

NO.: **IT-320R3**

DATE: July 1, 2002

SUBJECT: INCOME TAX ACT

**Qualified Investments – Trusts Governed by Registered Retirement Savings Plans, Registered Education Savings Plans and Registered Retirement Income Funds**

REFERENCE: The definitions of “qualified investment” in section 204 and in subsections 146(1), 146.1(1) and 146.3(1) of the *Income Tax Act* (the “Act”) and Parts XLIX and LI of the *Income Tax Regulations* (the “Regulations”) (also subsections 146(4), 146(6), 146(9), 146(10), 146(10.1), 146.1(2.1), 146.1(5), 146.1(7), 146.1(7.1), 146.1(13), 146(13.1), 146.3(3), 146.3(4), 146.3(7) to (10), 204.4(1), 207.1(1), 207.1(3), 207.1(4), and 207.2(1); paragraphs 146(2)(c.4) and 146.3(2)(g); clause 212(1)(b)(ii)(C); the definitions of “retirement income” in subsection 146(1), and “active business”, “small business corporation” and “specified shareholder” in subsection 248(1) of the Act; and Parts XXXII, XLVIII, and LXVII of the Regulations)

At the Canada Customs and Revenue Agency (CCRA), we issue income tax interpretation bulletins (ITs) in order to provide technical interpretations and positions regarding certain provisions contained in income tax law. Due to their technical nature, ITs are used primarily by our staff, tax specialists, and other individuals who have an interest in tax matters. For those readers who prefer a less technical explanation of the law, we offer other publications, such as tax guides and pamphlets.

While the comments in a particular paragraph in an IT may relate to provisions of the law in force at the time they were made, such comments are not a substitute for the law. The reader should, therefore, consider such comments in light of the relevant provisions of the law in force for the particular taxation year being considered, taking into account the effect of any relevant amendments to those provisions or relevant court decisions occurring after the date on which the comments were made.

Subject to the above, an interpretation or position contained in an IT generally applies as of the date on which it was published, unless otherwise specified. If there is a subsequent change in that interpretation or position and the change is beneficial to taxpayers, it is usually effective for future assessments and reassessments. If, on the other hand, the change is not favourable to taxpayers, it will normally be effective for the current and subsequent taxation years or for transactions entered into after the date on which the change is published.

Most of our publications are available on our Web site at: [www.ccra.gc.ca](http://www.ccra.gc.ca)

***If you have any comments regarding matters discussed in an IT, please send them to:***

***Manager, Technical Publications and Projects Section  
Income Tax Rulings Directorate  
Policy and Legislation Branch  
Canada Customs and Revenue Agency  
Ottawa ON K1A 0L5***

***or by email at the following address:***

***bulletins@ccra.gc.ca***

## ***Contents***

*Application*

*Summary*

*Discussion and Interpretation*

General (¶ 1)

Registered Holder of Investments (¶ 2)

Qualified Investments

*Definitions* (¶ 3)

*Borrowing money* (¶ 4)

*Publicly traded shares and shares of public corporations* (¶ 5)

*Shares of private and other corporations*

Shares of small business corporations (¶s 6-7)

Shares of eligible corporations (¶ 8)

Shares of venture capital corporations (¶ 9)

*Debt obligations*

Types (¶ 10)

Mortgages (¶s 11-12)

*Instalment receipts* (¶ 13)

*Money and deposits of money* (¶s 14-16)

*Trust interests* (¶ 17)

*Annuity contracts* (¶s 18-20)

*Warrants, rights and options* (¶s 21-23)

*Registered investments* (¶ 24)

*Royalty units* (¶ 25)

*Partnership units* (¶ 26)

*Depository receipts* (¶ 27)

Income Tax Consequences of Acquiring, Holding and Disposing of Property That is not a Qualified Investment

*Tax consequences for an annuitant under an RRSP or a RRIF* (¶ 28)

*Tax consequences for a recipient under an RESP* (¶ 29)

*Tax consequences for a plan trust*

Part I tax (¶ 30)

Part XI.1 tax (¶ 31)

Other Bulletins and Circulars (¶ 32)

*Appendix – Prescribed Stock Exchanges In and Outside Canada as of July 1, 2002*

*Explanation of Changes*

## Application

This bulletin replaces and cancels Interpretation Bulletin IT-320R2 dated January 17, 1992, called *Registered Retirement Savings Plans – Qualified Investments*. The effective date of a particular legislative provision discussed in the bulletin may be indicated in the *Discussion and Interpretation* section of the bulletin. However, where the bulletin is silent with respect to the effective date of a particular provision, such date can be obtained from the legislation itself.

## Summary

This bulletin discusses the kinds of property that constitute qualified investments for trusts governed by registered retirement savings plans (RRSPs), registered education savings plans (RESPs) and registered retirement income funds (RRIFs), as well as the income tax consequences of such trusts acquiring and holding property that is not a qualified investment. Certain trusts governed by registered plans may be subject to a special tax in respect of investments in foreign property. For a discussion on this matter, see the current version of IT-412, *Foreign Property of Registered Plans*.

