Canada Revenue Agency Agence du revenu du Canada

Compliance Bulletin No. 6

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For the past several years, the Registered Plans Directorate (RPD) has used its Compliance Bulletins to inform industry professionals about non-compliance issues relating to registered plans and to outline the tax implications for members and employers. In Compliance Bulletin No. 5, we informed the deferred income plans industry of the results of two Federal Court of Appeal decisions as they related to registered pension plans that had issues with "primary purpose requirements." The resulting message to the industry 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.

This year's Bulletin focuses on several areas of non-compliance with the *Income Tax Act* (Act) and the Regulations related to registered plans and outlines their potential tax impact. Further, the Bulletin 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).

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 the defined benefit (DB) pension plan. They are referred to as excess funds because they are in excess of the amount that was required to be transferred so that the PSPA could be certified in order to purchase the period of past service under the DB 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.

In situations like this, the member is not permitted to return the excess funds back to an RRSP, since there is no provision in the 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. The funds would then be included in income in the year in which the refund occurs, as per paragraph 56(1)(a) of the Act. Alternatively, the excess funds could remain in the DB plan and be listed as assets in that plan (provided the plan terms permit the member 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.

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In an attempt to minimize the impact of this prevalent issue, RPD will consider requests for administrative relief on a case-by-case basis. We 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. Please note that administrative relief will not be granted for those cases where RPD uncovered the issue.

Penalties

In Compliance Bulletin No. 3, we informed the deferred income plans industry that in certain circumstances where a plan administrator/issuer/carrier fails to comply with a duty or obligation imposed by the legislation, the plan administrator/issuer/carrier is subject to a penalty under the Act.

Effective January 1, 2010, we will apply a penalty under subsection 162(5) to:

- 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.

Effective January 1, 2010, we will apply a penalty under subsection 162(7) to:

- 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,

Effective January 1, 2010, we will begin applying the full penalty under subsection 162(7) to:

- the connected person information return for a **failure to file** prescribed Form T1007, *Connected Pension Information Return*.

The penalty under subsection 162(7) applied to the annual information return for a **failure to file** prescribed Form T244, *Registered Pension Plan Annual Information Return*, continues.

You are reminded that the legislation behind these penalties is not new. Please note that this list may be amended to include other prescribed forms, without prior notification going out to the industry.

RRSP Project

The Canada Revenue Agency (CRA) has identified an increasing number of questionable investments held by RRSPs and registered retirement income funds (RRIFs). The compliance issues that were previously identified and discussed in Compliance Bulletin No. 4 and in the November 29, 2007 and March 17, 2009 CRA Tax Alerts have continued to increase.

The following is an update of our compliance activities concerning these issues. We will not reiterate our fundamental concerns; however, you should note that the CRA has recently noticed that shares of public corporations traded on prescribed stock exchanges are being used to perpetrate RRSP schemes. This is noteworthy because it means that the compliance issues are no longer exclusive to securities that are not traded on prescribed stock exchanges.

Please note that the following discussion applies equally to RRIFs, with appropriate changes to legislative references.

Part XI.1 tax

When an RRSP trust acquires a non-qualified investment, the fair market value of the investment at the time it was acquired is included, by virtue of subsection 146(10) of the Act, in computing the income of the taxpayer who is the annuitant under the plan. If for any reason subsection 146(10) is not applied, then a tax under Part XI.1 of the Act may be assessed on the RRSP. Part XI.1 tax may also apply in situations where an RRSP acquires a qualified investment and that investment subsequently becomes a non-qualified investment.

Subsection 207.1(1) of Part XI.1 imposes a 1% per month tax on an RRSP that holds a non-qualified investment. Pursuant to subsection 207.2(2), the issuer may become personally liable for this tax if the RRSP does not remit the amount due. It is an issuer's obligation to file a Form T3GR, *Group Income Tax and Information Return for RRSP, RRIF or RESP Trusts*, and remit the tax whenever applicable. Failure to do so will result in the CRA assessing Part XI.1 tax and penalty where warranted.

