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As CISO consults on advisor incorporation, harmonization of rules proves challenging; The self-regulatory organization is looking to create one set of rules around incorporation – and the lower tax rates that come with it

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The Canadian Investment Regulatory Organization (CISO) is attempting to level the playing field on advisor incorporation, but experts say there are key tax, regulatory and investor protection details to iron out with the approaches put forward.

Under the mutual fund dealer rules, mutual fund-licensed advisors (except those in Alberta) can request their dealer pay commissions or fees related to non-registrable activity, such as financial and tax planning, to a personal corporation. However, the investment dealer consolidated rules prohibit these arrangements, and dealer firms must pay securities-licensed advisors directly.

The self-regulatory organization (SRO) is looking into harmonizing rules around incorporation – and the lower tax rates that come with it – for both sets of advisors. It released a policy paper earlier this year that outlined three potential approaches. The consultation closed in March.

Three options

CISO's favoured arrangement, the "incorporated approved person approach," would modify rules to permit advisors to use personal corporations to be compensated for non-registrable activities conducted in the name of their dealer as well as for other licensed financial services industry activities.

The second option, the "registered corporation approach," would require advisors to register their corporations with their provincial securities regulator for greater oversight and investor protection. That would necessitate securities legislation amendments to allow for a new registrant category and for advisors to engage in either non-registrable or registrable activities. The model would treat advisors as approved persons within their corporation.

CISO also contemplated an "enhanced directed commissions approach" that would allow securities-licensed advisors the same arrangements as their mutual fund-licensed counterparts but with stricter controls for all advisors to whom the corporation can belong.

CISO sought industry feedback on whether to pursue the incorporated approved person option, the registered corporation approach, or an interim use of enhanced directed commissions while pursuing one of the other two options. In all cases, securities legislation amendments would be necessary to allow advisors to engage in registrable activity through their corporations.

Tax and transparency issues

Lorraine Lynds, partner in Osler, Hoskin & Harcourt LLP's corporate group in Toronto, says CISO appears to recognize that there are limitations to the tax benefit advisors would enjoy through an enhanced directed commissions model, although it didn't say so explicitly in the paper.

However, she says, the paper didn't explore the tax implications of either the incorporated approved person or registered corporation models.

"The tax implications need to be understood before the regulators propose their final model," Ms. Lynds says. "A key question they should be thinking about and should be answered is, 'Will the [Canada Revenue Agency] and Revenue Quebec accept the tax characterization under whichever model they propose?'"

The Investment Funds Institute of Canada (IFIC) wrote in its submission that consideration also needs to be given to the employment and operational implications for dealers with longstanding employer-employee arrangements, noting that the paper didn't distinguish between employer-employee and

principal-agent arrangements. It recommends CRO make explicit in its rules that incorporation is available to both arrangements.
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Social Listening(/#/social-listening)

Ellen Bessner, partner at Babin Bessner Spry LLP in Toronto, says transparency into advisors' corporations needs to be a key feature of any harmonized approach.

"The issue is, can CRO and the dealer have access – can they see through [the corporation] and can they have all rights to review the activities, the remuneration that might flow through that company? Can they audit the company like they can an individual advisor?" she says.

"Furthermore, it needs to be clear to clients who they are dealing with, which can be resolved with business cards and signage as well as transparency in all documents."

Compliance and oversight questions

CRO said it would be able to obtain regulatory jurisdiction over the corporation in the incorporated approved person approach by amending its rules to introduce a new non-individual approved person category and include requirements corporations must meet to be approved as well as a requirement for advisors and dealers to sign agreements that detail their respective rights and responsibilities.

The SRO said it would limit the ownership of such corporations to an advisor or advisor team and their family members and require dealers to ensure compliance. Advisors would be held equally accountable to affected clients, their dealers and CRO under this model.

CRO said it would also have jurisdiction over corporations in the registered corporation approach, but legislative provisions would be necessary to introduce a new registration category, limit the ownership of and activities within the corporations, and give dealers, CRO and the Canadian Securities Administrators oversight of the limitations.

Investor advocacy organization FAIR Canada stated in its submission there's no need for a new approach and argued CRO should focus on addressing the existing limitations with the directed commission model. CRO currently lacks a clear view of the beneficial owners of an advisor's corporation or the activities the advisor directs their dealer to pay commissions to their corporation for, FAIR Canada said, and may lack the authority to act if an advisor is directing commissions related to registrable activities improperly.

Wealth management firms were split on which approach they preferred, but many raised concerns that adopting either the incorporated approved person or registered corporation approach without the ability for advisors to conduct registrable activity within their corporations would impose additional compliance requirements on firms with little benefit. They also highlighted the potential length of time involved for regulators and legislators to update securities laws and regulations to allow registrable activity.

"It would open up a lot more work for CRO," says Steph Condra, executive vice-president and chief experience officer at Wellington-Altus Financial Inc. in Toronto. The firm is advocating for a registered corporation approach, which she says gives advisors greater flexibility to "run their business like a small business" and would help with succession planning.

FAIR Canada noted provincial regulators could opt not to allow such changes, citing Alberta's refusal to allow directed commission arrangements.

However, IFIC said it believed changes to allow corporations to engage in registrable activity could be done through amendments to the national instrument on registration requirements, exemptions and registrant obligations.

"Whatever path the regulators take, hopefully it's a harmonized approach," Ms. Lynds says. "Especially for firms that do business across Canada, it'll be difficult to take advantage of the rules if they're not harmonized."

In an e-mail sent to Globe Advisor, CRO said it "continues to progress on the directed commission project" and is "collaborating closely with all stakeholders on key matters to ensure the rules we develop are effective, harmonized and provide investor protection."

The SRO didn't provide a timeline for next steps or say whether there would be additional consultation.

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