RRSP Over-Contributions: No Mercy, No Relief

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INTRODUCTION

The Federal Court of Appeal's recent decision of Patrick Connolly v Minister of National Revenue (herein "*Connolly v. MNR*") highlights the serious onus the taxpayer bears to understand and apply the complexities and nuances of the *Income Tax Act* (Canada) (the "Act") rules as they relate to the common and recurring issue of over-contributions by taxpayers to their respective Registered Retirement Savings Plans ("RRSPs").

LEGISLATION & POLICY PROVISIONS

RRSP & OVER-CONTRIBUTION

Generally speaking, a taxpayer's RRSP contribution limit for a given tax year is calculated at 18% of his/her prior year's earned income[1], less any "pension adjustment"[2] from a taxpayer's employer, plus any unused RRSP contribution room carried over from prior years.

Subsections 146(1), (5) and (5.1) provide that a taxpayer's contributions to an RRSP are deductible up to the taxpayer's RRSP deduction limit. Generally speaking, a taxpayer's RRSP deduction limit is comprised of both his/her RRSP premiums deductible and amount of his/her spousal RRSP premiums deductible. Where a taxpayer makes any contribution to his/her RRSP which exceeds his/her deduction limit, the total excess amount is taxed at the rate of one percent (1%) per month until it is withdrawn[3]. This special 1% "penalty tax" is payable by the individual and applies for each month that the excess contribution remains in place. The Act also provides that a Taxpayer has a $2,000 "cushion", before being subject to any over-contribution penalty. [4]

Paragraph 56(1)(h) and subsections 146(8), (8.2) and (8.21) of the Act provides that while a taxpayer is taxed on the withdrawal of any subject over-contribution from an RRSP, he/she is entitled to a corresponding deduction provided such withdrawal is made within the statutorily prescribed period. Commonly, this period is up to two years after the taxpayer made the over-contribution.

Meanwhile, subsection 204.3(1) of the Act provides that taxpayers who make over-contributions to their RRSP must file a T1-OVP return within ninety (90) days of the end of the taxation year to estimate and pay the amount of tax payable. However, since the taxes on RRSP over-contributions are payable at the end of each month, the taxpayer must typically pay interest on the unpaid taxes pursuant to subsections 161(1) and 204.3(2). This is compounded by the fact that there is usually a long period of time before a taxpayer may be aware that there was an over-contribution to their RRSP[5]. Furthermore, a taxpayer is liable also to pay penalties for failing to "file timely" the required T1-OVP return. [6]

DISCRETIONARY RELIEF

Subsections 204.1(4) and 220(3.1) of the Act provides for the possibility of discretionary relief by the Minister against such interest and penalties.

Subsection 204.1(4) provides, in part, that:

> *Where an individual would, but for this subsection, be required to a pay a tax under subsection… 204.1(2.1) in respect of a month and the individual* ***establishes to the satisfaction of the Minister*** *that…*
>
> a. *the…**cumulative excess amount** on which the tax is based **arose as a consequence of reasonable error**, and*
> b. *reasonable steps are being taken to eliminate the excess, the Minister may waive the tax.*

(Emphasis added.)

Subsection 220(3.1) of the Act provides, in part, that:

> *The Minister may, on or before the day that is ten calendar years after the end of the taxation year of a taxpayer…or on application by the taxpayer…on or before that day…waive or cancel all or any portion of any penalty or interest otherwise payable under this Act by the taxpayer…in respect of that taxation year…*

The facts, history, judicial history and ultimate judgment of *Connolly v. MNR* provide a demonstration of the many facets of the Act summarized in the above legislation.

OVERVIEW

In *Connolly v. MNR*, Mr. Connolly over-contributed to his RRSP over the course of the 2003 to 2010 taxation years. The Canada Revenue Agency (the "CRA") declined to waive the resultant taxes on the over-contributions, as well as the interest and penalties for the taxation years of 2003 to 2010[7].

The FCA denied Mr. Connolly's appeal for judicial reviews and thus, Mr. Connolly was left with a final bill in excess of $62,000 for taxes, interest and penalties.

The following tale stresses the importance of filing ones' tax returns regularly; responding to the CRA's correspondence promptly; and, using registered mail when sending any correspondence to the CRA.

BACKGROUND

Mr. Connolly failed to file his income tax returns for the 1997 to 2003 taxation years before the annual April 30th deadline, as his accountant advised him it was not necessary to file tax returns since he did not have any tax payable during those years. As no tax returns were filed, the CRA did not issue any notice of assessments for these taxation years. In the normal course, the CRA includes details in the

taxpayer's notice of assessment regarding any unused RRSP contribution room the taxpayer may have available to him/her.

Within this information vacuum, Mr. Connolly came to the view that he could make the maximum RRSP contributions to both his personal RRSP and his spousal RRSP, without consideration for the "pension adjustment" rules. Mr. Connolly's neglectful disregard of these rules was exacerbated by the fact that he was a member of an employer sponsored pension plan. The Court noted that Mr. Connolly made no inquiries about his contribution room, and neither his accountant nor financial institution discussed the issue with him. Ultimately, the pension adjustment resulted in Mr. Connolly having significantly less RRSP room than anticipated.