Note that a penalty may also apply when other related information returns such as the T4RSPSUM, or the T4RSP are required to have been but have not been filed.

We would like to highlight the risk these provisions present to issuers, particularly in the context of the "RRSP strip issue" detailed in Compliance Bulletin No. 4. By definition, when an RRSP is "stripped," value is removed from the trust so that it is left with property of little or no value. The consequence is that when the CRA issues an assessment under Part XI.1, the RRSP is unable to pay the tax and the liability falls to the issuer.

Compliance activities

The CRA has pursued, and will continue to pursue, enhanced compliance activities in this sector 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.

You are reminded that when an RRSP issuer opens a contract under a specimen plan, they are obligated to apply to the CRA to have these contracts registered within 60 days of the end of the calendar year. Such reporting is done by filing a completed Form T550 or providing CRA with the required information. This information is required for each specimen, under which contracts were sold, together with a CD-ROM listing the contract account numbers, names, addresses, and Social Insurance Numbers pertaining to the contracts. Transmitting the accurate information to CRA ensures that the plans sold in the year under the specimen are properly registered.

Tax Free Savings Account

Starting in 2009, Canadian residents who are 18 years of age or older are able to earn tax free investment income within a TFSA during their lifetime. The maximum amount that can be contributed to a TFSA in 2009 is $5,000. This amount will be indexed to inflation and rounded to the nearest $500 in subsequent years. Unused TFSA contribution room can be carried forward to later years. The total of TFSA withdrawals in a calendar year is added to the TFSA contribution room for the next calendar year. The CRA is responsible for monitoring and operating the TFSA, as applicable under the Act.

Some of the areas that the CRA will be reviewing to ensure compliance in respect of the operation of TFSAs include:

- qualifying arrangements are entered into by individuals who have attained 18 years of age;
- no contributions were made to a TFSA before January 1, 2009;
- contributions are not deducted;
- the investments made are qualified investments;
- contribution limits are respected; and

- TFSA elections are filed within the required time frame (by the end of February in the year following the year the arrangement was entered into).

This is not an exhaustive list. The CRA will review all facets of the TFSA to ensure that they are being administered in accordance with the Act and its Regulations. You are reminded that failure to adhere to the rules relating to TFSAs may lead to consequences such as income inclusions and the application of penalties.

Registered Disability Savings Plans

A registered disability savings plan is a trust arrangement between a holder and an issuer (a trust company in Canada). The purpose of such a plan is to provide for the long-term financial security of a beneficiary who has a prolonged and severe physical or mental impairment and is entitled to the Disability Tax Credit. The RDSP is being administered jointly with Human Resources and Skills Development Canada (HRSDC).

Some of the areas that will be reviewed to ensure compliance in respect of the operation of RDSPs include:

- approved specimen plans meet the requirements under section 146.4 of the Act;
- the plan is for a qualified beneficiary;
- contributions are not tax deducted;
- contribution limits are respected;
- the RDSPs have been registered; and
- disability assistance payment maximums are respected.

The CRA and HRSDC will review all facets of the RDSP to ensure that they are being administered in accordance with the applicable rules and regulations. You are reminded that failure to adhere to the rules relating to RDSPs may lead to consequences such as income inclusions and the application of penalties.

How to contact us

Contact us at the Registered Plans Directorate if you have questions about administering a registered plan in accordance with the Act:

- Our telephone enquiries service is available Monday to Friday from 8:00 a.m. to 5:00 p.m. Eastern Time (with a voice mailbox system to take messages outside those hours):

  In the Ottawa area:
  For service in English, call 613-954-0419.
  For service in French, call 613-954-0930.

  Toll-free elsewhere in Canada:
  For service in English, call 1-800-267-3100.
  For service in French, call 1-800-267-5565.

- Plan administrators who need guidance on issues related to a specific plan can write to us at the Registered Plans Directorate, Canada Revenue Agency, Ottawa ON K1A 0L5, or fax us at 613-952-0199.

- We welcome feedback on this Bulletin, as well as any comments related to auditing registered plans. Email your comments to **rpd/dre@cra-arc.gc.ca**.