Investment Management Fees for Registered Accounts

CRA Policy Changes Proposed for 2018

The Canada Revenue Agency ("CRA") has proposed changes to its administrative policy regarding the application of the "advantage" tax rules to investment management fees for registered accounts, which would come into effect in 2018. The following article provides a high level overview of these changes. Please consult with your tax advisor for more information on the specific tax implications that these policy changes may have on your registered accounts.

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The CRA's proposed changes specifically target individuals who pay their investment management fees for registered accounts outside of the registered plan. For BMO Nesbitt Burns clients, these proposed changes will only affect such clients that hold registered accounts in any of BMO Nesbitt Burns' fee for advice programs, including the Architect, BluePrint, Quadrant, Meridian or Managed Portfolio Account (MPA) programs, and are currently paying these management fees from another such non-registered account. The following article provides a general overview of this topic and uses language regarding registered accounts generically – it does not specifically discuss registered accounts in one of BMO Nesbitt Burns' fee for advice programs.

Background

Individuals often invest through various investment accounts to achieve specific financial and tax planning objectives. These include non-registered and registered plan accounts, such as Registered Retirement Savings Plans ("RRSPs"), Registered Retirement Income Funds ("RRIFs"), and Tax-Free Savings Accounts ("TFSAs"). To simplify the bookkeeping process, and to potentially reduce fees, clients with accounts in BMO Nesbitt Burns' fee for advice programs (Architect, BluePrint, Quadrant, Meridian, and MPA) may be charged one aggregate investment management fee. Clients often combine their accounts in their fee for advice program to increase their asset size, which results in lower management fees. Although the management fee for registered accounts is not tax deductible, regardless of whether the non-registered or registered account is used to pay the fee, it is not uncommon for individuals to pay the investment management fee directly from his/her non-registered investment account (i.e., paid outside of the registered plan).

The CRA has a long-standing administrative policy which states that investment management fees for a registered plan that are paid outside of the plan by the plan annuitant or holder ("controlling individual") will not constitute a contribution or gift to the registered plan for the purposes of applying the 'over-contribution' rules in the *Income Tax Act*.

However, in November 2016, as part of a round table discussion at the Canadian Tax Foundation's annual conference, the CRA addressed the possible application of certain "advantage" tax rules in the Income Tax Act (as described in the following section) to investment management fee payments made personally by the controlling individuals of registered plans. The CRA stated that, in most cases, management fees that are paid directly by a controlling individual from outside the plan would constitute an "advantage" under the *Income Tax Act*, resulting in the controlling individual potentially owing punitive taxes.

Understanding the advantage tax rules and the new CRA administrative policy

To curtail perceived abuse with respect to registered accounts, Canadian tax legislation imposes a 100% tax on the fair market value of an advantage in relation to a registered plan that is received by either the controlling individual or the registered plan itself. An advantage exists when:

- A benefit results in an increase in the total fair market value of the assets held within the registered plan;
- The increase in value is, directly or indirectly, attributable to transactions where one of the main purposes was to benefit from the tax exemption afforded to the registered plan; and
- The transaction would not have occurred in a normal commercial or arm's length dealing.

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In reviewing the advantage tax rules, the CRA noted that an increase in the value of the assets held within a registered plan is realized as an indirect result of the plan's management fees being paid from outside of the plan. The CRA further noted that it is also not reasonable for third parties to pay the management fees of another party. Therefore, the increase in the value of assets held in the registered plan as a result of this payment set up would likely constitute an advantage. As such, the plan's controlling individual could be subject to an advantage tax equal to 100% of the registered account's investment management fees paid outside of the plan, according to the CRA's proposed policy changes.

For further guidance, the CRA intends to issue an **Income Tax Folio** on the advantage tax rules, which is expected to be released later this year. However, the CRA has stated that it will provide a transition period by deferring the application of its new position until 2018, with a confirmed date to be announced shortly. Accordingly, to avoid future negative tax implications, individuals with registered account(s) who are currently paying their associated investment management fees outside of their registered plan(s) will need to ensure that the fees associated with a registered account are borne fully by the registered account itself, prior to the 2018 implementation date.

It is also important to note that the **2017 Federal Budget** proposes to extend the proposed advantage tax rules that are applicable to RRSPs, RRIFs, and TFSAs to Registered Education Savings Plans ("RESPs") and Registered Disability Savings Plans ("RDSPs"), so it is expected that these accounts will also become subject to the CRA's new administrative position.

How will this affect my BMO Nesbitt Burns registered account(s)?

With significant registered plan assets in our fee for advice solutions, BMO Nesbitt Burns is working on a technology-driven solution to ensure that your payments of management fees for all accounts are compliant with the updated policy by the effective date while we await the CRA's decision. Until that decision is announced, clients can continue to pay the management fees for their registered accounts as per their existing practice.

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