In 2005, Mr. Connolly's accountant filed income tax returns for the 1997 to 2004 taxation years. The CRA received and processed these returns and issued Notices of Assessment in the normal course for these years, including the 2003 and 2004 taxation years. These Notices stated that Mr. Connolly had "unused RRSP contributions" that he could then carry-forward and apply to future years' earned income. These Notices also made reference to a special tax payable on over-contributions to an RRSP, however, there was no suggestion that Mr. Connolly had made any over-contribution. Subsequently, Mr. Connolly's accountant filed his tax returns for the 2005 to 2008 taxation years. A significant amount of the RRSP contributions were in fact not deducted by Mr. Connolly.

On February 9, 2007, the CRA issued a letter explaining to Mr. Connolly that he may have over-contributed to his RRSP for the taxation years of 2003 to 2005, which, if so, the excess was subject to a penalty of one percent (1%) per month. The letter informed Mr. Connolly to file an RRSP over-contribution return (T1-OVP) for each year for which he made an excess RRSP contribution. The CRA told Mr. Connolly that he could withdraw the excess contributions and that, if he did so within the statutorily prescribed time frame, he could make such withdrawals without facing the imposition of withholding taxes by filing form T3012A.

Shortly after receiving this letter, Mr. Connolly instructed his accountant to prepare and file the requisite T1-OVP and T3012A forms. For reasons which remain undisclosed, the accountant did not send out these forms until one year later. Mr. Connolly did not inquire as to the status of the filings. In another strange turn of events, the CRA claimed it had no records of receiving these forms from Mr. Connolly or his accountant. It does not appear that Mr. Connolly or his accountant sent these documents via registered mail. In October of 2008, the CRA sent a further letter to Mr. Connolly, instructing him to file his T1-OVP returns within 30 days, or the Minister would arbitrarily assess him.

For reasons unknown, Mr. Connolly failed to respond to the CRA's then most recent request. So, as one would expect, on January 5, 2009, the CRA issued Notices of Assessment to Mr. Connolly. These Assessments required Mr. Connolly to pay: (1) taxes on the RRSP over-contributions; (2) penalties flowing from his failure to file T1-OVP returns in a timely fashion; and, (3) interest on both amounts.

Just over two weeks later, on January 21, 2009, Mr. Connolly's accountant filed the now overdue T1-OVP returns for the 2003 to 2007 taxation years as well as forms T3012A for the 2003 and 2004 taxation years. On February 26, 2010, Mr. Connolly withdrew $15,000 from his RRSP and $29,854.29 from his spousal RRSP, including the withdrawals in his income, and claiming a corresponding deduction. The Minister reassessed Mr. Connolly and denied the deduction.

OBJECTIONS FILED

Mr. Connolly filed objections to this reassessment of his 2003 and 2004 taxation years by way of appeal

to the Tax Court of Canada ("TCC") pursuant to its informal procedure. In an unreported judgement issued on April 5, 2013, the TCC allowed the appeal in part; the deduction corresponding to the 2004 over-contribution was allowed by the TCC, however, the TCC denied the deduction for the 2003 over-contribution. The Tax Court suggested that Mr. Connolly seek a ministerial waiver for the tax on the over-contributions, penalties and interest, and "intimated that the Minster would look favourably on such a request".[8]

On December 19, 2013, Mr. Connolly requested relief from the Minister from the taxes on the over-contributions to his RRSP and the resultant interest and penalties.

The Minister's delegate found that the facts surrounding Mr. Connolly's situation did not constitute a "reasonable error". The delegate did not accept Mr. Connolly's suggestions that his lack of awareness and receiving poor financial advice from his accountant or financial institution amounted to extraordinary circumstances. The delegate also refused to accept the fact that Mr. Connolly was suffering from emotional distress at the relevant times constituted a bona fide mitigating factor to Mr. Connolly's late filings of the required T1-OVPs or make the necessary payment on time. Finally, the delegate found that Mr. Connolly's delay in receiving the T3012A from the CRA was a factor beyond Mr. Connolly's control as the "Form T3012A is not necessary to withdraw the excess amount". Furthermore, the Minister found that Mr. Connolly had failed to take "reasonable steps" to eliminate the impugned over-contributions as quickly as possible. On November 30, 2016 the Minister denied Mr. Connolly's request.

Dissatisfied with this outcome, Mr. Connolly applied for judicial review at the Federal Court of Canada.

FEDERAL COURT

The Federal Court ruled against Mr. Connolly. It held that the Minister's delegate's refusal met the applicable standard of review of correctness. It noted that ignorance of the law and reliance on a third-party advisor were not available grounds for relief. Furthermore, the Federal Court cited the decision of *Corporation de L'Ecole Polytechnique Canada* (2004 FCA 127) for the principle that there is "*no such doctrine as a reasonable mistake of law*".

FEDERAL COURT OF APPEAL

Undoubtedly disappointed again, Mr. Connolly subsequently appealed the Federal Court's decision to the Federal Court of Appeal.

