducing regulatory burden, not adding to it. We believe that more frequent reporting will cause more problems for investors, for the CRA and for intermediaries; we can elaborate further on this during questions if you wish. As it is, the one-month period most see as "tax season" is effectively a full-time job within intermediaries, with planning starting as soon as one "tax season" ends. And in truth it never ends: since this April, some companies have come back to refile for 2006 reporting; then once the Budget ways and means motion is out, it is analysed; discussions with the CRA and/or Finance take place in late spring and summer; then discussions with services bureaus and printers in the summer about reporting changes; followed by programming starting no later than late summer/early fall; followed by systems testing in the fall and communications to prepare issuers for filing; followed by all-out file testing in January; corrections, printing, mailing, etc. in February and March, and corrections and follow-up in April. This makes tax reporting an almost seven-day-a week job for thousands of intermediary and supplier staff from January to April. Tax reporting is, in fact, a growth industry.

Recommendation #2: Amend the legislation to specify that transaction-related TFSA reporting by TFSA providers to the CRA be limited to a single, aggregated annual reporting file that does not require reporting of transfers between accounts of the same TFSA-holder. All monitoring and analysis the CRA requires to preserve the integrity of the tax system will be available, and the efficiency of the tax system for the majority of taxpayers, investors, CRA and intermediaries will be enhanced, through one annual report showing:

- contributions by SIN by date through the year
- withdrawals by SIN by date through the year
- marital break-up transfers and transfers by a surviving spouse by SIN by date
- year-end fair market value balances by SIN.

The CRA will aggregate TFSA balances by individual (SIN) in different accounts and institutions once a year (as presumably done for RRSPs), avoiding the need to report transfers or risk of error due to timing when transfers are in transit. The CRA will send notice of unused room, over-contributions and over-contribution penalties as done annually to taxpayers for RRSPs and the CRA may waive the penalty on over-contributions if the CRA believes this is warranted by the circumstances of the TFSA-holder. Additionally including year-end balances by SIN (not currently done for RRSPs) will enable the CRA to identify unusual increases in value year over year, allowing the CRA to investigate possible cases of prohibited investments.

Third, we believe that the treatment of TFSAs upon the death of a TFSA-holder should be as similar as possible to that of RRSPs. Income accumulates tax-free for both RRSPs and TFSAs; both are tax-assisted vehicles aimed at encouraging savings, with TFSAs being funded with after-tax dollars, meaning no upfront loss of government tax revenue. A family member's death means a difficult time for all involved and treating RRSPs and TFSAs the same – when most investors will be both RRSP (or RRIF) and TFSA-holders – will remove unnecessary complication and frustration at a time that these are hardest for a bereaved person to deal with. This said, Bill C-50 specifies that the income or capital gains on a TFSA become immediately taxable at the time the holder dies, in contrast to RRSPs where there is an exempt or transitional period after death during which income earned can be rolled over to an RRSP of a surviving spouse or eligible child or is taxable as ordinary income to simplify tax reporting. As with RRSPs, TFSA providers may not be advised of a holder's death until many months later, meaning no way to process the deemed disposition of assets, reset cost at fair market value on death, etc.

Recommendation #3.a: Amend the legislation to provide an exempt period after the death of TFSA-holders, similar to RRSPs. This will allow executors and family members to deal reasonably with the steps necessary to complete the required estate-related paperwork at, as I mentioned, what is a very difficult period for them. For RRSPs and RRIFs, most file what is required within the exempt period and the remainder – few – are managed manually. If there is to be *no* exempt period for TFSAs, but is a requirement to file tax slips breaking out capital gains, interest and dividends for the period between a TFSA-holder's death and when an intermediary is notified, the volumes will be significant and the current manual workload will have to be automated. If an exempt period similar to that for RRSPs is *not* possible to reduce problems for investors, the risk of error for intermediaries and costs associated with refilings for the CRA, then the legislation should specify that the income should be reported entirely as "other income."

Recommendation #3.b: Amend the legislation to provide that TFSAs can be transferred tax-free to a spouse's TFSA after the plan-holder's death in those cases where the holder did not name the spouse as a successor holder, but the spouse is entitled as beneficiary under the plan or will. The legislation provides that if certain criteria are met, then the amount can be transferred to the TFSA of the surviving spouse without it being treated as a contribution. However, until the time of transfer, we think the legislation requires tracking, reporting and presumably taxation of amounts earned in the TFSA of the deceased holder when such income should be tax-free. We will also be making recommendations to provincial governments that they make changes necessary to allow the same rights of survivorship/beneficiary designations for TFSAs as for RRSPs. We hope that this Committee's report will convey this message as well.

