THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

February 11, 2014

Via email: mickey.sarazin@cra-arc.gc.ca; mary-pat.baldwin@cra-arc.gc.ca

Mr. Mickey Sarazin
Director General
Income Tax Rulings Directorate
Canada Revenue Agency
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16th Floor, 320 Queen Street
Ottawa, ON K1A 0L5

Ms. Mary Pat Baldwin
Manager, Deferred Income Plans Section
Income Tax Rulings Directorate
Canada Revenue Agency
Place de Ville
16th Floor, 320 Queen Street
Ottawa, ON K1A 0L5

Dear Mr. Sarazin and Ms. Baldwin:

Re: Consistent Application of the 10% Rule

We are writing to seek clarification of the Canada Revenue Agency's interpretation of the 10% rule, following the discussions at the September 27, 2013 meetings of the National Pensions and Benefits Law Section of the Canadian Bar Association with Finance Canada, the Office of the Superintendent of Financial Institutions, and the CRA.

"Investment corporation" is defined similarly in subparagraph 149(1)(o.2)(iii) of the *Income Tax Act* (Canada) (the ITA) and section 1 of the investment rules in Schedule III to the Regulations to the *Pension Benefit Standards Act* (the PBSA Investment Rules).

Subparagraph 149(1)(o.2)(iii) of the ITA defines an "investment corporation" as a corporation:

> (iii) that made no investments other than investments that a pension fund or plan was permitted to make under the *Pension Benefits Standards Act*, 1985 or a similar law of a province, and
>
> (A) the assets of which were at least 98% cash and investments,
>
> (B) that had not accepted deposits or issued bonds, notes, debentures or similar obligations, and
>
> (C) that had derived at least 98% of its income for the period that is a taxation year of the corporation from, or from the disposition of, investments (*emphasis added*)

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Section 1 of the PBSA Investment Rules defines an "investment corporation" as a corporation that:

(a) is limited in its investments to those that are authorized for the plan under this Schedule,

(b) holds at least 98 per cent of its assets in cash, investments and loans,

(c) does not issue debt obligations,

(d) obtains at least 98 per cent of its income from investments and loans, and

(e) does not lend any of its assets to, or invest any of its moneys in, related party of the plan: (société de placement) (*emphasis added*)

Section 9 of the PBSA Investment Rules require that not more than 10% of the book value of a plan's assets be invested in any one person or two or more associated persons or affiliated corporations (the 10% Rule). The purpose of the 10% rule is to ensure adequate diversification of the investments of a pension plan.[1] All provinces other than Quebec, New Brunswick, Nova Scotia and Prince Edward Island have adopted the PBSA Investment Rules. Nova Scotia and New Brunswick have a similar rule to the 10% Rule.

The 10% rule will determine, in part, whether a particular investment is an authorised investment under the PBSA Investment Rules and whether a corporation qualifies as an "investment corporation" under either section 1 of the PBSA Investment Rules or subparagraph 149(1)(o.2)(iii) of the ITA. The question is whether the 10% Rule should be applied at the level of the pension fund or plan, or of the individual investment corporations.

This issue was raised with the Canadian Association of Pension Supervisory Authorities (CAPSA), to ensure consistent application of the 10% Rule by all CAPSA members.[2] On September 22, 2000, OSFI sent a memorandum to all CAPSA members (the CAPSA Memo, attached) stating that in response to a question from a stakeholder, OSFI intended to adopt an interpretation that the 10% Rule should be applied at the pension plan level rather than the investment corporation level. At our September 27, 2013 meeting, OSFI representatives confirmed that this continues to be OSFI's position.

A well-established principle of statutory interpretation presumes legislative coherence: two statutes dealing with the same subject matter are to be interpreted coherently and consistently unless a conflicting interpretation is unavoidable and the two provisions cannot stand together.[3] The definitions of "investment corporation" in the PBSA Investment Rules and the ITA should be presumptively interpreted in a coherent, consistent manner unless a contrary interpretation is unavoidable and the two definitions cannot stand together.

CRA rulings have interpreted the definition of "investment corporation" in subparagraph 149(1)(o.2)(iii) of the ITA in a consistent manner with the definition of "investment corporation" in section 1 of the PBSA Investment Rules. In Access Document 2000-0055463 a CRA ruling dealt with the separation of the assets of a pension fund into smaller pension funds. The 10% Rule is specifically referred to in paragraph 12. In paragraph E of the ruling, the CRA ruled:

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1 See Regulatory Impact Analysis Statement, SOR/-DORS/93-299 and R. v. Cristophe *et al.*, 2009 ONCJ 586 at para. 138

2 The CAPSA website lists the CRA as an Associate Member of CAPSA. www.capsa-acor.org/en/about/members.asp

3 See for example, *City of Lévis v. Fraternité des policiers de Lévis Inc.*, [2007] 1 SCR 591, and *Reference Re Broadcasting Regulatory Policy CRTC 2010-167 and Broadcasting Order CRTC 2010-168* [2012] 3 SCR 489.

> Provided that Investment Holdco meets the requirements to be an "investment corporation" under the PBSA Regulations and is in compliance with the undertakings filed in 13(f) above, Investment Holdco will be considered to have made no investments other than investments that a pension fund or plan is permitted to make for purposes of paragraph 149(1)(o.2)(iii) of the Act.

A similar ruling was issued in Access Document 2005-126841R3. We understand it was in the context of issuing the ruling in 2000-0055463 that OSFI was asked how the 10% Rule was to be interpreted and the CAPSA Memo was the result of that inquiry.

