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Sent by email

Dear Sir/Madam:

**Subject: Consultation on Possible Options for the Incorporation of Individual Representatives of Registered Dealers and Advisers in Canada**

Independent Financial Brokers of Canada (IFB) welcomes the opportunity to comment on this consultation and the 3 proposals under consideration which would permit registered securities advisors to direct commissions to their corporation.

IFB is a not-for-profit, national trade association which represents the interests of approximately 4,000 independent financial advisors. Our members are self-employed business people who are often dual-licensed, holding both life insurance and mutual fund or securities licenses, and operate small financial services businesses in their local communities.

IFB promotes the professional standards of its members by sponsoring comprehensive individual and corporate errors and omissions insurance plans, continuing education events and compliance support/training. In addition, IFB provides a central voice to communicate with government, regulators

and industry stakeholders to ensure the ongoing viability of financial advice through appropriately licensed independent advisers.

*Discussion of options*

The constraints on the ability of individual securities registrants to incorporate have long been of concern to our members. The issue has been debated by securities regulators since 1999. Various alternative solutions have been presented over the years, without a regulatory resolution.

Life insurance licensed brokers have this option available to them and recent changes to MFDA rules have provided mutual fund advisers with the option to direct their commissions to an unregistered corporation in most jurisdictions. This was a welcome change and we look forward to a similar resolution, aided by this consultation process, which will result in a consistent, harmonized approach for financial advisers, regardless of the jurisdiction in which they are licensed or product they provide. Having said this, incorporation is only a relevant choice for those who are not in an employer-employee relationship and whose earnings are at a threshold which makes the potential tax efficiencies and cost of incorporation worthwhile.

Below, we provide discussion of each of the questions posed by the Working Group. We note that only general information on each of the three options we have been asked to review has been provided, which restricts the depth of our analysis and comments. Nor have we been provided with any draft amendment wording.

Furthermore, each of the 3 options presented contemplate commissions being directed only to a non-registered corporation. The Investment Industry Regulatory Organization of Canada (IIROC), in the past, proposed an incorporation rule which would have permitted the corporation to be registered. We note that securities regulators had then expressed some reservations associated with this proposal, but it is unclear as to whether this proposal has been abandoned by regulators.

*Question 1: Should governments allow a broader range of registered dealers and advisers to redirect remuneration to a non-registered corporation?*

Yes. Advisers should have the ability to structure their business affairs in the most tax efficient manner, while still meeting the regulatory objective of protecting consumers.

The ability to redirect commissions to a non-registered corporation provides the adviser with greater flexibility in choosing how to structure his/her business in the most tax efficient manner. The use of a non-registered corporation does not shelter the individual from satisfying his/her professional or regulatory responsibilities which, if violated, could lead to enforcement or legal action. For greater certainty, securities registrants could be required to have a written agreement in place, like the one prescribed by the MFDA.

In short, we see incorporation as providing greater choice in arranging these adviser's business affairs, while having no effect on the adviser's relationship with clients and leading to no reduction in consumer protection. We note that the MFDA, the self-regulatory body with oversight of mutual fund dealers and advisers, has permitted Approved Persons to set up such arrangements for a number of years. Importantly, it has stated that the payment of commissions to a non-registered corporation has not reduced its ability to undertake enforcement action.

*Question 2: Should governments allow individual representatives of registered dealers and advisers to incorporate?*

Yes. Other licensed investment professionals (e.g. Life insurance brokers and mutual fund representatives), and indeed other professionals (e.g. accountants, lawyers, dentists, etc.), have this option available to them, subject to certain conditions, and we see no reason to continue the restriction for securities advisers. There are safeguards in place, within provincial legislation, that prevent professional corporations from being unaccountable for their dealings with the public. “Look through” laws ensure this accountability and do not limit regulatory action.

In addition, we support consistent treatment for investment professionals whether they be insurance licensed, mutual fund licensed or securities licensed. Ideally, a solution which recognizes that some of these advisers will already have a corporate structure in place, and because they are dual licensed would want to be able to continue under this structure, would be highly preferable.

*Question 3: If yes to Question 2, which incorporation option would in your view be the most effective and balanced alternative?*

Option 1 or 2, while offering a more comprehensive solution, would require changes to existing legislation prior to implementation. How quickly these legislative changes could be drafted and approved by each jurisdiction is, therefore, unknown. This delay has the potential for continuing the unequal treatment of incorporation for securities advisers, as compared to mutual fund advisers, for some time into the future. Alternatively, Option 3, which would replicate the incorporation model already in place for mutual fund advisers, could be implemented more quickly. However, it may not achieve the goal of improved tax efficiencies if those implementing it are subject to a higher risk of tax litigation.

Option 1, the Statutory Incorporation Framework, proposed by the Alberta Securities Commission, has the advantage of being consistent with the approach already in place for the treatment of professional corporations established by lawyers, accountants, medical and certain other professionals. In the provinces which permit it, this option would have the added benefit of allowing registered reps to have the advantage of tax savings through the splitting of capital gains and income with family members, while not affecting the flow of liability between the registrant and client, or registrant and dealer, or impacting on their legal or regulatory obligations. Under this model, the corporation itself would not be registered. However, securities registrants who set up such a corporation would be subject to obtaining an annual permit from their provincial/territorial securities commission, at a cost which is as yet unknown.

