PRE-BUDGET SUBMISSION TO THE STANDING COMMITTEE ON FINANCE

PARLIAMENT OF CANADA

CO-OPERATIVE SUPERANNUATION SOCIETY PENSION PLAN

PO Box 1850
Saskatoon SK
S7K 3S2

Tel: 306-244-1539
Fax: 306-244-1088
Website: csspen.com

SASKATOON

Introduction

The Co-operative Superannuation Society (CSS) Pension Plan is Canada's largest private defined contribution pension plan. The Plan was originally formed in 1939 at the co-operative refinery in Regina on the model of a British retirement savings society. The Co-operative Superannuation Society was incorporated in 1943 by a private Act of the Saskatchewan legislature on a non-profit, membership basis to serve as the Plan's administrator and trustee.

The CSS Pension Plan includes about four hundred and forty co-operatives and credit unions across Canada. The Plan has more than 35,000 contributing and deferred vested members. It pays benefits to more than 6,000 retired members. The Plan manages five investment funds on behalf of its members. The total value of assets under administration is approximately $3 billion. The Plan's MER is approximately 25 basis points.

Executive Summary

Background

- In 2005 the *Income Tax Regulations* were amended to permit retired members of Defined Contribution (DC) pension plans to receive periodic pension income payments directly from their pension plan. These are called "variable benefits".
- The *Income Tax Regulations* define variable benefits as "lifetime retirement benefits". Lifetime retirement benefits, whether paid from a Defined Benefit (DB) or DC pension plan, must be periodic and ***cannot start until retirement***.[1]
- Income tax is calculated, withheld and remitted the same for all periodic payments of pension income, whether paid from a DB or DC pension plan.
- RRIF withdrawals, not being periodic payments of pension income, are subject to a separate tax withholding and remittance regime.

Issue

In Bill C-10, 39th Parliament, second session (2009), it was proposed that variable benefits be added to the definition of "pension income" but not to the definition of "qualified pension income" set out in section 118(7) of the *Income Tax Act.* DB pension payments, however, are included in both definitions. Only retirees receiving "qualified pension income" may claim the pension income deduction and split pension income with their spouses immediately on retirement.

Although variable benefits are periodic payments of pension income to a retiree, Finance Canada indicates that they should not qualify for the pension income deduction or income splitting until age 65 like RRIF withdrawals. For the reasons outlined below, the CSS Pension Plan submits that variable benefits should qualify for the pension income deduction

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[1] In a Defined Benefit (DB) pension plan, the amount of the pension at retirement is determined by a formula and is therefore known in advance. The amount that must be contributed to secure the benefit, however, is unknown and varies with long-term interest rates and the performance of investment markets. In a Defined Contribution (DC) pension plan the amount that must be contributed to the plan is known in advance. The amount of the benefit at retirement, however, is unknown and varies with long-term interest rates and the performance of investment markets.

and income splitting immediately on retirement, like DB pension payments.[2]

Recommendation

To ensure fair and equitable taxation of DB and DC pension payments, it is submitted that variable benefits should be added to the definition of "qualified pension income" in section 118(7) of the Income Tax Act.

Reasons

- Under the *Income Tax Act* and *Regulations*, variable benefits are "lifetime retirement income" paid directly from a registered pension plan. Taxes are therefore withheld, remitted and reported to CRA in the same manner as DB pension payments and not the same as RRIF withdrawals.
- In both DB and DC pension plans, periodic payments of retirement income cannot start until the member retires. Unlike a RRIF, therefore, an "age 65" limit is not required to ensure that a taxpayer receiving variable benefits is retired.
- Unlike a DB pension, the amount of a variable benefit payment can be changed (within limits). Preventing DC retirees from using this flexibility to obtain inappropriate tax benefits would not be difficult.
- The tax cost of permitting DC pension plan members receiving variable benefits to claim the pension income deduction and split their pension income with a spouses immediately on retirement would be relatively modest.

Discussion

A) Background

In discussions with CRA held in September and October of 2005, the CSS Pension Plan was advised that "*[because] variable benefits are pension benefits that are paid directly from [a registered pension] plan they must meet all the requirements under the Income Tax Act & Regulations relating to pension plans and not RRIF's.*"

In particular CSS was advised as follows:

1. Variable benefits would be taxed on the "payroll method", the same as DB pension payments, and not like RRIF withdrawals.
2. Variable benefits would be reported in Box 16 of a T4A the same as DB pension payments – not on a T4RIF like RRIF withdrawals. Note that by reporting variable benefits in Box 16, they qualified for both the pension income deduction and for pension income splitting before age 65.
3. There would be no required minimum withdrawal from a variable benefit account until age 70 (now age 72).

