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Our file Notre référence

2021-091110

Helen Ferrigan

December 20, 2021

Dear Mr. MacDonald:

RE: Class Action Settlement Amounts

We are writing in response to your email to the Registered Plans Directorate (the “**RPD**”) of the Canada Revenue Agency (the “**CRA**”) dated September 9, 2021 and your subsequent discussions with RPD officials. You have requested the CRA’s views regarding the income tax treatment of amounts (the “**Settlement Payments**”) to be made pursuant to a court order with respect to the settlement of a class action lawsuit. The order requires a financial institution to make the Settlement Payments as compensation for certain fees imposed on registered retirement savings plans (“**RRSPs**”), registered retirement income funds (“**RRIFs**”) and tax-free savings account (“**TFSAs**”).

At the request of the CRA’s Assessment, Benefit and Service Branch, we have also included instructions to assist class members in reporting the Settlement Payments in their income tax and benefit returns (“**tax returns**”).

Issue

You have asked us to consider the application of the *Income Tax Act* (the “**Act**”) where

- (i) a Settlement Payment is made directly to the registered plan that suffered the loss; and
- (ii) (ii) the Settlement Payment is made directly to the registered plan’s controlling individual because the plan that suffered the loss has been collapsed.

Our Comments

This technical interpretation provides general comments about the provisions of the Act and related legislation. It does not confirm the income tax treatment of a particular situation involving a specific taxpayer but is intended to assist you in making that determination. The income tax treatment of particular transactions proposed by a specific

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taxpayer will only be confirmed by this Directorate in the context of an advance income tax ruling request submitted in the manner set out in Information Circular IC70-6R11, *Advance Income Tax Rulings and Technical Interpretations*.

Legislative Background

Under subsection 146(8) of the Act, benefits received by a taxpayer out of or under an RRSP are included in the taxpayer's income for a taxation year (other than certain inapplicable amounts). Paragraph 153(1)(j) of the Act requires every person paying an amount out of or under an RRSP to deduct or withhold the amount determined under the Income Tax Regulations from the payment and remit it to the Receiver General on account of the payee's tax for the year.

Parallel provisions of the Act apply to include benefits received out of or under a RRIF in the income of the recipient and to impose parallel withholding requirements on persons paying such amounts. There are no withholding requirements imposed on persons paying distributions from a TFSA as such amounts are not taxable.

General tax treatment of damages or settlement payments

In determining the tax character of an amount paid as damages or to settle a legal action, the courts have generally applied the *surrogatum* principle, which looks to the nature of the income or property which the payment is intended to replace. In *Lavoie v. R.*, 2009 TCC 293, for example, the Tax Court of Canada relied on the *surrogatum* principle to conclude that settlement payments made to an RRSP annuitant as a result of losses suffered by the RRSP were to be treated as benefits out of or under the RRSP. The application of the *surrogatum* principle required that the compensation be returned to the RRSP because that was where the loss had occurred. In retaining the payment, the annuitant effectively received a benefit paid out of the plan.

The CRA's long-standing position regarding the tax consequences of a settlement payment made to a registered plan in respect of an actionable loss suffered in connection with a plan investment is that the payment is not a contribution, premium or gift to the plan and will not result in an income inclusion to the plan's controlling individual. The same tax consequences apply if the payment is made directly to the controlling individual but returned to the registered plan within a reasonable time. Generally, we consider a reasonable time to be the later of six months from the time the payment is received and the end of the taxation year in which it was received. If the registered plan that suffered the loss no longer exists or has matured, the payment may be made into another registered plan of the same controlling individual and of the same plan type. For this purpose, we consider RRSPs and RRIFs to be plans of the same type.

If, however, the controlling individual chooses to retain the settlement payment and not return it to the registered plan, we consider the controlling individual to have received the payment as a benefit under the plan. The income tax treatment of the retained payment depends on the type of the registered plan. In the case of an RRSP or RRIF, the payment would be included in the annuitant's income under subsection 146(8) or 146.3(5) of the

Act, as applicable. In the case of a TFSA, the payment would not be taxable as TFSA distributions are not taxable.

Withholding tax

Where a settlement payment relating to losses within an RRSP or RRIF is made directly to the annuitant of the plan (regardless of whether the payment is subsequently returned to the plan or another plan), the financial institution making the payment is required to withhold and remit tax on account of the annuitant's tax for the year. The financial institution is also required to file a T4RSP or T4RIF slip reporting the amount of the benefit and the tax withheld. As noted above, however, if the payment is returned to the plan or to another RRSP or RRIF of the same annuitant, it will not result in an income inclusion. On that basis, the tax withheld would be treated as a credit to the annuitant's income tax liability for the taxation year in which the payment is received.

Tax treatment of the Settlement Payments

The same general principles will apply to the Settlement Payments in this case.

Reporting instructions

We understand that Settlement Payments have been or will be made either directly into the registered plan that suffered the loss or by cheque payable to the plan's controlling individual. The correct reporting procedure will depend on how the Settlement Payment is made and on the type of plan that suffered the loss.

Settlement Payment made to the registered plan that suffered the loss

If a Settlement Payment is made directly to the registered plan, the controlling individual does not need to take any further action as the payment is not taxable and is not considered a contribution to the plan.

Settlement Payment made to the controlling individual of an RRSP or RRIF

If a Settlement Payment is made by cheque in respect of a loss in an RRSP or RRIF, the gross amount of the Settlement Payment, as reported on the T4RSP or T4RIF slip, must be reported on the controlling individual's tax return for the year in which the payment is made (the "payment year"). The financial institution payor will issue a T4RSP or T4RIF, as appropriate, to each such recipient by the end of February of the year following the payment year in order to report the amount paid and the tax withheld. Taxes withheld at source should be reported on line 43700 (total income tax deducted) of the recipient's tax return for the payment year.

If the recipient of a Settlement Payment subsequently returns all or a portion of the payment to an RRSP or RRIF of which they are the controlling individual within the timeframe noted previously (see *General tax treatment of damages or settlement payments*), they will be able to claim a deduction for the amount returned on line 23200 (other deductions) of their tax return for the payment year. This deduction will offset the

income inclusion arising for the payment year as a result of the issuance of the T4RSP or T4RIF.

If the Settlement Payment is not returned to a registered plan until after December 31 of the payment year and the controlling individual has already filed a tax return for the payment year, the controlling individual should request an adjustment to the payment year return to ensure the line 23200 deduction is reported for the correct year. Please contact the CRA's Individual tax enquiries line at 1-800-959-8281 if you need more information about making adjustments to a past year's tax return.

Settlement Payment made to the controlling individual of a TFSA

If a Settlement Payment is returned by the recipient to a TFSA of which they are the controlling individual, nothing is to be reported on the controlling individual's tax return either in respect of the receipt of the Settlement Payment or the deposit to the TFSA.

All recipients of Settlement Payments should keep all of their documentation to support their reporting of the payment and any related deductions.

We trust that these comments will be of assistance to you.

Yours truly,

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