## Discussion and Interpretation

### General

¶ 1. This bulletin only discusses the kinds of property that constitute qualified investments for **trusts** governed by RRSPs, RESPs and RRIFs and does not include other types of arrangements such as a depository RRSP or an insurance contract RRSP. Unless otherwise noted

- a reference to an RRSP, an RESP or a RRIF in this bulletin means a trust governed by an RRSP, an RESP or a RRIF, respectively;
- a reference to a “plan trust” in this bulletin means a trust governed by an RRSP, an RESP or a RRIF; and
- all statutory references throughout the bulletin are to the Act.

### Registered Holder of Investments

¶ 2. All qualified investments of a plan trust must be owned by the trustee of the plan trust and not by the annuitant, beneficiary or subscriber under the plan trust. In the case of a share or other security, registration of the security in the name of the trustee of the plan trust demonstrates ownership by the trustee. However, there are situations where a security may be considered a qualified investment for a plan trust even though the trustee of the plan trust is not the registered holder of the security. This can happen, for example, where a security dealer holds the qualified investments of the plan trust as the agent for the trustee and it is necessary to register the investments in the dealer’s name. It can also happen where securities are issued and processed through a central depository for securities,

such as the Canadian Depository for Securities Limited. Where the registration and trading of a security is maintained by a central depository for securities, and the security is otherwise a qualified investment for plan trusts, the security will be a qualified investment for a plan trust if the trustee of the plan trust is the beneficial owner of the security.

## Qualified Investments

### Definitions

¶ 3. The kinds of property that constitute qualified investments for RRSPs, RESPs and RRIFs are described in the definitions of “qualified investment” in subsections 146(1), 146.1(1) and 146.3(1), respectively. Paragraph (a) of those definitions includes certain of the investments listed in the definition of “qualified investment” in section 204. In addition, properties prescribed by section 4900 of the Regulations are also qualified investments. Where a property is prescribed in a Regulation other than subsection 4900(1) of the Regulations, this has been indicated in the paragraph of the bulletin describing that property. Generally, in the case of an RESP, the restrictions on investments discussed in this bulletin apply to property acquired after October 27, 1998. Paragraph (d) of the definition of “qualified investment” in subsection 146.1(1) provides that any investment acquired by an RESP before October 28, 1998 is considered to be a qualified investment for the trust.

The term “at arm’s length” is used numerous times in this bulletin (see ¶s 6 to 8, 11 and 15). For a discussion on the criteria used to determine whether or not persons deal with each other at arm’s length, refer to the current version of IT-419, *Meaning of Arm’s Length*.

Prescribed stock exchanges in and outside Canada are indicated in sections 3200 and 3201 of the Regulations, respectively (see the appendix).

### Borrowing money

¶ 4. Adverse income tax consequences may occur if a plan trust borrows money or uses or permits its property to be used as security for a loan. Subject to certain exceptions, if an RRSP has borrowed money in the year or in a previous year and has not repaid the amount before the beginning of the year, paragraph 146(4)(a) requires that the trust pay income tax on its taxable income for that year. If an RRSP uses or permits its property to be used as security for a loan, subsection 146(10) requires that the fair market value of the property be included in computing the annuitant’s income for the year. In the year such a loan ceases to exist, a deduction from the annuitant’s income is permitted under subsection 146(7). The equivalent provisions for a RRIF are in subsections 146.3(3), (7) and (10). In the case of an RESP, paragraph 146.1(2.1)(d) provides that an RESP is revocable where the trustee of the RESP borrows money and certain conditions are not met. These provisions do not apply where the trust acquires a qualified investment that is payable on an instalment basis (see ¶ 13), because an obligation to pay instalments does not constitute a loan or borrowed money

with a relationship of lender and borrower between the parties.

### ***Publicly traded shares and shares of public corporations***

¶ 5. Shares of a corporation listed on a prescribed stock exchange in or outside Canada are qualified investments for a plan trust. Shares of a public corporation (other than a mortgage investment corporation) are also qualified investments for a plan trust. For comments on the meaning of “public corporation”, see the current version of IT-391, *Status of Corporations*. Shares of a corporation that were listed on a prescribed stock exchange but that have been suspended from trading or de-listed continue to be qualified investments if the corporation that issued the shares was, and remains, a public corporation, and the shares do not otherwise cease to be qualified investments.

A share of a corporation subject to an escrow agreement may be a qualified investment if

- the share has been issued and not simply allotted to a plan trust;
- the shareholder has all the rights of ownership that every other shareholder has in relation to the issuer; and
- shares, identical to the escrowed share, that are not subject to an escrow agreement, are qualified investments.

### ***Shares of private and other corporations***

#### **Shares of small business corporations**

¶ 6. Subject to certain conditions noted below, paragraph 4900(12)(a) of the Regulations provides that a plan trust may acquire as a qualified investment a share of a small business corporation (other than a cooperative corporation) provided that, immediately after the acquisition of the share, each person who is an annuitant, a beneficiary or a subscriber under the plan trust is **not** a “connected shareholder” of the corporation. For this purpose, “small business corporation” is defined, in general, as a Canadian corporation (other than a corporation controlled at that time, directly or indirectly in any manner whatever, by one or more non-resident persons) all or substantially all of the fair market value of the assets of which is attributable to assets that are

- used principally in an active business carried on primarily in Canada by the corporation or by a corporation related to it;
- shares or debts of connected small business corporations; or
- a combination of the above two.

