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M. David R. Brown

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Résumé de l'article

L'auteur traite principalement de la réforme fédérale des pensions et, subsidiairement, de certaines innovations apportées en ce domaine par les gouvernements québécois et ontarien. Sur le plan fédéral, il décrit certains aspects du Bill *C-52* (adopté en juin 1990), qui introduit des changements à l'aide fiscale pour l'épargne à la retraite. Sont notamment mis en lumière les objectifs de la nouvelle réglementation fiscale et quelques cas concrets d'application. Sur le plan provincial, il résume certains changements apportés par le Projet de loi 116 du Québec (devenu *Loi sur les régimes complémentaires de retraite*, 1989, c. 38) et ceux promulgués en Ontario en vertu de la loi dite *Ontario Pension Benefits Act*.

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Pension Regulation*

by

M. David R. Brown**

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The possible scope of subject matter for this discussion is very broad. My plan, however, is to focus mainly on pension tax reform and follow that with some brief comments on regulation changes in Ontario and Quebec.

Pension Tax Reform - Blii C-52

The federal government's bill to overhaul the tax treatment of savings for retirement became law on June 27, 1990 after more than six years of debate, consultation, revisions and rewriting. Despite some last minute attempts at simplification, the new law is complex. In this discussion, I will give only a general description of how the law works, with some comments on aspects of special interest to

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*This article was prepared for the 23rd Annual Conference (1990) entitled "Canadian Employee Benefits Conference," held in Halifax from August 27-31, 1990.

**Partner with Eckler Partners, an actuaries and consultants firm in Toronto.

trusteed rnultiernployer pension plans. The final version of the regulations under the new law is still in the works in Ottawa. Apart frorn that, there are a good rnany limitations on rny own understanding of many of the details in the law.

The objectives of the new tax rules are as follows:

1. To provide the opportunity for an average worker to replace his or her preretirement income with tax-assisted savings;
2. To equalize (as much as practicable) the assistance provided through various forms of savings arrangements (pension plans, RRSPs, deferred profit-sharing plans);
3. To provide flexibility in the mix and timing of each person's savings arrangements;
4. To limit full tax assistance to upper middle income eamers, i.e., up to two and one-half rimes the average wage;
5. To control aggressive tax planning and perceived abuses of retirement tax shelters.

For a person at the average wage level, replacement of 100% of preretirement income means that tax-assisted savings should be able to replace 60%. (See Figure 1.)

Figure 1

Old Age Security	15%
Canada/Quebec Pension Plan	25%
Tax-Assisted Savings	
	100%

For a person at two and one-half rimes the average wage, the same relative level of tax-assisted savings will yield total income replacement of 70%. (See Figure 2.)

Figure 2

Old Age Security	0%	(claw-back)
Canada/Quebec Pension Plan	10%	
Tax-Assisted Savings		
	70%	

The theoretical model for the limits on tax-assisted savings under the new rules has been described as a *Buick* pension plan. Under this plan, contributions of 18% of earnings over a 35-year period will provide a retirement income at age 63 of about 65% of final pay with a 60% surviving spouse pension and indexing at 1% less than the Consumer Price Index.

How does ail this theory corne out in practice? The central idea of the new tax rules is that every taxpayer is entitled to tax-assisted retirement savings of 18% of earnings, subject to a dollar limit. The dollar limit is phased up over a transition period from $11,500 in 1991 to $15,500 in 1995. After that, it is indexed. You canuse the 18% to make deposits in your RRSP or to obtain benefits through an employment pension plan or a deferred profit-sharing plan. If your pension plan is a good one, that will leave less room for RRSP contributions and vice versa if it is not so good. If you do not use up all your 18% this year, you can carry forward the unused room and use it in a future year.

Another feature of the new rules is that, in order to integrate all types of plans under a single limit, there is a one-year lag in the calculation of RRSP room. Thus the limit on your 1991 RRSP contribution will be as shown in Figure 3.

Figure 3

18% of your 1990 earnings
(with a maximum of $11,500)
� the value of your pension plan
benefits accrued in 1990

The *value of your pension plan benefits* will be reported to Revenue Canada each year on your T4 slip, starting with your 1990

T4, which you will receive in February. The amount reported on your T4 slip is described in the new rules as a *pension adjustment* or *PA.*

For money purchase pension plans, an employee's PA will simply be the total amount contributed by the employee and the employer for the year. In this way, each dollar contributed to the pension plan reduces the employee's minimum RRSP contribution by a dollar.

