Relevé 16 changes and potential impacts for the mutual fund industry

Revenue Quebec (RQ) has introduced significant modifications for 2011 to the RL-16 slip that is used by mutual fund trusts to report income and capital gains.

Instead of reporting the foreign portion of capital gains in a note in the middle of the slip, they have introduced box A-1 to report the foreign portion of capital gains. The total amount of capital gains, including foreign-source capital gains, must still be reported in box A.

In addition, they want foreign-source capital gains reported separately for each country of source. For example, a fund that allocates capital gains realized in ten countries should produce ten RL-16 slips.

While this is the first year they have asked for Box A to be split into country-by-country reporting, it is not the first year they have asked for total foreign capital gains to be identified separately from domestic capital gains (previously this was done in a note on the RL-16), and it is not the first year they have asked for other foreign-source income (box F) and foreign income tax (box L) to be reported separately for each country of source.

In addition, if an RL-16 allocates both foreign capital gains (box A and A-1) and foreign investment income (box F) from a single country, and if there were any foreign tax in box L that relates to both or either of these, then separate slips are required so that it would be clear what portion of the tax in box L pertains to the capital gain in box A and A-1, and what portion pertains to the foreign investment income in box F.

For example, if a trust were to allocate foreign capital gains and foreign investment income from ten countries, and each country has withheld tax with respect to capital gains, income, or both, then the trust would need to produce 20 RL-16 slips to each beneficiary. A group of mutual fund trusts might have to produce hundreds of RL-16 slips per beneficiary if it were not for consolidated reporting.

The reason for such complicated reporting is that the taxpayer, in claiming a foreign tax credit, is required to make a separate claim with respect to each country, and in the process, different income types are treated separately.

The T3 Guide has for several years included a requirement for country-by-country reporting on T3 slips with respect to foreign capital gains, foreign investment income and foreign tax. There is a different way to report the necessary income, as it is generally supposed to be done in the footnote area of the T3 slip, which is impractical for mutual funds that hold investments from many countries. Only the taxable portion of foreign capital gains is supposed to be reported on the T3 (as opposed to the total foreign capital gain on the RL-16), country-by-country, and the T3 does not require the reporting of foreign tax to be proportioned between foreign taxable capital gains and foreign investment income.

Consequently, it appears necessary to develop a capacity to provide a country-by-country breakdown for the amounts reported in boxes A/A-1, F and L and their federal equivalents, and to segregate the foreign tax in box L into the portion relating to capital gains (perhaps zero in all or most cases) and the portion relating to other foreign investment income.

RQ has provided a one-year grace period to produce country-by-country reporting and to move foreign capital gains from note form into box A-1. Where current reporting does not comply with previous years' requirements for country-by-country reporting of foreign investment income and reporting foreign capital gains in a note, and where it is too late to make these changes for 2011 reporting, it appears reasonable to combine all these changes into a single systems update for implementation in 2012, although it would be okay to implement any or all of these changes in 2011 if possible.

For mutual fund trusts, which are entitled to prepare consolidated T3/RL-16 reporting, it would probably be possible to combine all these requirements into a new Foreign Income and Capital Gains Statement that could be provided to clients. But the design might be complicated, and may depend on reaching an agreement with both the CRA and the RQ.

For example, to give the RQ everything it wants (assuming it could be done on a spreadsheet attached to the existing consolidated reporting rather than through the requirement of separate RL-16 slips with respect to each country of source), tax slip preparers might be able to offer unitholders a spreadsheet for foreign income and capital gains, with a line for each country and a column for each RL-16 box (A-1, F and L). Column L may have to be split into two columns, one with respect to tax withheld on column A-1 amounts, and one with respect to tax withheld on column F amounts, although perhaps the RQ might be willing to skip this requirement since the CRA doesn't require it, as long as each line pertains to a single country. To satisfy the CRA, another column might have to be added for taxable capital gains from foreign sources, i.e. half of column A-1, although perhaps they might be willing to skip this requirement since the spreadsheet would clearly show that column A-1 pertains to gross capital gains.

Either government may want a separate page of the Foreign Income and Capital Gains Statement with respect to each mutual fund, although since that kind of breakdown is not needed for purposes of preparing the beneficiary's tax return, hopefully they would both allow this statement to be produced on a consolidated basis for all the funds held by each unitholder, as long as the column totals balanced with the column totals in the existing consolidated reporting.

In addition to this new statement, the existing consolidated reporting would need a new column to report A-1, foreign-source capital gains.