Where 90% or more of the fair market value of the assets is used in the described manner, the “all or substantially all” test is considered to have been met. “Active business” is defined in subsection 248(1) as any business that is carried on by a taxpayer resident in Canada other than a “specified investment business” or a “personal services business.” See the current version of IT-73, *The Small Business Deduction*,

for a discussion of “specified investment business” and “personal services business.”

Generally, a connected shareholder of a corporation (as defined in subsection 4901(2) of the Regulations) at any time is a person who owns, directly or indirectly, at that time, **10%** or more of the shares of any class of shares of the corporation or of any other corporation related to the corporation. However, where

- such a person **is** dealing at arm's length with the corporation or any other related corporation; and
- the aggregate cost amount of all shares of the corporation or any other related corporation the person owns, or is deemed to own, is less than **\$25,000**

that person will **not** be a connected shareholder of the corporation.

For purposes of the **10%** and **\$25,000** tests, the rules in the definition of “specified shareholder” in subsection 248(1) apply with the result that certain shares will be deemed to be owned by the shareholder. For example, by virtue of paragraphs (a) and (b), respectively, of that definition, an annuitant, a beneficiary or a subscriber under a plan trust is deemed to own the shares owned by a person with whom the annuitant, beneficiary or subscriber is **not** dealing at arm's length, as well as the shares owned by the plan trust.

In addition, any share that

- the annuitant, beneficiary, or subscriber under a plan trust; or
- a person not dealing at arm's length with any of the above has a right to acquire is also included in the calculation of the percentage and cost amount of the shares held for purposes of the **10%** and **\$25,000** tests pursuant to subsection 4901(2.2) of the Regulations.

The condition that the corporation be a small business corporation must be satisfied only at the time the share of the corporation is acquired by a plan trust, or at the end of the taxation year of the corporation ending before the time the share is acquired. Similarly, the condition that the annuitant, beneficiary or subscriber under a plan trust **not** be a connected shareholder must be satisfied only at the time immediately after the share is acquired by the plan trust. Should these conditions fail to be met at a time after the share has been acquired, the share will not, as a consequence, cease to be a qualified investment for the plan trust.

Subsection 4900(13) of the Regulations addresses the nature of the return from an investment in shares of a small business corporation made by a plan trust. If the return on shares can reasonably be considered to represent, for example, a payment made to a plan trust by the issuer of the shares

- for services rendered by an individual to the issuer of the shares, or a person related to the issuer; or
  - for goods or services provided to an individual by the issuer of the shares or a person related to the issuer
- the shares will, immediately before the amount is received, cease to be a qualified investment for the plan trust.

¶ 7. In a situation where two unrelated shareholders each own 50% of the shares of a small business corporation and use their own plan trusts to acquire some shares of the corporation, it is a question of fact whether the shares will be a qualified investment for each plan trust. The facts and circumstances that occur immediately after the acquisition must be examined in order to make this determination because, in order not to be a “connected shareholder” of the corporation, the annuitant, beneficiary or subscriber under the plan trust has to deal at arm’s length with the corporation immediately after the plan trust has acquired the shares. Where the voting power in a closely held corporation is equally divided between two shareholders who are not related persons, the corporation will generally be viewed as being controlled by the group consisting of the two shareholders, but not by either shareholder. Therefore, in these circumstances, it is possible for the annuitant, beneficiary or subscriber under the plan trust to be dealing at arm’s length with the corporation immediately after the acquisition of the shares. However, there may be other circumstances that indicate that such person did not deal at arm’s length with the corporation, e.g., where the shares owned by the plan trust allow excessive returns on the investment.

### Shares of eligible corporations

¶ 8. Subject to certain conditions noted below, paragraph 4900(6)(a) of the Regulations provides that a plan trust may acquire as a qualified investment a share of an “eligible corporation” provided that each person who is an annuitant, a beneficiary or a subscriber under the plan trust is **not** a “designated shareholder” of the corporation. The shares of a single corporation may satisfy the conditions of being both shares of

- an eligible corporation, and
- a small business corporation (see ¶ 6).

However, it should be noted that the conditions for shares of a small business corporation to be a qualified investment must be satisfied only at the time of acquisition of those shares by a plan trust, while in the case of shares of an eligible corporation, the conditions to be a qualified investment must be satisfied not only at the time of acquisition of those shares but throughout the entire period during which the shares are held by the plan trust.

An “eligible corporation” is defined in subsection 5100(1) of the Regulations and generally means

- a “specified holding corporation” as defined in subsection 5100(1) of the Regulations,
- a venture capital corporation described in section 6700 of the Regulations, or
- a taxable Canadian corporation (as defined in subsection 248(1)) as long as all or substantially all of its property is
  - (i) used in a qualifying active business carried on by it or by a corporation it controls;
  - (ii) shares or debts issued by related eligible corporations; or

(iii) a combination of the above two.

Specifically excluded from the definition of “eligible corporation” are those entities listed in paragraphs (c) to (e) of that definition and they include securities traders or dealers, banks, credit unions and insurance corporations, as well as corporations controlled by non-residents.

A “qualifying active business” is defined in subsection 5100(1) of the Regulations to be any business carried on primarily in Canada by a corporation **except** where the principal purpose of the corporation is to earn income from property including interest, dividends, rent or royalties; or the corporation derives gains from the disposition of property (other than property in the inventory of the business). A qualifying active business may, however, include a business of leasing property other than real property.