For defined benefit pension plans, the procedure is more complicated. Here the employer will have to calculate the *pension credit* for the year, which will depend on the benefit formula in the pension plan. For example, for a flat benefit plan with a formula of $20 of monthly pension times years of service, the PA calculation for an employee who works a full year is nine times $240 ($20 per month times 12) minus $1,000, which works out to $1,160. For a plan with a 1% of final average salary formula, the PA for an employee who earned $40,000 in the year is nine times $400 (1 % of $40,000) minus $1,000, which cornes to $2,600.

The regulations will contain a number of specific rules for the calculation of the PA for defined benefit plans, covering various kinds of plan formulas and employment arrangements. I do not propose to go into any of that just now.

Having heard this short description of how the PA is determined, you may be asking yourself how it will be handled in the typical multiemployer plan that has both a defined contribution (like a money purchase plan) and a defined benefit formula. Which method will be used to calculate the PA and who will be responsible for reporting it?

Not to keep you in suspense, the short answer is that the PA will be calculated on the money purchase method (i.e., the amount contributed in the year), and the contributing employers will be responsible for reporting it, not the plan administrator. The plans for which this kind of reporting will apply are referred to in the legislation as *specified multiemployer plans (SMEPs).* In order to qualify as an SMEP, a plan has to meet ail of the following criteria:

- First, the plan must be primarily a defined benefit plan. When the legislation was introduced in December 1989, there was a

prohibition against any money purchase provision in an SMEP, but this has been softened slightly in the final version.

- Second, no more than 95% of active members can be employed by a single employer or a group of related employers.
- Third, participation of employers must flow from a collective agreement or a similar arrangement.
- Fourth, most of the employers must be taxable. This will not preclude plans where Crown corporations (e.g., Ontario Hydro) or municipalities are participating employers.
- Fifth, the contributions by the employers must be based on a negotiated formula.
- Sixth, the plan must be controlled and operated by a board of trustees, with not more than 50% employer representation.
- Seventh, the plan benefits must be determined by the board of trustees, subject to the requirements of collective agreements (e.g., ratification by the union and/or employer groups).

The regulations will give Revenue Canada some discretion to designate as an SMEP a plan that may not completely meet all of these criteria. Once a plan has been designated as an SMEP, it keeps that designation until Revenue Canada terminates it even though the plan may no longer meet some of the criteria.

One question that many people are starting to ask and to which I do not have the answer is, "What do we need to do in order to be designated by Revenue Canada as an SMEP?" I assume they will be letting us know fairly soon.

Reverting for just a minute to the subject of PA reporting, there are a couple of other points worth noting. The amounts reported are supposed to be for time actually worked during the year. The report of December 1990 hours and the contributions for those hours will typically be remitted in January 1991, but those contribution amounts should be included in the member's 1990 PA. The only xception is that if for some reason the contributions for any month m 1990 are late and do not get paid until sometime after the end of February 1991, then they should be reported as part of the PA for 1991, not 1990.

At the other end, contributions paid early in 1990 for hours worked in 1989 should *not* be included in the PA for 1990.

One other point to remember about PA reporting is that if the plan provides pension credit for members who are on workers' compensation or who meet other tests of disability, the plan administrator will be required to do the PA reporting with respect to those credits.

Now coming back for a moment to the definition of an SMEP and what it means, the first and most important result of being designated as an *SMEP* is that you can do your PA reporting on the simplified basis I have just been describing. However, there are a few other interesting consequences.

To begin with, employer contributions to an SMEP will generally be considered as tax deductible without applying any of the other tests in the new tax rules. For example, for defined benefit plans with large surpluses, the employer will generally not be able to make deductible contributions, but this will not apply to an SMEP.

Similarly, various other limitations that apply under the new rules to other defined benefit plans will not apply to SMEPs, for example, the maximum limit on employee contributions and the maximum limit on retirement pension amounts. Sorne other restrictions that flow from the need to be able to calculate the PA will not apply to SMEPs. SMEPs will generally be allowed to grant additional credited hours when employees contribute directly to the plan.