Subsequent amendments to the *Income Tax Act & Regulations* were passed in 2007 to permit retired couples to split their pension income. The *Act* was also amended to allow

[2] For RRIF withdrawals, the purpose of this age requirement is to ensure that tax relief intended for retired Canadians will not be available before retirement.

retirees from DB pension plans to take “phased retirement”.[3]

Although drafted in 2004 at the same time as the amendments that created variable benefits, subsection 118(7)(a)(iii.1) of the *Income Tax Act* (which adds variable benefits to the definition of “pension income”) was not proclaimed in force in 2005. Rather, this provision was left dormant for three years before becoming part of Bill C-10 in 2009.

Upon being advised by Finance Canada that subsection 118(7)(a)(iii.1) was included in Bill C-10, CSS expressed concern that this new provision would conflict with CRA’s previous advice regarding the taxation of variable benefits. In response, the Plan was advised by Finance Canada that would not qualify for the pension income deduction or pension income splitting until age 65.

B) Issue

Section 106(2) of Bill C-10 provides for the enactment of subsection 118(7)(a)(iii.1) of the *Income Tax Act*. This new provision adds variable benefits to the definition of “pension income” set out in section 118 of the *Act* as follows:

> (7) ’pension income’ received by an individual in a taxation year means:
> (a) the total of all amounts each of which is an amount included in computing the individual’s income for the year that is:
> *(iii.1) a payment . . . payable on a periodic basis under a money purchase [DC] provision . . . of a registered pension plan.*

Section 118(7) of the *Act* also includes a definition of “qualified pension income”. However, it is currently not proposed to add variable benefits to this definition. This is important because only taxpayers receiving “qualified pension income” can claim the $2,000 pension income deduction before reaching age 65, and only taxpayers receiving “qualified pension income” can elect to split pension income with a spouse before age 65.

By adding variable benefits to the first definition but not the second, therefore, variable benefits receive different tax treatment than DB pensions.[4] Up to age 65, more tax will be paid on pension income by DC retirees than by DB retirees. It is respectfully submitted that this result is both unfair and unnecessary.

C) Recommendation

To ensure fair and equitable taxation of DB and DC pension payments, it is submitted that variable benefits should be added to the definition of “qualified pension income” in section 118(7) of the Income Tax Act.

D) Reasons

By adding variable benefits to the definition of “pension income” but not “qualified pension

[3] In a phased retirement situation, an employee who reaches age 55 is permitted, with his/her employer’s agreement, to commence retirement benefits while continuing to accrue further tax-deferred benefits.

[4] Payments from DB pension plans are already included in the definition of “qualified pension income”.

income" as provided by Bill C-10, retired members of DC pension plans under the age of 65 will be required to pay more tax on their pension income than retired members of DB pension plans.

It is respectfully submitted that there is no valid policy reason for this unequal treatment.

1. Finance Canada maintains that the age 65 limit is necessary to ensure that only retired taxpayers can claim the pension income deduction and split pension income with their spouse. While this may be necessary for RRIF holders, it is not true for pension plan members. DC plan members cannot receive variable benefits until they retire, just like DB plan members. An age limit is therefore redundant and unnecessary for pension plan members.

2. Finance Canada maintains that DC retirees receiving variable benefits could obtain an unfair tax advantage by varying the level of pension income received from year to year. If this is the concern, it would be relatively simple to impose a limit on the amount of variable benefits that would come within the definition of "qualified pension income". Two examples of possible limits are:

   i. The annual amount that the DC member could have purchased as annuity on retirement;
   ii. Six percent of the balance remaining in the DC retiree's variable benefit account at the end of the immediately preceding year.

   Either of these limits would prevent any unfair tax advantage resulting from payment flexibility.

3. Finance Canada argues that permitting DC retirees to claim the pension income deduction and spit pension income before age 65 would be unfair to RRSP savers. However, RRSP savers can split income by using spousal RRSP's without any age limit. They can also convert their RRSP into an RRIF and begin withdrawals without retiring. An age 65 limit to permit an RRSP saver to claim tax relief as a retiree is therefore reasonable.

4. The tax cost associated with qualifying variable benefits for the pension income deduction and income splitting immediately on retirement would be low as compared to the cost of permitting these same tax benefits to DB retirees. Approximately nine hundred thousand Canadians belong to DC pension plans. This is only about 20% of the 4.5 million taxpayers who belong to DB pension plans in Canada. Further, on average, members of DC pension plans tend to retire later than members of DB pension plans. A typical DC retiree would therefore receive "qualified pension income" for a shorter time before reaching age 65 than a DB retiree.

Until recently, only the four western provinces permitted the payment of variable benefits under their pension legislation. Recently, the Governments of Ontario and Canada have amended their pension legislation to permit variable benefits as well. The unfair tax treatment that will result from the proposed amendments to section 118 (7) of the *Income Tax Act* will therefore have a greater impact going forward. The Government of Canada is encouraged to eliminate this unfairness by including variable benefits in the definition of "qualified pension income".