A corporation’s business will be considered to have been carried on primarily in Canada if

- at least 50% of its full-time employees are employed in the business in Canada; or
- at least 50% of the salaries or wages paid to its employees are reasonably attributable to services provided in Canada.

If a corporation is part of a group of related corporations, the combined services of their employees and the combined salaries and wages paid must be considered in making this determination.

A “designated shareholder” of a corporation (as defined in subsection 4901(2) of the Regulations) at any time is an annuitant, a beneficiary or a subscriber under a plan trust that holds shares of the corporation who, at that time, either does **not** deal at arm’s length with the corporation, **or** is, or is related to, any one of the following:

- a person described in the discussion of “connected shareholder” in ¶ 6;
- a member of a partnership that controls the corporation;
- a beneficiary under a trust that controls the corporation; or
- an employee of the corporation or a related corporation where any group of employees of the corporation or the related corporation control the corporation, except where the corporation is controlled by one person or a related group of persons.

In addition, any share that

- an annuitant, a beneficiary or a subscriber under a plan trust, or
- a person not dealing at arm’s length with any of the above has a right to acquire is included in the calculation of the percentage and cost amount of the shares held for purposes of the **10%** and **\$25,000** tests referred to in ¶ 6 (pursuant to subsection 4901(2.3) of the Regulations). As previously noted, the conditions described above must be satisfied at the time the plan trust acquires the shares, and thereafter. Should these requirements fail to be met at a later date, the shares will no longer be qualified investments and the plan trust will be subjected to the penalty tax under Part XI.1 of the Act (see ¶ 31).

Under subsection 4900(8) of the Regulations, if a plan trust holds a share of an eligible corporation, and a person who is the annuitant, beneficiary or subscriber under the plan trust provides services to or for the issuer or a person related to the issuer of that share, the share may cease to be a qualified investment in certain circumstances. If the circumstances are such that it can reasonably be considered that any amount received in respect of the share is on account, in lieu or in satisfaction of payment for those services, the share will cease to be a qualified investment immediately before the payment was received and will not be a qualified investment for the plan trust thereafter. Factors to be considered in making this determination include the terms and conditions of the share, any related agreement and the rate of interest or the dividend provided on the share.

### Shares of venture capital corporations

¶ 9. In accordance with paragraph 4900(12)(b) of the Regulations, a plan trust may acquire, as a qualified investment, shares of a venture capital corporation described in any of sections 6700, 6700.1 or 6700.2 of the Regulations, provided that:

- immediately after the time the property was acquired by the trust, each person who is an annuitant, a beneficiary or a subscriber under the plan trust was **not** a connected shareholder of the corporation; and
- subsection 4900(13) of the Regulations does not apply.

For comments on the definition of “connected shareholder” and on subsection 4900(13) of the Regulations see ¶ 6.

### Debt obligations

#### Types

¶ 10. The most common debt obligations that are qualified investments for a plan trust are as follows:

- (a) bonds, debentures, notes, mortgages, or similar obligations of, or guaranteed by, the Government of Canada (e.g., Canada Savings Bonds) or of a province, municipality or Crown corporation;
- (b) guaranteed investment certificates issued by a Canadian trust company;
- (c) bonds, debentures, notes or similar obligations (hereinafter referred to as “debt obligations”) issued by a corporation the shares of which are listed on a prescribed stock exchange in Canada;
- (d) debt obligations of corporations the shares of which are listed on a prescribed stock exchange outside Canada;
- (e) debt obligations of public corporations other than mortgage investment corporations;
- (f) debt obligations issued by an authorized foreign bank (as defined in subsection 248(1)) and payable at a branch in Canada of the bank;
- (g) debt obligations issued by a mutual fund trust the units of which are listed on a prescribed stock exchange in Canada;

- (h) debt obligations issued by a government of a country other than Canada provided the obligation had, at the time of purchase, an investment grade rating with a bond rating agency that, in the ordinary course of its business, rates the debt obligations issued by that government; and
- (i) “stripped bonds” (that is, a bond certificate from which the interest coupons have been detached prior to maturity) or detached coupons therefrom; or an undivided interest in a right to receive the principal or interest in respect of such a bond. A plan trust is considered to have acquired a qualified investment if the bond would otherwise have been a qualified investment. Such a stripped bond, coupon or undivided interest is regarded as a “similar obligation” to the complete bond, debenture or note for the purposes of the definition of “qualified investment”.

### Mortgages

¶ 11. A mortgage, or an interest therein, in respect of real property situated in Canada is a qualified investment for a plan trust. There is no requirement that the mortgage be a first mortgage or a residential mortgage. However, where the mortgagor is

- a person who is an annuitant, a beneficiary or a subscriber under the plan trust, or
- any other person who does **not** deal at arm’s length with such person

the mortgage must be administered by an approved lender under the *National Housing Act* and insured

- under the *National Housing Act*, or
- by a corporation that offers its services to the public as an insurer of mortgages and is approved as a private insurer of mortgages.

Where an RRSP or a RRIF holds a mortgage on real property owned by the annuitant, or by a person who does not deal at arm’s length with the annuitant, the registration of the plan trust may be jeopardized and/or certain benefit and penalty provisions of the Act may apply where

- the amount of the mortgage interest rate and other terms do not reflect normal commercial practice; and
- the mortgage is not administered by the approved lender in the same manner as a mortgage on property owned by a stranger.

