

Compliance Bulletin No. 6

The Registered Plans Directorate (RPD) of CRA issues from time to time Compliance Bulletins which are intended to “inform industry professionals about non-compliance issues relating to registered plans and to outline the tax implications for members and employers”.

Compliance Bulletin No. 5, dealt with the results of court cases relating to the “Primary Purpose” requirements of the Income Tax Act.” The message was that “extreme care must be taken when establishing an Individual Pension Plan when there are concerns that meeting the primary purpose requirement of the Income Tax Regulations (Regulations) may be problematic.” RPD has just released Compliance Bulletin No. 6 which focuses on several areas of non-compliance related to registered plans and outlines their potential tax impact.

It also discusses RPD’s compliance requirements for the two newly created products—the tax free savings account (TFSA) and the registered disability savings plan (RDSP).

The following summarizes the content of the Compliance Bulletin together with comments from Westcoast Actuaries

Excess Qualifying Transfers in respect of Past Service Pension Adjustments (PSPAs)

An “excess qualifying transfer” refers to any excess funds that were transferred from the member’s registered retirement savings plan (RRSP) to a defined benefit (DB) pension plan. “Excess” in this context means amounts transferred to the plan in excess of the PSPA created by purchasing a period of past service under the plan. This excess is usually created by an incorrect calculation of the member’s PSPA in the initial actuarial valuation report, either due to improper earnings being used or periods of service not being eligible.

If this happens, the member is not permitted to return the excess funds back to an RRSP, since there is no provision in the Income Tax Act to provide for such an action. Accordingly, the excess funds would have to be removed from the plan and paid out to the member to be included in income.

RPD state that they may permit excess funds to remain in the plan (provided the plan terms permit the member to make contributions to fund the benefit), as long as the excess does not exceed the total liability relating to the past service event and the employer had not already funded the remaining portion of the liability. They will consider allowing the excess funds to be deposited into an additional voluntary contribution (AVC) account, to be effective as at the date of the request. Application should be made for administrative relief which RPD will consider on a case-by-case basis. Please note that administrative relief will not be granted for those cases where RPD uncovered the issue.

Westcoast Comment:

In situations where the “excess” Qualifying Transfer has been made, we will apply on the plan sponsors’ behalf for administrative relief from RPD such

that the excess amounts be treated as additional voluntary contributions (AVCs. Our specimen plan document for IPPs already includes provision for AVCs so no additional documentation is required.

It is important to note that the administrative relief will only be granted if this issue is not "uncovered" by RPD. This seems to be a general CRA policy that they are considerably more lenient in situation where the taxpayer has voluntarily approached them rather than in a situation where CRA has discovered non-compliance which has not been reported to them. Our advice to clients in this regard is to disclose any issues might be non-compliant rather than leave them for CRA to discover at a later date.

Penalties

Effective January 1, 2010, CRA will apply a penalty in respect of:

- ✓ the pension adjustment for unreported or misreported amounts on a filed T4 form, or the related summary,
- ✓ the past service pension adjustment for misreported amounts on a filed prescribed Form T215, Past Service Pension Adjustment (PSPA) Exempt from Certification, or the related summary, and
- ✓ the pension adjustment reversal for misreported amounts on a filed prescribed Form T10, Pension Adjustment Reversal (PAR), or the related summary.
- ✓ the past service pension adjustment for a failure to file prescribed Form T215,
- ✓ the pension adjustment reversal for a failure to file prescribed Form T10,
- ✓ the connected person information return for a failure to file prescribed Form T1007, Connected Pension Information Return.

The penalty for a failure to file prescribed Form T244, Registered Pension Plan Annual Information Return, continues.

Westcoast Comment:

As noted by RPD the legislation behind these penalties is not new. What is new is that non-compliance in this area (even to items not listed above) will be accompanied by penalties. Westcoast's administration systems are designed such that non-compliance should not occur but we are aware of situations beyond our immediate control which might give rise to problems and will be taking action to address these issues to avoid, to the extent possible, any of our clients from paying fines unnecessarily.

RRSP Project and compliance activities

CRA have an ongoing project with respect to the increasing number of questionable investments held by RRSPs and RRIFs. Their concerns have been identified in previous Compliance Bulletins and Tax Alerts. They state that it is noteworthy that shares of public corporations traded on prescribed stock exchanges are being used to perpetrate RRSP schemes - this means that the compliance issues are no longer exclusive to securities that are not traded on prescribed stock exchanges.

RPD list the tax issues which pertain to non-qualified investments in RRSPs and RRIFs. They then reiterate the steps they are taking to protect retirement assets

held by Canadians from questionable promotions and arrangements. These compliance initiatives will include audits of issuers in order to verify RRSP and RRIF accounts.

CRA is concentrating on identifying questionable RRSP/RRIF schemes which promise the following:

- withdrawal of funds from an RRSP or RRIF without paying tax - promoters often promise to return part of the taxpayer's investment by offshore debit or credit cards, offshore bank accounts, or loan-back arrangements;
- immediate access to assets in "locked-in" RRSPs or RRIFs;
- income tax receipts providing deductions of three or more times the amount invested in an RRSP; and
- unrealistic returns on investments.

CRA comment that, typically, promoters of these questionable schemes direct the owner of a self-directed RRSP or RRIF to purchase a particular investment through a specific trustee. The particular investment could be shares in a company, units of participation in a co-operative, a mortgage, or other types of investments. The promotion of these schemes usually appears very professional, and makes the schemes appear legitimate. Various promotional methods may be used, such as the Internet, local newspaper advertisements, and/or promotional meetings.

Promoters often provide opinion letters from professionals that give the impression that the letter writer endorses the scheme. These letters should not be interpreted as providing any assurance that these schemes do what they claim to be doing or that the promised tax benefits are in accordance with the *Income Tax Act*.

Westcoast Comment:

While Westcoast does not give consulting advice specifically related to RRSPs and RRIFs we note that such questionable schemes can put retirement savings at risk to the extent that the promoter walks away with all the funds and cannot be found, the full amount of any withdrawal or ineligible investment is included in the taxpayer's income even when the savings are lost to the promoters and interest and penalties may also be levied for amounts not reported.

Tax Free Savings Account (TFSA) and Registered Disability Savings Plans

RPD's comments in these areas are basically that they will be reviewing these vehicles for compliance with the tax rules