IIACACCVM
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**
Director, Special Projects
416.687.5488/bamsden@iiac.ca

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Ms. Alexandra MacLean
Acting Director, Tax Legislation Division
Finance Canada
140 O'Connor St.
Ottawa, ON K1A 0G5
Tel: (613) 995-0405/Fax: (613) 947-1677
E-mail: alexandra.maclean@fin.gc.ca

Dear Alex:

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

Thank you very much for our teleconference meeting on June 3. As you know, the IIAC is the national association of investment dealer firms regulated by the Investment Industry Regulatory Organization of Canada (IIROC). The IIAC represents its 170 member firms on securities, tax and other public policy matters to improve the savings-to-investment process. To this end, the IIAC has worked extensively with the Department of Finance and Canada Revenue Agency (CRA) on registered plan issues so that our members can properly deliver federal tax savings programs to clients while managing the related costs and risks. Our members help millions of Canadians meet their investment objectives and these clients have invested with IIROC-regulated dealers:

- $280 billion in registered retirement savings plans (RRSPs);
- Over $65 billion in registered retirement income funds (RRIFs);
- $5 billion in registered education savings plans (RESPs); and
- $13 billion in tax-free savings accounts (TFSAs).

Our members strongly support the government's efforts to ensure that registered savings programs are not abused and that all taxpayers pay their fair share of taxes. For a number of reasons, the risks to our members in delivering these tax-advantaged programs have increased, we believe substantially, and for this reason we are writing to you.

**Request**

We are asking the Department of Finance to introduce legislative amendments to the *Income Tax Act* (ITA) to ensure that liability for taxes where a registered plan either holds a non-qualified investment or carries on business remains, as it should, with either the registered plan or with the annuitant or holder

of any registered plan, as is generally the case in ITA Part XI.01 – Taxes in respect of RRIFs, RRSPs, and TFSAs. In Part XI.01, the only instance when an issuer of a registered plan is liable for penalty taxes otherwise assessed on the holder/annuitant or the registered plan is in the limited circumstances where the issuer extended an advantage to the holder or annuitant [see ITA subsection 207.05(3)].

In the interim, we request a letter of comfort in this regard, given both the amount at risk for our members and their desire not to impede the smooth functioning of these programs for Canadians.

**Background**

As you know, securities trades in registered accounts are directed by the accounts' annuitants or holders; our member broker-dealers execute their clients' instructions. Not knowing all the facts and circumstances surrounding their clients' affairs, the brokers and the account trustees cannot make a determination as to whether a particular account may be carrying on business. Consequently, any tax liability should remain with the account and the annuitant/holder client.

That said, there have been significant developments in the financial marketplace over the last 30 years that have a bearing on our concern. These include:

1. A significant drop in interest rates necessitating those saving for retirement to move from deposit-type financial products towards more capital market offerings;
2. A major change in the philosophy and practices surrounding workplace retirement benefits due not only to interest rates, but also to the treatment of pension surpluses and employee preferences, leading to a transition from defined benefit plans to ones where risk is shared with or borne by the employee;
3. The significant increase in RRSP contribution limits and introduction of new tax-advantaged savings plans;
4. Advances in technology allowing financial institutions to meet client requests for self-service options; and
5. Greater financial literacy.

Two major results of these developments, since the 1984 publication of IT-479R, Transactions in Securities, are:

1. A much larger proportion of Canadians buy and sell securities more frequently from among a wider range of investments in the capital markets than ever before, increasingly through online means.

2. Low interest rates and stagnant market returns are creating significant pressure for the development of new yield-enhancing investment options that can be hard to value.

These issues are similarly leading to significant changes in securities legislation that affect our members and add considerable challenges. The combination of compliance with securities and tax legislation has

led to a substantive increase in fixed costs for our members in not only absolute, but also relative terms. In the past six years, inflation grew by 12%. Over this same period, in contrast, our largest members' non-salary cost per dollar of revenue almost doubled to 21%. For smaller retail dealers (many of which are small businesses by the Statistics Canada definition), such costs have more than tripled to 39% – 61 cents of every revenue dollar. This has contributed to the fact that over 40% of IIROC dealer firms experienced operating losses in 2012. The outcome is that, while some smaller firms have opened since when the market crash began in earnest, 42 firms have merged with others, been acquired or closed down.

While we know that tax and securities law have different ends, the foregoing information is provided here to show that many of our members cannot absorb the losses that may arise should the CRA demand payment of taxes, which ought to be paid by a registered plan or by an annuitant or holder of a registered plan, from the plan's trustee that requires indemnification in agreements with our members. These indemnity clauses allow the trustee to reclaim any tax liability, which the CRA seeks with respect to a registered plan, from the broker-dealer through which the plan is offered. Moreover, there would be some consequential, although un-estimated, effect on Canada's capital markets, as well as on the choice and availability of registered plans to Canadian investors. The latter are issues that we believe should be of concern to the Department of Finance's Economic and Fiscal Policy, Economic Development and Corporate Finance, and Federal-Provincial Relations and Social Policy Branches.