¶ 12. Although real property is not a qualified investment for a plan trust, in the particular case where it is acquired as a consequence of a mortgage that is in default under which the plan trustee was the mortgagee, such a transaction will not be regarded as an acquisition of a property that is not a qualified investment if it is offered for sale under reasonable conditions and it is sold within a reasonable period of time. Except in unusual circumstances, a reasonable period would not exceed one year from the date of acquisition by the plan trust.

### ***Instalment receipts***

¶ 13. An instalment receipt reflects a partial payment on property and gives the owner a beneficial interest in that property. For example, a corporation may have an arrangement to sell shares on an instalment basis, where the shares are sold at a predetermined price with a portion of the sale price payable at the time of sale and the balance to be paid at some future date. The purchase and beneficial ownership of the share is evidenced by the issue, at the time of the initial payment, of an instalment receipt to the purchaser. If the receipt reflects a partial payment on, for example, a share listed on a prescribed stock exchange, the beneficial interest in that share will constitute a qualified investment for the plan trust.

### ***Money and deposits of money***

¶ 14. Money and deposits of money may be qualified investments. Money denominated in any currency is a qualified investment except where the money is held for its collectible value, or the fair market value of the money exceeds its stated value as legal tender in its country of issue. A deposit of money is a qualified investment if it is an amount defined to be a deposit by the *Canada Deposit Insurance Corporation Act* or an amount on deposit with a branch in Canada of a bank (including, after June 27, 1999, a branch in Canada of an authorized foreign bank). Bank and authorized foreign bank have the meanings assigned to those words by section 2 of the *Bank Act*. Prior to 2003, a deposit also includes an amount on deposit with a bank outside of Canada that is listed in Schedule I or II to the *Bank Act*.

¶ 15. A deposit with a credit union will be a qualified investment at a particular time for a plan trust provided that, in the case of RRSPs and RRIFs, certain conditions are met. The credit union may not, at any time in the calendar year in which the particular time occurs, grant any benefit or privilege to

- a person who is an annuitant or a beneficiary under the RRSP or RRIF; or
- any other person who does not deal at arm's length with the annuitant or beneficiary

as a result of the ownership by:

- the RRSP or RRIF of a deposit with the credit union; or
- a registered investment (see ¶ 24) of a deposit with the credit union, where the RRSP or RRIF has invested in that registered investment.

A credit union is deemed to have granted a benefit or privilege to a person in a year if, at any time in that year, the person continues to enjoy a benefit or privilege that was granted in a prior year.

¶ 16. With some transactions involving securities, a plan trust may be required to leave cash on deposit with a broker. While such a deposit is not a qualified investment, it is our

position that there will be no adverse income tax consequences (as described in ¶s 28-31) if the deposit is left with the broker for no more than a few days.

### ***Trust interests***

¶ 17. An interest in a trust is a qualified investment at a particular time if it was a registered investment (see ¶ 24) during the calendar year in which the particular time occurs, or in the immediately preceding year. In addition, a unit of a trust will be a qualified investment at a particular time if the trust is at that time

- a mutual fund trust;
- a unit trust resident in Canada that, among other things, is widely held and makes a lawful distribution in a province to the public of its units without having been required to file a prospectus or other documentation under the laws of the province before doing so;
- a foreign stock exchange index trust that meets the requirements of paragraph 4900(1)(n.1) of the Regulations; or
- pursuant to paragraph 4900(6)(c) of the Regulations, a "small business investment trust" (as defined in subsection 5103(1) of the Regulations) unless it is excluded from being a qualified investment by virtue of subsection 4900(8) or (9) of the Regulations.

### ***Annuity contracts***

¶ 18. An annuity payable to the annuitant at the maturity of an RRSP is a qualified investment for the RRSP if the annuity

- is purchased from a licensed annuities provider; and
- is described in the definition of "retirement income" in subsection 146(1).

¶ 19. An annuity is also a qualified investment for an RRSP or a RRIF if the annuity

- is purchased from a licensed annuities provider; and
- is similar to an annuity described in ¶ 18, except that the annuity payments can be made to the trust before the maturity date of the RRSP or RRIF.

¶ 20. An annuity is a qualified investment for an RRSP, an RESP or a RRIF if

- the annuity is purchased from a licensed annuities provider;
- the plan trust is the only person who is or may become entitled to any annuity payments under the contract (unless the contract is transferred by the trust); and
- the holder of the contract may surrender the contract at any time for an amount that is approximately equal to its fair market value.

### ***Warrants, rights and options***

¶ 21. A warrant or right is a qualified investment for a plan trust if it gives its owner the right to acquire, either immediately or in the future, property that is a qualified investment.

¶ 22. A call option is an agreement under which the writer agrees to sell a property at an agreed upon price, should the holder of the option elect to purchase the property. A put option is an agreement under which the writer agrees to purchase a property at an agreed upon price should the holder of the option elect to sell the property. Where a plan trust purchases a call option that, if exercised will result in the acquisition of a qualified investment, such option is a warrant or right as contemplated in ¶ 21. Where a plan trust purchases a put option, this results in the acquisition of a property which is not a qualified investment since the right the plan trust acquires is one to dispose of property. Where a plan trust sells (writes) a call option or a put option, there is merely an obligation on the plan trust to sell or buy the property at the agreed upon price should the holder of the call or put option so require. As no property has been acquired by the plan trust, the issue of whether such an option is a qualified investment is not relevant.