There is, however, one important limitation that an SMEP will have to observe in exchange for escaping from these other restrictions, and that is that in the aggregate and for the plan as a whole, the PAs reported by contributing employers in total must be expected not to exceed 18% of the members' compensation. This limitation should not present any great difficulty for most plans. If the governing collective agreement provides a straight rime hourly wage rate of, say, $20 per hour, then any pension contribution rate up to $3.60 per hour (18% of $20) will satisfy the new tax rules.

A final advantage of being an SMEP is that, generally, a plan escapes the requirement imposed on other defined benefit plans to report past service pension adjustments (PSPAs) when benefits are increased for prior service. The PSPA procedures are perhaps the

nastiest aspect of the new tax rules. I don't propose to describe them in any detail, but escaping from them is certainly a big advantage for SMEPs.

As I mentioned earlier, the new tax rules are contained in lengthy and complex documents. What I have given you is a quick tour through the highlights with an emphasis on how the rules will affect trusteed multiemployer plans. However, before I finish this part of my discussion, there are a few other odds and ends I want to tell you about.

One complex area I have not even mentioned is the new registration requirements. For many years, Revenue Canada has granted registered status under the Incarne Tax Act on the basis of departmental rules set out in an Information Circular. These rules have been changed several times over the years, but Revenue Canada has not insisted on immediate amendments to registered plans to comply with these changes in the requirements. As a result, there are today many registered plans that are technically "offside" of the existing rules. Moreover, the rules themselves are not part of the Incarne Tax Act and Regulations. This has permitted the Department to exercise a fair amount of discretion in interpreting and applying the rules, but it left plan sponsors in a legal limbo if they wanted to challenge Revenue Canada on some aspect of the rules.

Part of the present "reform" exercise is to codify the rules and make them part of the act and regulations. In this connection, all existing plans will be required to register with Revenue Canada. As I understand it, the intention is to correct existing offside provisions and to ensure compliance with all the new rules. The new rules include a number of restrictive requirements for defined benefit plans, such as limitations on early retirement and disability pension provisions. We could spend this whole session looking at these new registration requirements, but I do not think that would be a profitable use of our time, because there is a fondamental question to which we need the answer before we get into such a discussion and that is whether Revenue Canada will consider SMEPs to be *defined benefit* plans for all or some or none of these new requirements. This question also affects the timing of the application of the new rules. A plan with "defined benefit provisions" that was registered before March 28, 1988 will be considered a grandfathered plan. The new registration requirements will apply to such plans as of January

1, 1992. For all other plans and for "money purchase provisions," the effective date is January 1, 1989.

There is a new definition of *earned income,* which will apply starting in 1991. The most important use of this term is in the application of the 18% maximum on retirement savings. One important part of the definition is that it will *include* maintenance payments received from a former spouse and will *exclude* alimony and maintenance payments made by the taxpayer.

Let me conclude this part of my discussion with a brief comment on the bottom-line impact of the new rules on the average rank and file member of a trusteed multiemployer pension plan. My belief is that most plan members will prefer the new rules to the old ones and that some of those who have been dissatisfied with their pension plans in the past will now be less so.

In the first place, most members will be able to make larger RRSP contributions if they want to. For a member earning $50,000 yearly, the maximum **RRSP** contribution under the old rules was $3,500 (less any employee pension plan contribution). Under the new rules, the maximum is $9,000 minus the total contributions to the pension plan. Even if the pension plan contribution rate were as high as say $2 an hour, at 2,000 hours per year that would still leave a member $5,000 of RRSP contribution room.

Second, some members have complained in the past that their membership in a pension plan prevented them from saving as much for retirement as they would be able to if they did not belong to the pension plan. For example, if the pension plan contributions amounted to $1,000 per year, the old rules in effect limited total tax-sheltered retirement savings to $4,500 ($1,000 in the pension plan and $3,500 to an RRSP), whereas nonmembers of pension plans could tax-shelter up to $7,500 per year. This anomaly disappears under the new rules, where "a buck is a buck," no matter which form of retirement savings it is contributed to.

Third, the greater flexibility of timing that is permitted by the carryforward under the new rules will be appreciated by plan members. Younger members who cannot afford RRSP contributions will no longer be in the position that if they fail to use the available RRSP contribution room in a given year, it will be lost to them forever.

