

TAX ALERT **RRSP RULE CHANGE**

(by Ian MacInnis & Peter Guselle)

The federal budget proposals to amend the Income Tax Act (Canada) originally released on March 22, 2011, and subsequently re-released on June 6, 2011 following the federal election, include a proposal to extend certain anti-avoidance rules, introduced in connection with tax-free savings accounts, to registered retirement savings plans and registered retirement income funds. In particular, the budget proposes to modify certain tax rules which apply when an RRSP acquires a "non-qualified investment", and introduces the concept of a "prohibited investment", which includes a share of a corporation in which the holder together with any non-arm's length persons hold 10% or more of the shares of any class, applicable to both RRSPs and RRIFs. When an RRSP acquires a prohibited investment, or where an investment becomes prohibited after it was acquired by an RRSP, a tax equal to 50% of the fair market value of the investment will apply to the RRSP annuitant, which tax will be refunded if the investment is disposed from the RRSP by the end of the following year. In addition, any income (including capital gains) derived from a prohibited investment will be treated as an "advantage", which is subject to a 100% tax payable by the RRSP annuitant.

The existing regulations with respect to qualified investments permit an RRSP to hold shares of a private Canadian corporation which is carrying on a qualifying active business, provided that the annuitant, together with persons with whom he is not dealing at arm's length, holds less than 10% of the issued shares of any class of the capital stock of the corporation. The regulations also provide that a person who deals at arm's length with the corporation may hold shares above the 10% threshold, provided that the cost of the shares is less than \$25,000. By contrast, the "prohibited investment" concept which is being extended to RRSPs does not include a carve out exception for shareholdings with a cost of less than \$25,000. As a result, shares in a private corporation which previously met the "qualified investment" test may now be a "prohibited investment".

Any transfer of property with an RRSP, known as a "swap transaction", will not be subject to the RRSP advantage rules if completed on or before June 30, 2011. If a swap transaction is undertaken to remove what would otherwise be a prohibited investment from an RRSP or RRIF, the proposed 50% tax will not apply provided the transaction is completed before 2013. Note,

however, that as long as an RRSP continues to hold a prohibited investment which was held on March 22, 2011, any increase in value from that date or income generated after that date will be subject to the 100% tax as an advantage.

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