¶ 23. The writing of a naked call option, whereby a plan trust sells a call option in respect of an underlying property which it does not own, may result in the plan trust being considered to be carrying on a business. The same result may arise where a plan trust engages in a short sale, i.e., the plan trust sells property that it does not own. An RESP that is carrying on a business is revocable. An RRSP or a RRIF will be liable for income tax on its taxable income for any year in which it is carrying on a business.

### ***Registered investments***

¶ 24. A trust or a corporation may apply and may be accepted by the Minister as a registered investment (as defined in subsection 204.4(1)) for RRSPs or RRIFs, or for both RRSPs and RRIFs. An interest in a trust or a share of a corporation is a qualified investment for an RRSP or a RRIF at a particular time in a year if the trust or corporation was a registered investment for that type of plan trust at any time in the year or the immediately preceding year. If an RRSP or a RRIF acquires shares of a corporation before the corporation becomes a registered investment, the shares will be considered qualified investments at the time of their acquisition if the corporation becomes a registered investment for that type of plan trust before the end of the year in which the shares are acquired. Also, if a corporation loses its status as a registered investment for an RRSP or a RRIF, shares of the corporation acquired by the particular type of plan trust before deregistration will continue to be qualified investments until the end of the calendar year immediately following the year in which the deregistration occurred. However, thereafter, they will not be qualified investments at a particular time unless they can qualify under any of the other definitions of “qualified investment”. In the

case of an RESP, subsection 4900(5) of the Regulations provides that an interest in a trust or a share of a corporation is a qualified investment for an RESP at a particular time in a year if the trust or corporation was a registered investment for an RRSP at any time in the year or the immediately preceding year.

### ***Royalty units***

¶ 25. A plan trust may acquire as a qualified investment a royalty unit if the royalty unit is listed on a prescribed stock exchange in Canada and its value is derived solely from Canadian resource properties (as defined in subsection 248(1)).

### ***Partnership units***

¶ 26. A limited partnership unit that is listed on a prescribed stock exchange in Canada is a qualified investment. In addition, by virtue of paragraph 4900(6)(b) of the Regulations, a limited partnership interest in a “small business investment limited partnership” (as defined in subsection 5102(1) of the Regulations) is a qualified investment unless it is excluded by virtue of subsection 4900(8) or (9) of the Regulations. However, an interest in a general partnership is **not** a qualified investment.

### ***Depository receipts***

¶ 27. A right to a share of a corporation where the right is evidenced by a depository receipt that is listed on a prescribed stock exchange in or outside Canada is a qualified investment for a plan trust.

## **Income Tax Consequences of Acquiring, Holding and Disposing of Property That is not a Qualified Investment**

### ***Tax consequences for an annuitant under an RRSP or a RRIF***

¶ 28. When an RRSP acquires a property that is not a qualified investment, the fair market value of that property at the time it is acquired is added to the income of the annuitant under the RRSP pursuant to subsection 146(10). However, subsection 146(10) does not apply to property that was a qualified investment at the time of acquisition and **subsequently** becomes property that is not a qualified investment. By virtue of subsection 146(6), when an RRSP disposes of property that is not a qualified investment, the annuitant can deduct from income for the year of disposition, the lesser of

- the amount previously included in income at the time the property was acquired, and
- the proceeds of its disposition.

If the income inclusion exceeds the proceeds of disposition of that property, the excess cannot be deducted. The equivalent provisions for a RRIF are in subsections 146.3(7) and (8).

### ***Tax consequences for a recipient under an RESP***

¶ 29. Paragraphs 146.1(2.1)(a) and (b) state that an RESP is revocable at any time if:

- the trust acquires property that is not a qualified investment; or
- property held by the trust ceases to be a qualified investment and the property is not disposed of by the trust within 60 days after that time.

See ¶ 30 for the income tax consequences to an RESP upon its revocation.

Distributions from a revoked RESP, as either educational assistance payments or accumulated income payments, are included in the income of the recipient (see the current version of IC 93-3, *Registered Education Savings Plans*).

### ***Tax consequences for a plan trust***

#### **Part I tax**

¶ 30. Generally, a trust pays no Part I tax on its taxable income in any taxation year throughout which it was an RRSP. One of the exceptions is described in subsection 146(10.1) which provides for the payment of Part I tax by an RRSP that holds, at any time in a taxation year, a property that is not a qualified investment. Income tax is payable on a notional taxable income which is calculated using only the income or loss from such property and the full capital gain or capital loss from disposition of such property. The similar provision applicable to a RRIF is in subsection 146.3(9).

In the case of an RESP, subsection 146.1(5) provides that a trust shall pay no Part I tax on its taxable income in any taxation year throughout which it was an RESP. Thus, where an RESP ceases to be registered (see ¶ 29), the trust will be subject to tax under Part I on its taxable income. If an RESP holds property that is not a qualified investment and the registration of the RESP is not revoked, Part XI.1 tax will apply (see ¶ 31).

