

2017 Issue No. 45
2 October 2017

Tax Alert – Canada

Application of advantage tax rules to investment management fees delayed

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

In a newly released technical interpretation dated 15 September 2017, the Canada Revenue Agency (CRA) announced the deferral of the implementation date for applying the advantage tax rules to investment management fees incurred by registered plans, but paid outside of the plan by the annuitant or holder.

The advantage tax rules

Special anti-avoidance provisions known as the advantage rules are designed to discourage "transactions or events that would not have occurred in a normal commercial or investment context in which parties deal with each other at arm's length and act prudently, knowledgeably and willingly." Under the advantage rules, a tax equal to 100% of the advantage is payable for a calendar year if, in the year, an advantage in relation to a registered plan¹ is extended to, or is received or receivable by, any of the following:

- ▶ the registered plan annuitant or holder;
- ▶ a trust governed by the registered plan; or
- ▶ any person who is not dealing at arm's length with the holder or annuitant.

¹Before the 2017 federal budget, these anti-avoidance rules applied to tax-free savings accounts (TFSAs), registered retirement savings plans (RRSPs), and registered retirement income funds (RRIFs). Budget 2017 proposed to extend the rules that applied at the time to registered education savings plans (RESPs) and registered disability savings plans (RDSPs). See Tax Alerts [2017-9](#), [2017-12](#) and [2017-36](#).

An advantage is defined as a benefit, loan or indebtedness that is in any way conditional on the existence of the registered plan, excluding:

- ▶ benefits stemming from the provision of administrative or investment services;
- ▶ loans or debts reflecting arm's-length terms and conditions;
- ▶ payments out of a registered plan in satisfaction of all or part of the annuitant's or holder's interest in the plan;
- ▶ the payment or allocation of an amount to the registered plan by the issuer or carrier;
- ▶ amounts paid in respect of federal or provincial grants or contributions to RDSPs and RESPs; and
- ▶ certain benefits provided under incentive programs that are offered to a broad class of persons and reflect arm's-length terms.

Benefits that satisfy the above conditions may still be considered an advantage and subject to the 100% tax if there is an increase in the fair market value of property held within the registered plan and the increase is attributable to any of the following:

- ▶ a transaction or event (including a series of transactions or events) that does not reflect arm's-length terms, and one of the main purposes of the transaction or event is to benefit from the income tax exemption available to the registered plan;
- ▶ a payment received for services provided by or income received (including proceeds of disposition in respect of property held outside the registered plan) from a person not dealing at arm's length with the annuitant, holder or registered plan;
- ▶ a swap transaction; or
- ▶ specified non-qualified investment income that has not been removed from the registered plan within 90 days of receiving CRA notice.

Application to investment management fees

At the 2016 Canadian Tax Foundation Annual Conference, the CRA was asked whether the advantage tax rules for registered plans would apply where investment management fees incurred by the plan are paid outside of the plan by the annuitant or holder. In response, the CRA indicated that investment management fees represent a liability of the registered plan trust, and thus would be expected to be paid by the trustee using funds from within the plan. The CRA is of the view that there is an increase in the value of the property of a registered plan as a direct result of the plan's management fees being paid by a party outside of the plan. This increase in value of the property of the registered plan would likely constitute an advantage since:

- ▶ it would not be commercially reasonable for an arm's length party to gratuitously pay the expenses for the registered plan; and
- ▶ a compelling reason for entering into such arrangements would be to maximize registered plan savings and thereby benefit from the tax exemption provided to the registered plan.

As a result, the plan's annuitant or holder could be subject to an advantage tax equal to 100% of the amount of the investment management fees paid by the annuitant or holder.

To avoid adverse tax consequences, investment management fees that are charged to the plan annuitant or holder should instead be charged to the registered plan itself.

The CRA committed to working with the investment industry to identify the different types of fee structures and the appropriate application of the advantage rules to these structures. Recognizing the need for a period of transition to allow the investment industry to review how registered plan fees are processed, the CRA originally announced its intention to defer application of this position until 1 January 2018.

In a recently released income tax technical interpretation (CRA document number 2017-0722391E5), the CRA indicated that it is considering a number of submissions from various stakeholders impacted by this policy and, as a result, will be deferring the proposed implementation date by one year, to 1 January 2019.

Learn more

For more information on the application of the advantage tax rules to investment management fees or any other topics that may be of concern, please contact your EY or EY Law advisor, or one of the following professionals:

Reya Ali-Dabydeen

+1 416 943 2220 | reya.ali-dabydeen@ca.ey.com

Nancy Avoine

+1 418 640 5129 | nancy.avoine@ca.ey.com

Doris Foo

+1 416 943 2232 | doris.foo@ca.ey.com

Russ Lavoie

+1 416 943 2295 | russ.lavoie@ca.ey.com

Mal Leighl

+1 416 943 3986 | malkit.leighl@ca.ey.com

Matt MacInnis

+1 416 943 3991 | matthew.macinnis@ca.ey.com

Benoît Millette

+1 514 879 3562 | benoit.millette@ca.ey.com

Jillian Nicolson

+1 416 943 4474 | jillian.nicolson@ca.ey.com

Mike Vantil

+1 604 891 8315 | michael.p.vantil@ca.ey.com

Martin Wickins

+1 416 943 2598 | martin.wickins@ca.ey.com

And for up-to-date information on the federal, provincial and territorial budgets, visit ey.com/ca/budget.

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

About EY's Tax Services

EY's tax professionals across Canada provide you with deep technical knowledge, both global and local, combined with practical, commercial and industry experience. We offer a range of tax-saving services backed by in-depth industry knowledge. Our talented people, consistent methodologies and unwavering commitment to quality service help you build the strong compliance and reporting foundations and sustainable tax strategies that help your business achieve its potential. It's how we make a difference.

For more information, visit ey.com/ca/tax.

About EY Law LLP

EY Law LLP is a national law firm affiliated with EY in Canada, specializing in tax law services, business immigration services and business law services.

For more information, visit eylaw.ca.

About EY Law's Tax Law Services

EY Law has one of the largest practices dedicated to tax planning and tax controversy in the country. EY Law has experience in all areas of tax, including corporate tax, human capital, international tax, transaction tax, sales tax, customs and excise.

For more information, visit <http://www.eylaw.ca/taxlaw>

© 2017 Ernst & Young LLP. All Rights Reserved.

A member firm of Ernst & Young Global Limited.

This publication contains information in summary form, current as of the date of publication, and is intended for general guidance only. It should not be regarded as comprehensive or a substitute for professional advice. Before taking any particular course of action, contact EY or another professional advisor to discuss these matters in the context of your particular circumstances. We accept no responsibility for any loss or damage occasioned by your reliance on information contained in this publication.