WeirFoulds LLP

CLIENT UPDATE

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New Penalty Taxes: Prohibited Investments and Advantage Rules for RRSP, RRIF and RCA Deferred Income Plans

By Maralynne A. Monteith and Diana Yeung

Recent amendments to the *Income Tax Act* (Canada) have extended the penalty taxes that were initially aimed at TFSAs, to situations where you hold certain types and/or percentages of assets through RRSP, RRIF and RCA tax deferred plans or access certain advantages in connection with such plans. Take a look at the following to see if these changes will affect you.

Step One

1. Do you own 10% or more of any class of shares issued by any corporation (private or public)?
2. Do one or more persons not dealing at arm's length with you own 10% or more of any class of shares issued by any corporation (private or public)?
3. Does the collective group described in 1 and 2 own 10% or more of any class of shares issued by any corporation (private or public)?
4. Do you, alone or together with any non-arm's length person, own:
   (a) 10% of more of the fair market value ("FMV") of any partnership; or
   (b) 10% or more of the FMV of any trust?

If you answered yes to any of 1 through 4 then you have a "**Significant Interest**" in the relevant entity.

5. Does your plan hold any debt owed by you?
6. Does your plan own any shares that when acquired were qualified investments as shares in:
   (a) a specified small business corporation;
   (b) a venture capital corporation; or
   (c) a specified co-operative corporation?

If you answered yes to <u>any</u> of the Step One questions, then you need to look at the **Prohibited Investment Rules**!

<u>Prohibited Investment Rules</u>

The following are Prohibited Investments when held in a relevant plan:
1. debt of a plan holder/annuitant/RCA beneficiary (referred to herein as a "**Relevant Person**")[1];
2. (subject to certain exemptions for demonstrably portfolio-style investments) investments or interests (including options) in entities: (a) where the Relevant Person has a Significant Interest; or (b) which do not deal at arm's length with either the Relevant Person or with an entity where the Relevant Person has a Significant Interest [See items 1-4 above]; and
3. certain prescribed property that was a qualified investment at the time of acquisition by the plan but which ceases to qualify as: (a) a share of a "specified small business corporation"; (b) a share of a "venture capital corporation", or (c) a qualifying share of a "specified cooperative corporation".

Step Two

Did you, or anyone not dealing at arm's length with you enjoy any advantage related to the existence of the plan (other than by taxable withdrawal), including:

i) accessing any benefits or indebtedness conditional in any way on the existence of the plan (including but not limited to earning income or gains on Prohibited Investments), or
ii) undertaking transactions that would increase the value of assets held by the plan that would not have occurred in the open market between arm's length parties?

If you think the answer may be yes, keep reading!

1 exemptions exist for certain insured mortgages.

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Penalty Taxes on the Relevant Person

Prohibited Investments Tax
50% tax on the FMV of **Prohibited Investments** acquired or held by the plan at any time in a calendar year. This tax may be refundable if the Prohibited Investment is disposed of by the plan, generally within one year from the end of the year in which this tax arose.

Advantage Tax
Under the Advantage Rules, there is a **100% tax** on any **Advantage** obtained by the Relevant Person (or any non-arm's length person). For the purposes of these rules, **Advantage** is very broadly defined and includes income and capital gains on Prohibited Investments, any access to benefits or indebtedness conditional in any way on the existence of the plan (subject to certain exceptions), and transactions that would not have occurred in the open market between arm's length parties. Note, if the Advantage is extended by the issuer or carrier of the plan, the liability for the tax shifts to the issuer or carrier.

Transitional Rules

RRSP/RRIF
Limited relief may be available in respect of Prohibited Investments held in a RRSP or RRIF that were owned by the plan on March 23, 2011. This relief requires an election to be made by **December 31, 2012**, in the prescribed form (RC341) to avoid the tax under the Advantage Rules in respect of income or capital gains (net of losses) that are earned or accrued and realized on Prohibited Investments in the plan after March 22, 2011, PROVIDED that such income/gains are paid out of the plan within 90 days from the end of each year to which the relief applies.

RCA
Penalty taxes for RCAs will generally apply in respect of investments that are acquired as Prohibited Investments or become Prohibited Investments after March 29, 2012, and to Advantages extended, received or receivable after that date.

Summary

All investments in affected plans that might be Prohibited Investments and transactions conducted that might be Advantages should be reviewed to ascertain whether steps need to be taken to mitigate exposure to Penalty Taxes.

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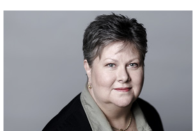

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