PROPOSAL FOR A PROVINCIAL TAX CREDIT TO SUPPORT INVESTMENT IN ONTARIO’S SOCIAL ECONOMY - REGISTRATION OF INVESTMENTS

A BRIEF TO THE PARTNERSHIP PROJECT FROM THE ONTARIO SOCIAL ECONOMY ROUNDTABLE (OSER)

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October 2010
SUMMARY

Should the province move forward with either the proposal to create a provincial tax social enterprise investment tax credit or with the creation of regulated community bonds, Ontario's social economy would benefit most if these investments were eligible for registration under Registered Retirement Savings Accounts and Tax-Free Savings Accounts. Because RRSPs are the primary vehicle through which most Canadians save and make investments, they make up and important source of capital from which new social enterprise investments could be attracted. Liaison with the Canada Revenue Agency will be important to smooth the registration process for individual non-profits and social investment funds.

BACKGROUND

Registered Retirement Savings Plans (RRSPs) are perhaps the single-most important financial assets held by individual Canadians. For every dollar in household assets in Canada, $0.11 are held in an RRSP only workplace pensions and owner-occupied real estate are larger in the portfolios of individual investors.¹

RRSPs provide investors with a mechanism to save for the longer-term by claiming a capped deduction on eligible annual contributions, sheltering any investment earnings from taxation and then paying taxes on withdrawals from the plan. As an instrument to support retirement savings, they are designed with the expectation that RRSPs will be held as long-term investments, benefitting from many more years of tax sheltered growth and then taxing withdrawals at lower, post-retirement, income tax rates.

RRSPs may be held by individual investors who:

• Purchase them from eligible financial service providers (banks, trusts, insurance companies) registered to issue RRSPs with the Canada Revenue Agency; the investments are selected by the RRSP provider
• Join a group RRSP, generally as part of a workplace retirement savings plan; the investments are selected by the RRSP provider
• Design their own self-directed RRSP plan and choose their own selection of eligible investments to be held under their registered plan.

RRSP providers and investments are regulated under the Income Tax Act and must be registered with the Canada Revenue Agency. Section 146 of the

Act describes which bodies can issue RRSPs in Canada while section 204 describes which investments qualify for registration and preferential tax treatment. To become eligible to offer an RRSP, banks, trusts and insurance providers must apply to the Canada Revenue Agency and undergo a review process.

Eligible investments for RRSPs include:

- Cash holdings
- Debt obligations such as bonds, guaranteed investment certificates, mortgages
- Annuity contracts
- Shares of public corporations
- Shares of corporations traded on a recognized stock exchange
- Shares of small business corporations (other than co-operatives)

In all cases, the Act stipulates that the investor must deal at arm's length with any corporation receiving an investment under a registered plan. In the case of small businesses, this means that no investor may hold more than 10% of the stock in the corporation or $25,000 of total investment in the corporation, whichever is less. Only in certain cases will shares or partnerships in some Canadian co-operatives be eligible. Similar to the process for issuing RRSPs, Canadian corporations or trusts can apply to the Minister of Revenue to be recognized as an eligible investment. The Canada Revenue Agency publishes, at least annually, a list of recognized RRSP investment vehicles.

Tax-Free Savings Accounts (TFSAs) are much newer avenues for individuals to invest but they are likely to grow in importance over time. Introduced in the 2008 federal budget, TFSAs are registered accounts like RRSPs but they treat all contributions and withdrawals as "tax-pre-paid". In other words, deposits into a TFSA are not given any tax credit or deduction but withdrawals are not taxed either and can be used for any purpose by the account holder. Investment income earned by the registered investments is also given tax-preferred status and, unlike RRSP withdrawals under a TFSA do not reduce an account holder's eligibility for income-tested seniors' benefits. For this reason, TFSAs have been described as an important instrument for modest-income investors and an important complement to RRSPs. In the year they were introduced, 4.8 Million TFSAs were opened by Canadians.

The Canada Revenue Agency has not yet published detailed information on the investments that qualify for registration under a TFSA, however investments that meet the rules for RRSPs will generally be recognized for TFSAs.

The proposed investment tax credit and community bond would each be substantially enhanced if Ontario investors are able to use RRSP and TFSA

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3 The list is published in the Canada Gazette.
4 Information provided by Canada Revenue Agency officials. October 2010.
assets. Ontario investors are likely to be more attracted to investment opportunities in eligible non-profit organization if they are able to use the instruments that are most familiar to them. In some cases, they may mean shifting some portion of existing RRSP or TFSA investments towards non-profits but it is more likely that eligibility will, over the medium and longer-term, attract more new investment.

The potential tax interactions of the credit with the TFSA are negligible given the tax-treatment of TFSA assets. The interactions of the RRSP deduction and the credit would similarly be small. Because the deduction against taxable income would already apply before the value of the provincial non-refundable credit it calculated, it may result in a small marginal decrease in the value of the credit for the highest income Ontarians but will not increase the net tax expenditure to the province.

In Nova Scotia, the provincial government promotes investments held under Community Economic Development Investment Funds as eligible RRSP investments. The Canadian Worker Co-op Federation offers interested CEDIFs an avenue to sell shares to self-directed RRSPs.

Registration of eligible investments for RRSPs and TFSAs are exclusively an area of federal jurisdiction but the government of Ontario can do much to smooth the path for individual non-profits and/or proposed social enterprise investment funds:

• The province, as part of the design and implementation of the proposed community bonds, can set the provincial policy to maximize the opportunities for community bonds to be viewed as eligible investments.5

• The province, as part of the implementation of the proposed community bonds, can liaise with the Canada Revenue Agency (CRA) to brief them on the design of the bond to support subsequent inquiries or applications from RRSP providers interested in investing non-profits offering community bonds, and by individual non-profits who would like to confirm their eligibility as qualified investments.

• The province may also want to request a formal ruling from CRA on eligibility of the community bonds at the earliest possible opportunity to simplify future applications to register community bonds as qualified RRSP and TFSA investments.

• Once RRSP eligibility is determined, the province can also work with provincial stakeholders to ensure that existing RRSP trusts and TFSA providers are informed and aware of new eligible investment opportunities for their clients in social enterprises that offer economic and social returns to Ontarians.

5 In the case of the community bonds, this likely means ensuring the arms length test is met and meeting the prescribed features under section 204 of the Income Tax Act.
Because the process to register as a qualified investment is likely to be too onerous for most non-profits in Ontario with limited resources, the best opportunity for investments in self-directed or other RRSPs and TFSA may come from the creation of new social enterprise investment funds benefitted by the proposed provincial social enterprise investment tax credit. If and when these funds are launched, the funds themselves may wish to seek a ruling from CRA as eligible RRSP and TFSA investments. Again the province can play an important role in smoothing the process through dialogue with the Canada Revenue Agency.