Fourth, we believe that two changes are required to Bill C-50 to ensure a smoother implementation. The draft legislation provides that qualifying TFSA arrangements must be entered into *after* 2008. This would appear to prevent opening accounts to a zero balance earlier and lead to a rush following the New Year – our members are already getting calls – possibly from some of you! – about opening TFSAs. This risks negative publicity for TFSA providers and for the government, particularly from seniors who are expected to be a primary beneficiary group of TFSAs.

Recommendation #4.a: Amend the Bill C-50 definition of "qualifying arrangement" in proposed subsection 146.2(1) to read along the lines of "an arrangement ... into which no contributions may be made prior to January 1, 2009 between a person ...".

This will ensure that investors can transfer or pay into the TFSA when businesses open after the New Year, as accounts will already have been opened.

Recommendation #4.b: Amend the legislation to provide the Minister of Revenue with the ability to provide administrative relief if needed. We very much appreciate that Finance and the CRA initiated an early start to discussion of administrative matters and forms pertaining to the TFSA. Nevertheless, delays beyond the control of either Finance or the CRA can occur. Two years ago, what was otherwise a positive and equitable measure – a tax rate reduction on dividends to eliminate double taxation – led to extensive problems and costs as the related legislation did not pass until after tax season had started for intermediaries, and did not take effect until 90 days following Proclamation – after tax season was over. We believe that the legislation should be amended to – and that, in fact all tax legislation introducing new government policy should – provide the Minister of Revenue with the right to provide appropriate administrative relief in the first year of implementation where situations beyond the reasonable control of those affected arise.

In summary, we support introduction of TFSAs. Like you, we want to see implementation proceed smoothly from an investor – and taxpayer – perspective. We want the CRA to have manageable reporting to monitor and protect the tax base. We would like the TFSA reporting and administrative framework to be efficient for TFSA providers – tax reporting is not cost-free and we applaud the government's commitment to reduce the regulatory burden on small and mid-sized businesses, as are many of our members, and for businesses generally, by 20% by this November, as promised in *Advantage Canada*. Therefore, our recommendations are to amend legislation to

1. Allow brokers to offer TFSAs directly, under an account agreement and not just as a trust from the perspective of efficiency and fairness
2. Mandate annual reporting by TFSA providers to the CRA and do not require reporting of transfers between the same TFSA-holder – this is for efficiency, without diminishing the CRA's ability to manage the integrity of the tax base
3. Treat TFSAs like RRSPs in the event of a TFSA-holder's death by providing an exempt transition period and transfer to spouses without triggering extensive tax monitoring and reporting
4. Allow TFSA providers to open accounts before the New Year, while still preventing contributions until January 1, and allow the Revenue Minister to provide administrative relief if situations warrant.

We are requesting that this Committee approve legislative changes that we believe to be straightforward and non-contentious. At the same time, we do not want to delay the process of implementation. Should the four legislative changes we have recommended for clarity, accuracy and efficiency purposes risk delaying passage of the legislation, our industry can operate under a letter of comfort (or written confirmation from Finance and the CRA in the case of the ability to open accounts before January 1), and await later legislative updates.

In conclusion, I must emphasize that, while the new TFSAs will promote increased savings modestly given their relatively small size, they are not a substitute for a tax incentive to promote and encourage risk investment in the Canadian economy. The Canadian securities industry, through the IIAC, has advocated strongly prior to the past three federal budgets for capital gains tax relief, trying to turn the government's policy platform promise of lower capital gains tax rates into a reality. Increased savings through TFSAs alone will not necessarily form the scarce capital needed to fund risk investment. It is financing for the equities of small and mid-sized businesses that is the key to capital formation, global competitiveness and economic growth. Lower capital gains tax rates, by reducing the income inclusion rate below 50% for the gains earned on the common shares of Canadian companies – even if only in select sectors – is the most effective mechanism for unlocking capital and stimulating the flow to productive investment. Research indicates that lowering capital gains tax rates actually tends to increase tax revenues by stimulating investment activity.

We would be pleased to answer your questions.