Option 2, Advocis Legislative Proposal, has the advantage of being the most seamless for advisors who are licensed for mutual funds/securities and life insurance, since it is premised on the incorporation model available to life insurance brokers. It is a broader incorporation model with no shareholder restrictions unlike Option 1.

The questions raised by these “legislative” options are:

- How would they be implemented across all jurisdictions? Will all jurisdictions agree to a standardized approach?
- Will some provinces/territories have barriers to implementation in that they would have to make legislative or regulatory changes in advance of implementation and how long will this take?

- This proposes options that are different from that already in place for mutual fund advisers. Will there be an undertaking by regulators to adopt a consistent approach (i.e. will MFDA Rule 2.4.1 be amended to comply if a legislative option is chosen)?
- What about registered reps who are licensed in multiple jurisdictions? Will they need to obtain a permit from each jurisdiction or only from their principal jurisdiction? One suggestion would be to provide a mobility exemption, similar to that which exists under NI31-103, where a limited number of clients could be serviced without incurring the additional cost to obtain various annual permits.

Option 3, Redirection of Remuneration to Unregistered Corporations, seems to be the least complex, however, limits the tax benefits – perhaps even increasing the tax risk to the individual – as noted in our response to Question 5 below.

Furthermore, the MFDA, in response to the comments received on the consultation to amend MFDA Rule 2.4.1, acknowledged the temporary and less desirable solution of the redirection model: *MFDA staff acknowledges industry concerns with respect to the lack of regulatory harmonization regarding this matter and agrees with comments expressing the need for a permanent solution that is harmonized across the industry and all jurisdictions. With respect to the approach to be adopted in arriving at such a solution, we acknowledge the comments of the industry that the preferred solution is for an incorporated salespersons model.*

*Question 5: Do you have any concerns or comments about potential income tax consequences or regulatory obstacles regarding each option?*

In our view, individual sales representatives considering incorporating should first seek out expert advice to ensure this is a suitable choice for them. The complexity of this evaluation, while critical to the individual, resides outside of the mandate of securities regulators. However, there is little benefit in extending this choice to the registrant if it has little application in real life. Therefore, some consideration of the tax situation is warranted and seems to lend support for commissions to be paid to unregistered corporations through one of the legislative choices presented in Option 1 or 2.

Some of this discussion, which we believe to still have relevance, took place during the MFDA consultation on amendments to Rule 2.4.1. IIAC, in its submission to the MFDA on the suspension of Rule 2.4.1, noted that “under the *Income Tax Act*, the Canada Revenue Agency (CRA) may recognize a corporation as carrying on a professional practice unless provincial law or the regulatory body for the particular profession provides that only individuals may practice the profession”, in which case “income derived from the profession will normally be considered to be earned by the individual who rendered such professional services and not by the corporation”. Since securities legislation only recognizes individuals as performing registerable activities, Option 3 may place the adviser at greater risk.

In another submission, the law firm, McInnes Cooper LLP, expressed the view that, “since an unregistered corporation is not authorized to carry on a securities-related business, any income earned from such a business through the efforts of an Approved Person would not be beneficially earned by the corporation. This could be hazardous, from a tax point of view, for an Approved Person, relying on Rule 2.4.1, to direct qualifying income to an unregistered corporation on the assumption that the corporation, and not the Approved Person, would be taxable on that income”.

In fact, there is an example from 2007, of the CRA reassessing income received from trailer fees by a mutual fund advisor’s personal corporation and requiring that the tax be paid at the higher individual

rate. The decision, which was appealed and ultimately upheld by the Tax Court of Canada, rested on whether the corporation was “engaged in an active business in earning the trailer fees”. While a number of factors were at play in the decision, the situation would no doubt have been made clearer if the corporation was able to engage in registerable activity.

Making the legislative changes to recognize professional corporations of individual sales representatives, premised on the model which already exists for certain other professionals, would add much needed clarity for these advisors.

*Question 6: Do you have any concerns or comments about the potential impact of the incorporation options on investor protection?*

No. It appears that there are sufficient safeguards in place through any of the proposed incorporation options which would meet the consumer protection test. Whether a registrant is incorporated will have little if any visibility to clients. Incorporated registrants, like any registrant, should be required to maintain liability insurance and be legally responsible for their actions to clients and regulators.

We reiterate our previous comment that the MFDA, in expressing support for the payment of commissions to unregistered corporations, indicated that it had experienced no problems with advisors who had used unregistered corporations, from being held directly responsible for their acts. We believe their experience is valuable in the assessment of investor protection.

*Concluding remarks*

IFB supports a comprehensive and permanent solution for the payment of commissions to corporations of individual sales representatives – one that will ensure a level playing field for advisers whether securities or mutual fund licensed and ideally one which will not present barriers to life insurance brokers who are already licensed or to mutual fund reps who wish to move to a securities dealer. We propose that this consistency, along with greater tax certainty, could best be achieved by Option 1 or 2.

In the event that lengthy implementation delays are anticipated, Option 3 could be endorsed as a short-term solution. However, it is our preference that, at a minimum, the MFDA and IIROC move to implement a consistent approach so as not to disadvantage one set of registrants over another.

We look forward to further discussion on this matter as the Working Group assesses the input it receives from this consultation. We hope that the next steps will occur in a timely manner.

Yours truly,



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