McMillan Binch Mendelsohn

Pensions and Employee Compensation Bulletin

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Impact of Budget 2007 on Pension Plans and Retirement Savings Arrangements

The federal Budget 2007 which was unveiled by conservative Finance Minister Flaherty on March 19, 2007 contained several initiatives which indicate the government's interest in providing policies and programs that assist employers in retaining older workers in Canada's workforce. The extension of the tax deferred period for registered savings plans and the accommodation of "phased retirement" are both geared to enhancing the retention of older workers

Age Limit Extended for Conversion of Retirement Savings from Tax Deferred to Taxable

Budget 2007 proposes that effective January 1, 2007, benefits under a registered pension plan ("RPP"), or a registered retirement savings plan ("RRSP") or a deferred profit sharing plan ("DPSP") do not have to be converted from a tax deferred retirement savings arrangement into a registered retirement income fund ("RRIF") until the end of the year in which a tax-payer reaches age 71. The change brings back the age 71 benchmark for such retirement plans. The proposed change means that individuals who are 70 or 71 in 2007 and have already converted benefits under an RPP, RRSP or DPSP to an RRIF can reconvert back to an RRSP provided that the RRSP is subsequently converted into an RRIF by the end of the taxation year in which the individual turns 71. In addition, such individuals may continue to make tax deductible RRSP contributions to age 71, provided they have eligible earnings and RRSP room. Budget 2007 also proposes to waive the 2007 specified minimum withdrawal from an RRIF for RRIF recipients who turn 71 in 2007 and the specified minimum withdrawals in 2007 and 2008 for RRIF recipients who turn 71 in 2008. If enacted, this budget proposal could allow taxpayers to defer taxes on retirement savings for an additional two years, and, in some cases, to make contributions to retirement savings for up to an additional two years.

Plan sponsors may be required to amend RPPs to change the mandatory date at which plan members cease contributing or earning benefit accruals and begin receiving benefits from a plan from the end of the year in which a member reaches age 69 to the end of the year in which the member reaches age 71. Further, RPPs that currently allow former members to retain balances in plans or to defer receipt of plan benefits to age 69 may also be amended to permit plan balances to remain in the plans until the end of the year in which the former member reaches age 71. Plan administrators should review administrative policies and procedures to adjust the date for mandatory termination of membership in their RPPs and amend all member communications to reflect the extension of plan membership to age 71.

If enacted, the increase in the maturation age to 71 is still not in accord with human rights legislation in most provinces that prohibits mandatory retirement based on age. A plan sponsor may still be at risk of a claim of age discrimination if, in compliance with the *Income Tax Act,* an RPP requires active employees who continue to work to terminate plan membership at age 71 and the employer does not provide equivalent compensation to affected employees for the value of foregone pension benefit accruals.

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Workforce Planning and "Phased Retirement"

Budget 2007 proposes that effective 2008, after consultation, the *Income Tax Regulation* will be amended to permit the payment of up to 60% of the unreduced value of a defined benefit pension and bridge benefits to qualified employees. A qualified employee must be:

- age 55 or older;
- entitled to an unreduced defined benefit pension;
- not a member of a designated plan (for example, an individual pension plan, or a small plan applicable to executives, owner/managers or highly compensated employees); and
- not "connected" (i.e. an employee who does not deal at arm's length with the employer, or owns 10% or more of the shares of the employer or related corporation);

Budget 2007 describes this change as supporting employers in retaining older workers through "phased retirement". In this case, qualified older workers who wish to work part-time and continue to earn a salary may receive up to 60% of their full pensions. At the same time, the employee would continue to accrue benefits under the pension plan for actual time worked. Budget 2007 also proposes to allow a qualified employee to receive 60% of full pension earned to date while continuing to work full-time and receiving full salary. During this period, in addition to the advance pension, the employee would continue to accrue service credit and credit for pensionable earnings for active service in accordance with the terms of the pension plan.

Under the proposed changes, certain plan sponsors could use their RPPs to support work force management programs for qualified targeted employees by supplementing part-time employment or providing, in effect, retention bonuses to qualified employees who continue to earn full-time salaries while receiving additional income from the pension plan. However, based on the proposed limitations and qualifications, these provisions appear to be of most value to a limited number of plan sponsors whose RPPs provide full unreduced pensions at age 55. Further, it remains to be seen whether qualified active full-time employees will view the tax implications of receiving a full-time salary and additional pension earnings as an incentive or a disincentive, although there may be offsetting benefits based on new pension-splitting rules.

Plan sponsors whose pension plans meet the requirements proposed in Budget 2007 should consider how the proposed changes could be used to support a workforce management program or assist in managing other workplace issues; who should be eligible for such a program; and what percentage of full pension up to 60% should be made available to targeted employees. If an employer does want to take advantage of the changes in the *Income Tax Regulations*, the plan administrator should review RPP provisions to determine what amendments are needed to incorporate and set out the rules for the payment of a phased-in retirement pension or an advance pension. In addition, where plan sponsors have already factored in phased retirement programs to incorporate legislation in Quebec and Alberta, or in anticipation of legislation in Manitoba, such plan terms may have to be amended to be consistent with the changes in the *Income Tax Regulation*.

In anticipation of enactment of the proposed changes, plan sponsors may also consider when and how payments of phased-in pensions or advance pensions should be recalculated. As additional benefits and increases in pensionable earnings accrue during the phased-in period, the value of a member's full pension will continue to increase and the original amount of the phased-in pension or advance pension will represent less than 60% of the full pension.

Expanded List of Qualified Investments Held in Registered Plans and RRSP

Budget 2007 proposes that effective March 19, 2007, the list of qualified investments for RRSPs and RPPs will be expanded to include:

- any debt obligations with an investment grade rating from a recognized credit rating agency and part of a minimum $25 million issuance; and
- any securities listed on a designated stock exchange, other than a futures contract or other derivative instrument in respect of which the holders risk of loss may exceed the holders cost.

If enacted, plan sponsors should review their statements of investments policies and procedures (“SIP&P”) to consider including investments from the expanded list of qualified investments, for example, foreign listed trusts, Canadian dollar bonds issued by foreign equities, or partnership units. Plan sponsors of defined contribution plans should also review the list of investment options currently available to determine whether the plan administrator should make additional options available to DC Plan members, and what communications or educational tools are required to introduce such options.

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The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.