In the CRA Roundtable at the November 2007 Canadian Tax Foundation Annual Conference, the CRA suggested that the 10% Rule would apply at the investment corporation level but stated that the CRA would discuss this issue with Finance Canada. In January 2008, a letter from eight of the largest law firms in the country and four of the largest accounting firms to the CRA Income Tax Rulings Directorate pointed out that this position was inconsistent with the CAPSA Memo and the plain wording of the ITA. To date there has been no response to this letter and the lack of resolution of this point is creating administrative and legal issues for pension plans which use investment corporations in their structures for a variety of purposes.

Subparagraph 149(1)(o.2)(iii) was added to the ITA in 1978 at the same time the new definition of pension corporation was added in paragraph 149(1)(o.1). Finance Canada described the purpose of paragraphs 149(1)(o.1) and (o.2) of the ITA in the 1978 Budgetary Supplementary Information:

> The new definition will include only existing corporations all of the shares of which are held at all times after November 16, 1978 for the exclusive benefit of registered pension plans. <u>The exemption for pension fund corporations will also apply to any new corporations formed by them for the purpose of investing in properties which would be qualified investments if they were owned directly by the pension fund corporation</u>. (*emphasis added*)

The Budgetary Supplementary Information shows the intent of subparagraph 149(1)(o.2)(iii) is to permit pension funds to make investments through new corporations formed by them in circumstances where the underlying investments would be qualified investments if made by the pension funds directly. This supports an interpretation of subparagraph 149(1)(o.2)(iii) of the ITA that is consistent with the interpretation of the definition of "investment corporation" in section 1 of the PBSA Investment Rules in terms of applying the 10% Rule at the pension fund or plan level rather than at the level of the particular investment corporation (i.e., if an investment meets the 10% Rule at the pension plan level that would be a permitted investment for the plan, it would also be a permitted investment for an investment corporation owned by the plan).

Interpreting the definition of "investment corporation" in subparagraph 149(1)(o.2)(iii) of the ITA to apply the 10% Rule at the pension plan level is also consistent with the plain wording of that subparagraph. This can be illustrated as follows:

Assume Pension Plan X has assets with a book value of $1B and is contemplating an investment of $50M to acquire 25% of the shares of a foreign mining corporation (FMC). To insulate itself from any potential liabilities arising from the investment, Pension Plan X decides to invest in FMC through a newly formed investment corporation (Investco). The relevant part of the definition of "investment corporation" in subparagraph 149(1)(o.2)(iii) of the ITA is:

> ... made no investments other than investments that a pension fund or plan was permitted to make under the *Pension Benefit Standards Act*, 1985 or a similar law of a province.

The question is whether an investment in 25% of the shares of FMC is an investment that a pension plan or fund could make. Pension Plan X is a pension plan or fund and it is permitted to make an investment in 25% of the shares of FMC under the PBSA Investment rules. Based on the plain wording of the provision, the investment by Investco in FMC would meet the test in subparagraph 149(1)(o.2)(iii) of the ITA because it is an investment that Pension Plan X could make directly.

Interpreting the 10% Rule to apply at the level of the particular investment corporation rather than the plan level would require each investment corporation to simultaneously acquire at least 10 different investments. This is an unworkable result. It is well settled law that where a provision can be interpreted in two ways, one of which leads to an unworkable result and one that leads to a workable result, the Courts should adopt the interpretation that leads to a workable result.[4]

In summary, interpreting the 10% Rule in subparagraph 149(1)(0.2)(iii) to apply at the pension plan level would:

(i) be consistent with the interpretation OSFI provided to CAPSA and the principle of statutory interpretation that two pieces of legislation dealing with the same subject matter are to be interpreted coherently and consistently;

(ii) be consistent with the stated intent of that provision in the Budgetary Supplementary Information which accompanied its release;

(iii) be consistent with the plain wording of that provision; and

(iv) be a reasonable and workable interpretation of that provision, following the principal of statutory interpretation that favours an interpretation that leads to a workable result over one that leads to an unworkable result.

The CBA Section would appreciate clarification from the CRA on whether they intend to interpret the 10% rule at the pension plan level as set out in this letter.

We would very much appreciate an opportunity to discuss this matter with you.

Yours truly,

(original signed by Noah Arshinoff for Lawrence J. Swartz)

Lawrence J. Swartz
Chair, CBA Pensions and Benefits Law Section

cc: Mike Godwin, Director General, Canada Revenue Agency
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[4] See for example *Berardinelli v. Ontario Housing Corp.,* (1978) 90 D.L.R. (3d) 481 (SCC). and *The Queen vs. Harold Ast Estate.,* 97 DTC 5197 (FCA).

To: CAPSA members

From: Glenn McAllister

Sr. Supervisor

Private Pension Plans Div.

OSFI

Date: September 22, 2000

Note: this message is particularly directed at the jurisdictions having incorporated the *Pension Benefits Standards Regulations* into their own rules.

Re: **Application of Schedule III's quantitative rules to Investment, Real Estate and Resource Corporations**

In response to a question from a stakeholder, OSFI intends to provide the following interpretation of Schedule III of the *PBSR*:

The restrictions detailed in sections 9 & 10 of Schedule III of the PBSR must be satisfied at the plan level rather than met individually by the corporations into which the plan invests.

Please communicate any questions regarding this proposed interpretation to myself by September 29, 2000.

Regards;

Glenn M. 613 990 7865 gmcalli@osfi-bsif.gc.ca