Quebec Regulations

I want to include only a few observations about regulatory developments in Quebec. Pension reform arrived in Quebec at the beginning of 1989 in the form of Law 116. I do not want to deal in any general way with this law, but just with two or three points that may be of particular interest to this audience.

Section 147 of Bill 116 requires that pension plans are to be administered by a pension committee composed of at least three members designated in accordance with certain conditions. At least one member must be an individual who is not a party to the plan. There are a number of long-established multiemployer plans in Quebec that have always been administered by a committee or board of trustees consisting of equal numbers of employer and union representatives. As nominees of parties to the collective agreement that supports the plan, these individuals do not meet the test of not being a party to the plan. So it would seem that the law will require them to arrange for the appointment of an outside or independent trustee or committee member. Some committees have felt that this requirement is unnecessary and inconvenient and have asked the Régie des rentes to exempt them from it. The Régie has not responded formally so far, but it is beginning to seem unlikely that the request for exemption will be granted.

In a somewhat similar vein, Section 166 of Law 116 requires an annual meeting of members, employers and the pension committee. The purpose of the meeting is to inform the parties of any amendments to the plan, to enable groups of active and nonactive members to designate a member to the pension committee and for the pension committee to render an account of the plan's administration. The requirement for such a meeting is seen by some pension committees as burdensome and unnecessary, in view of all the other disclosure and notice requirements in the new law. Appeals to the Régie for exemption from this requirement are apparently not meeting with much sympathy from them.

A third innovation in the Quebec law and regulations that is being received more positively by trustees and plan members is the provision for a new format for the payment of certain pension benefits. This new format is called a *life income fund* or *LIF*. It will generally be available with respect to vested benefits otherwise

provided through RRSPs or deferred annuity contracts, both of which require that at maturity, the benefit distribution must be in the form of a life annuity. Under an LIF, payment of a variable income is permitted, within prescribed limits, until the member reaches age 80, at which point the remaining balance in the fund must be converted into a life annuity. The variable payments during the period up to age 80 must be in a specified range that is recalculated each year. The lower limit of the range is the balance in the fund divided by the number of years remaining to age 90, and the upper limit is the balance in the fund divided by the value of a temporary life annuity to the member's age 90.

Although the Quebec regulations now permit these LIFs, there is presently no provision for them in the federal Income Tax Act, although it may be that the provisions governing Registered Retirement Income Funds (RRIFs) could be adapted or interpreted to cover LIFs. In any event, I understand that the situation will soon be sorted out and that other provinces with pension legislation will adopt rules similar to Quebec's permitting LIFs.

Ontario Regulations

There have so far only been some minor changes in the regulations under the Ontario Pension Benefits Act, with some others still in the works.

One change that has been made is to end the moratorium on cash withdrawals of actuarial surplus from ongoing pension plans. This moratorium has been in effect for several years with the expectation that it would only be lifted when legislation was brought in to require a minimum standard of indexing or inflation adjustment and that legislation would require that surplus could only be withdrawn after the pension plan was amended to provide for indexing of pensioners' and past service benefits. This whole legislative package now seems to be on indefinite hold, so the government has changed the regulations to open a very small window for plans to take surplus withdrawals under specified conditions. The principal conditions are that every member and pensioner sign a written agreement consenting to the employer's withdrawal of surplus, that the 50% rule must be applied retroactively so that no employee's contributions provide more than 50% of accrued benefits, and that where benefits are improved, the employee must be given the option of

applying the improvement in some form of inflation protection or indexing.

Sorne further changes in the Ontario regulations were announced by the government about two months ago, and these are expected to take place in the near future. These deal mainly with some changes in the solvency funding requirements that were introduced about three years ago and that have had an unexpectedly severe effect in requiring additional funding for certain types of pension plans. The changes in the regulations will permit funding of certain liabilities over 15 years that would otherwise have to be funded over a five-year period. They will also state that, as a general rule, it will be permissible for an employer to take a contribution holiday, that is, to use actuarial surplus to fund the current service cost of the plan. The legal right to do this was thrown into some doubt by a decision of the Ontario Court of Appeal involving the Ontario Hydro pension plan, and the change in the regulations is intended to clarify the situation.