**Legislative References**

There is a concern among our member firms that the CRA could take the position that pursuant to section 159 of the ITA, the trustee of a registered plan is jointly liable with the registered plan for taxes arising as a result of a registered plan earning income from a non-qualified investment, inadvertently purchasing a security for a short period of time on margin, or carrying on a business pursuant to subsection 159(1) of the ITA. The CRA discussed this issue in Technical Interpretation Number 2011-040553 (Liability of issuers of TFSAs, September 22, 2011) as follows:

> "A TSFA trust could be liable for tax under Part I on its taxable income pursuant to subsection 146.2(6) where at any time in the taxation year it carried on a business or held one or more properties that were non-qualified investments. With respect to the Part I tax pursuant to subsection 146.2(6), the Crown will look to the trustee for any outstanding liability of the trust pursuant to subsection 104(1). Reference to a trust is, generally, deemed to include a reference to a trustee having ownership or control of the property. As subsection 104(1) equates the trustee with a trust, any liability under the Act in respect of a trust becomes the liability of the trustee, for the purposes established in this subsection.
>
> The definition of "legal representative" of a taxpayer in subsection 248(1) includes a trustee administering, winding up, controlling or otherwise dealing in a representative or fiduciary capacity with the property that belongs or belonged to, or that is or was held for the benefit of, the taxpayer. Based on the definition, an issuer of a TFSA, governed by a trust, is considered to be the legal representative of the TFSA trust. Consequently, the issuer could be held liable for the Part I tax owing by the TFSA trust [of the taxpayer], not only pursuant to subsection 104(1), but also vicariously pursuant to subsection 159(1)."

In addition, where income was earned on a non-qualified investment prior to the repeal of subsection 207.1 of the ITA, our member broker-dealers are worried that the CRA could look to the trustee for collection of such taxes pursuant to subsection 207.2(2) of the ITA. There also is a concern that issuers will start requiring CRA clearance certificates prior to permitting assets to be transferred to a registered plan issued by a third-party carrier, which would lead to problems and additional workload for the registered plan annuitant or holder, the CRA and the broker-dealer. Additionally, a number of trustees have introduced a significant charge to plan sponsors where the CRA has sent an audit notification regarding a particular trust to the trustee and annuitant/holder to recoup the costs of the trustee's legal and administrative work.

This legal and administrative work then also will have to be undertaken by the plan sponsor, at a cost that should be borne by the taxpayer whose activity has occasioned CRA attention. At a time that the government speaks of red tape reduction, we hope that the Department of Finance will amend the legislation to avoid duplicative work and cost for trustees, plan sponsors (our members) and, importantly, taxpayers (our members' clients).

**History**

As discussed in our call, we thought it possible that the provisions relating to the Crown turning to the trustee for any outstanding liability of the trust under subsection 104(1), and holding the trustee jointly and severally liable according to subsection 159(1), may have arisen due to complex and large family, not-for-profit or other such trusts. Our industry understands the value of such provisions in such situations, where a "legal representative" is in fact often a lawyer and has direct and close responsibility for an individual trust. We have now confirmed that the predecessors to the two referenced subsections existed before 1950.

The first registered plan – the RRSP – was created in 1957 and we surmise that there may have been no exhaustive consideration of the differences between proportionally few, individually unique family/other trusts and the much more homogenous, often smaller and certainly much more numerous registered plan trusts, where in practice the trustee is not the typical "legal representative" described above. The trustees and our member broker-dealers make sure that the trust meets the ITA provisions by withholding appropriate tax, reporting as required, etc., but otherwise do not have the in-depth involvement that the trustee of a major family or other organization would have.

Nor do we believe that our members, trustees, or other financial institutions would have agreed to accept at that time unquantified liability for taxes on what has become millions of accounts, especially when the person for whom the trust was operated may have closed the account before the trustee and issuer/carrier receive a notice to pay the annuitant's/holder's tax debt in the event the annuitant/holder does not. Certainly, in the case of registered plans, compensation received is for account operation rather than customized services (which may attract liability) sought by family and other trusts.

**Financial Impact of Proposal for Government**

We believe that there should be no untoward financial impact on federal coffers from adopting our recommended solution, as the tax-advantaged programs were designed to serve law-abiding Canadian taxpayers and not to shift the tax burden of others onto those firms that provide a service, helping to reduce the likelihood of Canadians requiring social support from governments in their retirement years.

**Conclusion**

We would very much appreciate your earliest possible review of our request for the noted tax amendment and – extremely importantly for an interim period – a letter of comfort that our proposed amendment will be made. As you know, we have been making every effort to work with CRA officials and hope to hear from them shortly on a number of technical issues.

That said, we remain concerned that Canadian taxpayers, unaware of the implications of, for example, greater trading and investment in non-dividend-paying investments, remain unfairly at risk. We have asked the CRA to provide greater clarity to Canadian taxpayers via the CRA website or other methods as soon as possible on the CRA position of what constitutes carrying on a business. This is consistent with Part 6 of the CRA's *Taxpayer Bill of Rights*, which states: "You can expect us [CRA] to provide you with <u>complete, accurate and timely information</u> that will explain <u>in plain language</u> the laws and policies that apply to your situation, to help you get your entitlements and <u>meet your obligations</u>" *[emphasis added]*). While the provisions of IT 479-R may be well-understood by day traders, we believe this will not be true, for example, in the case of retirees who may do some online investing as a hobby. We understand that work on updating the rule, as part of the CRA's 'folio' process, is not due to begin for some time. We hope that a plain-language clarification of the CRA's intentions can be completed sooner.

We know that there are many considerations in your review of the complex area of trusts and that there are other priority issues for the Department of Finance. Given the potential impact of a chill on the market, and for investors and issuers, I will call you shortly to discuss how we might best proceed on this matter of great importance to our members and, we believe, Canadian taxpayers.

Yours sincerely,

Cc: Jason Ward, Department of Finance
Michael Chun, CRA