#### **Part XI.1 tax**

¶ 31. Generally, Part XI.1 of the Act imposes a tax at the end of each month on a plan trust in respect of its property that is not a qualified investment. An RRSP or a RRIF is required to pay a tax in respect of each month of 1% of the fair market value **at the time of acquisition** of the property that the trust holds that is not a qualified investment. However, Part XI.1 tax has no application to property the fair market value of which has been included in the income of the annuitant (see ¶ 28). An RESP is also required to pay a tax in respect of each month of 1% of the fair market value **at the time of acquisition** of **all** property that the trust holds at the end of the month that is not a qualified investment. Part XI.1 tax is payable at the time the annual return is required to be filed pursuant to subsection 207.2(1).

### **Other Bulletins and Circulars**

¶ 32. In connection with the subject matter of this bulletin, the current version of the following interpretation bulletins and information circulars may also be of interest:

#### Interpretation Bulletins

IT-124	<i>Contributions to Registered Retirement Savings Plans</i>
IT-307	<i>Spousal Registered Retirement Savings Plans</i>
IT-337	<i>Retiring Allowances</i>
IT-408	<i>Life Insurance Policies as Investments of Registered Retirement Savings Plans and Deferred Profit Sharing Plans</i>
IT-415	<i>Deregistration of Registered Retirement Savings Plans</i>
IT-500	<i>Registered Retirement Savings Plans – Death of an Annuitant</i>
IT-528	<i>Transfers of Funds Between Registered Plans</i>

#### Information Circulars

IC 72-22	<i>Registered Retirement Savings Plans</i>
IC 78-18	<i>Registered Retirement Income Funds</i>



## Appendix

### *Prescribed Stock Exchanges In and Outside Canada as of July 1, 2002*

**Note:** The National Association of Securities Dealers Automated Quotation System (NASDAQ) Over-the-Counter (OTC) Bulletin Board facility, as well as other over-the-counter facilities or exchanges such as the Canadian OTC Automated Trading System are not prescribed stock exchanges. Accordingly, securities listed on the NASDAQ OTC Bulletin Board are generally not qualified investments. Similarly, Tier 3 of the Canadian Venture Exchange which accommodates the transfer of stocks from the Canadian Dealing Network, Canada's over-the-counter market, is not proposed to be added to the list of prescribed stock exchanges in Canada as indicated by the Department of Finance in its *News Release* No. 2000-101 dated December 21, 2000. [In 2002, the Canadian Venture Exchange (also known as CDNX) changed its name to the TSX Venture Exchange.]

#### Prescribed stock exchanges in Canada

Alberta Stock Exchange  
Montreal Stock Exchange  
Toronto Stock Exchange

Vancouver Stock Exchange  
Winnipeg Stock Exchange

**Note:** *As announced in the Backgrounder released with the Department of Finance News Release No. 2000-101, dated December 21, 2000, it is proposed that Tiers 1 and 2 of the Canadian Venture Exchange will be added to the list of prescribed stock exchanges in Canada.* [As noted above, the Canadian Venture Exchange is now known as the TSX Venture Exchange.]

#### Prescribed stock exchanges outside Canada

in Australia, the Australian Stock Exchange  
in Austria, the Vienna Stock Exchange  
in Belgium, the Brussels Stock Exchange  
in France, the Paris Stock Exchange  
in Denmark, the Copenhagen Stock Exchange  
in Finland, the Helsinki Stock Exchange  
in Germany, the Frankfurt Stock Exchange  
in Hong Kong, the Hong Kong Stock Exchange  
in Ireland, the Irish Stock Exchange  
in Israel, the Tel Aviv Stock Exchange  
in Italy, the Milan Stock Exchange  
in Japan, the Tokyo Stock Exchange  
in Mexico, the Mexico City Stock Exchange  
in the Netherlands, the Amsterdam Stock Exchange  
in New Zealand, the New Zealand Stock Exchange  
in Norway, the Oslo Stock Exchange  
in Singapore, the Singapore Stock Exchange  
in South Africa, the Johannesburg Stock Exchange

in Spain, the Madrid Stock Exchange  
in Sweden, the Stockholm Stock Exchange  
in Switzerland, the Zurich Stock Exchange  
in the United Kingdom, the London Stock Exchange  
in the United States:

- the American Stock Exchange
- the Boston Stock Exchange
- the Chicago Board of Options
- the Chicago Board of Trade
- the Cincinnati Stock Exchange
- the Intermountain Stock Exchange
- the Midwest Stock Exchange
- the National Association of Securities Dealers Automated Quotation System
- the New York Stock Exchange
- the Pacific Stock Exchange
- the Philadelphia Stock Exchange
- the Spokane Stock Exchange

## *Explanation of Changes*

### **Introduction**

The purpose of the *Explanation of Changes* is to give the reasons for the revisions to an interpretation bulletin. It outlines revisions that we have made as a result of changes to the law, as well as changes reflecting new or revised interpretations.

### **Reasons for the Revision**

We have revised the bulletin to reflect S.C. 1994, c. 21 (formerly Bill C-27), S.C. 1998 c. 19 (formerly Bill C-28), S.C. 1999, c. 22 (formerly Bill C-72), S.C. 2000, c. 12 (formerly Bill C-23), S.C. 2001, c. 17 (formerly Bill C-22); various amendments to Parts XXXII, XLVIII, XLIX, LI and LXVII of the Regulations enacted after January 1992 and before the date of this bulletin; and to add interpretative material.