Ultimately, the Federal Court of Appeal ruled that the Federal Court had not made an error in dismissing Mr. Connolly's application for judicial review. The Federal Court of Appeal agreed with the Federal Court's decision, which in turn had found in manner consistent with the Minister's delegate. They found that Mr. Connolly's error regarding the limit(s) on his RRSP contributions was not a reasonable error.

The Federal Court of Appeal found that the delegate's interpretation of the applicable law to be incorrect:

> "*In short, there is no way to equate the provision's requirement of a reasonable error with a requirement that the error result from extraordinary circumstances. Nor is it reasonable to exclude from consideration all errors flow from a mistake about the quantum of available contribution room or all error caused by bad advice received from a third party. Similarly, it is unreasonable to interpret the taking of reasonable steps to withdraw on over-contribution from an RRSP to mean that a taxpayer must withdraw the over-contributions as soon as possible or*

within the two-month timeframe mentioned in the CRA's internal 'Guidelines for waiving tax – 1922317.23'."

However, despite the above findings, the Federal Court of Appeal still found against Mr. Connolly. After reviewing Mr. Connolly's affidavit, the Federal Court noted that although Mr. Connolly was aware that there was a limit on RRSP contributions, it did not appear that he was aware of the impact of his pension contributions on his contribution room. The Court also found that it did not appear that Mr. Connolly turned his mind as to how the contribution to his spousal RRSP was determined. The Court also noted that Mr. Connolly made no inquiries to confirm his RRSP contribution room with any of: (1) his bank; (2) his accountant; or (3) his employer. In view of these lack of shortcomings, the Court found Mr. Connolly's error was not one which could be classified as a "reasonable one". The Court further concluded that the steps Mr. Connolly took to correct his RRSP over-contributions could not be found to be reasonable. The Court found that although Mr. Connolly instructed his accountant to correct the situation with respect to his RRSP contribution, he failed to follow up with his accountant. This lack of diligence and follow through by Mr. Connolly was found to be not reasonable by the Court.

Mr. Connolly was ultimately liable for taxes on the amount of the over-contributions to his RRSP, plus penalties plus interest thereon.

THE TAKEAWAY

As noted in another article published by one of the authors of this blog last year:

> *Very complex [RRSP] legislation should not be used to penalize the innocent and the uninformed." Despite this clear statement from the judiciary in McNamee v. the Queen (2009 TCC 630, at page 13), the CRA continues to take the position that taxpayers should know everything about the complex calculations that underlie the RRSP deduction limit.*
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> *…*
>
> *Most taxpayers want to follow the rules and be compliant, but the CRA has to help them do so if Canada is to have a truly fair and functional tax system.***[9]**

In another recent case, *Gekas v. Canada (Attorney General)* ("Gekas")[10], the CRA assessed a taxpayer for excessive TFSA contributions that arose as a result from the taxpayers financial institution misunderstanding instructions that he had given. Subsection 207.06(1) of the Act provides that the Minister may waive the tax on an excess TFSA contribution where "the individual establishes to the satisfaction of the Minister that the liability arose as a consequence of reasonable error", and that the excess was distributed without delay. Prior to judicial review by the Federal Court, the Minister refused to waive any penalties associated with the excess contribution, despite it not being the fault of the taxpayer. At Federal Court, the Court found that "the Delegate's decision is unreasonable because it did not fully assess the extent to which the excess contributions resulted from the mistakes of persons other than the Applicant."

Unfortunately, the trials and tribulations of the taxpayer in Connolly v. MNR and Gekas only seems to underscore the CRA's *harsh modus operandi* when it comes to the issue of RRSP and TFSA over-contributions. These provisions of the Act are extremely complex, and unfortunately, quite often missed. This results in seemingly unnecessary extremely punitive penalties to taxpayers, which ends up costing the taxpayers a significant amount in penalties when they are trying to contribute to their retirement plans. This is particularly an issue when the mistake is not one of the taxpayers, as shown in Gekas, where the taxpayer had to pursue judicial review in order to obtain relief.

[1] To a maximum of $26,500 for 2019.

[2] The pension adjustment is calculated by the employer and is usually reported to the CRA on a T4 annually. With a defined contribution plan, the pension adjustment is typically the total of contributions to the plan made by the individual and their employer.

[3] Part X.1, subsections 204.1(2.1), 204.2(1.1) and section 204.3

[4] Subsection 204.2(1.1)

[5] In *Pouchet v. Canada*, the Taxpayer was not aware that she over-contributed to her RRSP until 7 years after the over-contribution.

[6] Subsections 162(1), 204.3(2), plus interests thereon, pursuant to subsections 161(11) and 204.3(2)

[7] Unfortunately, it is quite common to have penalty relief denied on an over-contribution to an RRSP. Quite often this has been found to be a "reasonable" decision upon judicial review in the Federal Court of Appeal.

[8] *Connolly* at para 12

[9] See: Aasim Hirji, "*RRSP Over-contributions: CRA Continues to Punish When It Should Assist*" Canadian Tax Foundation: Tax for the Owner-Manager Volume 18, Number 4, October 2018.

[10] 2019 FC 1031