The 2011 Federal Budget proposed several changes to the enforcement of anti-avoidance rules on Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs), making them more consistent with the rules currently enforced for Tax Free Savings Accounts (TFSAs). While not passed into law at the time of writing, it is fully expected that these proposals will be adopted in the coming months. The consequences of the changes may be significant for some RRSP/RRIF holders and caution should be taken to ensure that you are not affected by the new penalty taxes described below.

The anti-avoidance rules proposed for RRSP/RRIF accounts fall into the following three areas:

- The Advantage Rule
- The Prohibited Investment Rules
- The Non-Qualified Investment Rules

Advantage Rule

An "advantage" is a benefit obtained from a transaction that is intended to exploit the tax attributes of a registered plan, such as shifting returns from a taxable investment to a tax deferred investment, commonly referred to as a "swap" transaction. As a result of these rules now being applied to RRSP/RRIFs, Richardson GMP and some other investment dealers will no longer allow swap transactions, unless the swap occurs from one RRSP/RRIF account to another RRSP/RRIF account with the same beneficial owner, or if the swap occurs in relation to the prohibited investment rules below.

Prohibited Investment Rules

The budget introduces a "prohibited investment" concept for RRSP/RRIFs, based closely on the TFSA prohibited investment rules. Securities that trade on a public stock exchange will continue to be considered qualified investments for RRSP/RRIFs, however, two new penalty taxes will be levied on an RRSP/RRIF holder who owns a prohibited investment, which is defined as follows:

A prohibited investment for an RRSP/RRIF would include property that at any time:

- Is a share of a corporation in which you, the annuitant, have a significant interest because you own (including deemed ownership through non-arm's-length persons and shares or interest owned by the annuitant's RRSP) 10 percent or more of the shares of any class of the corporation or a corporation related thereto, or
- Is an interest in a partnership or trust and you (alone or with persons with whom you do not deal at arm's length) own 10% or more of the fair market value of all the interests in that partnership or trust, or
- Is a share in a corporation that does not deal at arm's length with you or with a corporation, partnership, or trust in which you have a significant interest.

Based on the proposed legislation, if your RRSP/RRIF holds a prohibited investment after March 22, 2011, the following two penalties may be imposed:

1. A special tax of 50% of the fair market value of the investment will be applied on the date the investment is acquired, or otherwise becomes a prohibited investment. This tax can be avoided if the investment is disposed of, swapped, or removed from the RRSP/RRIF or ceases to be a prohibited investment by December 31, 2012.
2. The second penalty tax is calculated as 100% of income earned or capital gains realized from the prohibited investment held in an RRSP/RRIF after March 22, 2011. This tax may be waived by the Canada Revenue Agency (CRA) if the RRSP/RRIF makes a taxable distribution to the holder equal to the amount of the waived penalty tax. For investments that became prohibited investments on March 23, 2011, transitional rules may apply in certain circumstances.

Note that shares of a Private Corporation, e.g. CCPC's, Small Business, and Venture Capital Corporations are now considered to be prohibited investments. A professional evaluation of the fair market value of private company shares would be required in order to dispose of, withdraw, swap or remove these shares from an RRSP/RRIF.

Non-Qualified Investment Rule

The budget also modifies certain tax rules that apply when an RRSP/RRIF acquires a "non-qualified investment". These modifications are also based on rules already in place for TFSAs. Under this proposal, an RRSP/RRIF annuitant will be subject to a special tax of 50% of the fair market value of the non-qualified investment. A non-qualified investment for an RRSP/RRIF includes shares in foreign private companies, real property and any other investment that is not permitted under the Income Tax Act.

Richardson GMP Procedural Changes

Effective September 1st, 2011 the following procedural changes will be implemented to ensure compliance with the new proposed law:

- All swap transactions will be discontinued, with the following two exceptions:
  - The removal of prohibited investments. The budget proposes to have all prohibited and non-qualified investments removed from an RRSP or RRIF before December 31st, 2012.
  - Swaps from an RRSP/RRIF to an RRSP/RRIF with the same beneficial owner.
- Contributions to a registered plan account must be a qualified investment as described in the Income Tax Act. Important Note: Shares of a Private Corporation, e.g. CCPCs, Small Business, and Venture Capital Corporations are now considered to be prohibited investments.
- Previously, Non-Brokered Private Placements were necessarily treated as swap transactions where the funds used to purchase were in the client's registered plan account. Going forward, Non-Brokered Private Placements will be prohibited with use of funds from a registered plan due to the new swap restrictions.
- Purchases of Brokered Private Placements in a registered plan will be allowed as long as the investment is an RRSP eligible purchase and the underlying security trades on a recognized exchange.

What options are available if you currently hold a prohibited investment in your RRSP/RRIF?

If you believe that you currently hold a prohibited investment in your RRSP or RRIF, you have a few options to deal with the situation:

- You can withdraw the securities from your RRSP, which would be treated as a withdrawal of the fair market value of the shares. This amount would need to be included in your taxable income in the year of the withdrawal.
- If the investment is a prohibited investment because you own a significant interest (more than 10%) of a corporation and some of the shares are held outside your RRSP, you could sell just enough shares of the corporation outside the RRSP to an arm's length buyer. This transaction could bring your interest in the corporation under the threshold of 10% ownership, however 50% of any capital gains realized as a result of the sale would be taxable in your hands in the year in which the shares are sold.
- If the investment is a prohibited investment because you own a significant interest (more than 10%) of a corporation, partnership or trust within your RRSP, you could sell just enough of the investment within the RRSP to an arm's length buyer and use the proceeds to purchase a different, qualified investment in the same RRSP. This would reduce your interest in the corporation, partnership or trust to less than the threshold of 10% ownership and would not result in a taxable disposition.
- You can swap the prohibited investment with an investment in a non-registered account, provided the swap transaction occurs prior to December 31, 2012.

Conclusion

The investments held in your RRSP or RRIF should be reviewed to determine whether these new rules could apply. If you may be affected by the new penalty taxes, please contact your Richardson GMP Investment Advisor and your personal tax advisor for assistance. Please note that, as of September 2011, the provisions proposed by Federal Budget 2011 have not yet become law and the information contained in this document may change in the future.