### **Legislative and Other Changes**

The bulletin has been expanded to discuss qualified investments for RESPs and RRIFs. In light of the additional coverage, the title of the bulletin has been changed from *Registered Retirement Savings Plans – Qualified Investments*.

¶ 1 (part of former ¶ 1) has been modified to include RESPs and RRIFs.

¶ 2 (part of former ¶ 1) is revised to discuss situations where a security may be considered a qualified investment even though the trustee of the plan trust is not the registered holder of the security.

¶ 3 (part of former ¶ 1) is changed to include the definitions of “qualified investment” for RESPs and RRIFs as well as other definitions used in the bulletins.

New ¶ 4 was added to comment on the adverse tax effects that may occur if a plan trust borrows money or permits its property to be used as security for a loan.

¶ 5 (part of former ¶ 5) was edited to delete material that is more appropriately described in the current version of IT-412, *Foreign Property of Registered Plans*, and was expanded to provide comments on shares that have been delisted from a prescribed stock exchange and shares that are subject to an escrow agreement.

New ¶s 6 and 7 include and expand on comments made in our *Income Tax Technical News* No. 9 dated February 10, 1997 concerning the addition of paragraph 4900(12)(a) of the Regulations that permits the shares of a small business corporation to be qualified investments.

Former ¶s 6 and 19 have been deleted because the discussion of Part XI of the Act is outside the scope of the bulletin and found in the current version of IT-412, *Foreign Property of Registered Plans*.

¶ 8 (part of former ¶ 15) contains an expanded discussion of “eligible corporation” and “designated shareholder”.

New ¶ 9 notes that, as a result of the addition of paragraph 4900(12)(b) of the Regulations, the shares of certain venture capital corporations are qualified investments.

¶ 10(a) (former ¶ 3(a)) is expanded to include Canada Savings Bonds which were discussed in former ¶ 4. The remainder of former ¶ 4 has been deleted as it is beyond the scope of the bulletin. New ¶s 10(d), (e), (g) and (h) reflect the addition of paragraphs (p), (c.1), (d.1) and (o), respectively, to subsection 4900(1) of the Regulations. ¶ 10(f) contains new subparagraph (b)(ii) of the definition of “qualified investment” in subsections 146(1), 146.1(1) and 146.3(1).

¶ 11 (part of former ¶ 9) dealing with mortgages on real property has been revised to reflect recent changes to paragraph 4900(1)(j) of the Regulations and the repeal of subsection 4900(4) of the Regulations.

New ¶ 13 is added to include a discussion concerning whether instalment receipts are qualified investments.

¶ 14 (former ¶ 7 and part of former ¶ 8) has been revised to indicate that certain foreign currency and foreign deposits are now qualified investments (pursuant to revisions to paragraph (a) of the definition of “qualified investment” in section 204).

¶ 15 (part of former ¶ 8) provides expanded comments regarding the granting of a right or privilege by a credit union and indicates that RRIFs are also subject to that restriction (as per paragraph 4900(1)(g) of the Regulations).

New ¶ 16 indicates that cash left with a broker may cease to be a qualified investment.

¶ 17 (former ¶ 3(f) and parts of former ¶s 11 and 15) dealing with trust interests has been edited to delete material that is more appropriately described in the current version of IT-412, *Foreign Property of Registered Plans*. In addition, the list of trust interests is expanded to include those described in new paragraphs 4900(1)(d.1), (d.2) and (n.1) of the Regulations.

¶ 18 (part of former ¶ 12) and new ¶s 19 and 20 provide information on the new types of annuities that are qualified investments for RRSPs (by virtue of the addition of paragraphs (c.1) and (c.2) in the definition of “qualified investment” in subsection 146(1)), for RESPs (by virtue of new paragraph (c) of the definition of “qualified investment” in subsection 146.1(1)), and for RRIFs (pursuant to new paragraphs (b.1) and (b.2) of the definition of “qualified investment” in subsection 146.3(1)).

¶ 21 (part of former ¶ 14) reflects the amendment to paragraph 4900(1)(e) of the Regulations which no longer requires rights or warrants to be listed on a prescribed stock exchange in Canada.

¶s 22 and 23 (part of former ¶ 14) includes additional information concerning the writing of “covered” and naked call options, put options and short sales.

¶ 24 (part of former ¶ 11) has been expanded to provide a more detailed discussion of registered investments.

New ¶ 25 notes that royalty units are, by virtue of the addition of paragraph 4900(1)(m) of the Regulations, qualified investments.

¶ 26 (part of former ¶ 15) describes that, as a result of the addition of paragraph 4900(1)(n) of the Regulations, a limited partnership unit may be a qualified investment.

New ¶ 27 notes that depository receipts are qualified investments pursuant to new paragraph 4900(1)(p.1) of the Regulations.

¶s 28 to 31 (former ¶s 2, 17, 18 and 21) have been revised to include comments applicable to RRIFs and RESPs acquiring and holding property that is not a qualified investment and the resulting application of Part I and Part XI.1 tax. The tax consequences to an annuitant or recipient under those plan trusts are also discussed.

New ¶ 32 has been added to list other interpretation bulletins and information circulars that may be of interest to the reader.

An appendix has been added in order to provide the reader with a list of prescribed stock exchanges.

Throughout the bulletin, we have made minor changes for clarification or readability purposes and deleted comments that are no longer timely.