

April 13, 2011

The Honourable James M. Flaherty  
Department of Finance Canada  
140 O'Connor Street  
Ottawa, ON  
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The Honourable Ted Menzies  
Office of the Minister of State (Finance)  
140 O'Connor Street  
Ottawa, ON  
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Dear Sirs:

We are a group of pension actuaries with vast experience and expertise in the area of Individual Pension Plans (IPPs). We are all Fellows of the Canadian Institute of Actuaries (FCIA) and work for many different actuarial consulting firms across Canada. This is our joint submission to comment on the following two proposed changes in the 2011 Federal Budget tabled on March 22, 2011 with respect to the tax rules for Individual Pension Plans (IPPs):

1. Annual minimum amounts will be required to be withdrawn from IPPs, similar to current minimum withdrawal requirements from Registered Retirement Income Funds (RRIFs), once a plan member attains the age of 72; and
2. Contributions made to an IPP that relate to past years of employment will be required to be funded first out of a plan member's existing Registered Retirement Savings Plan (RRSP) assets or by reducing the individual's accumulated RRSP contribution room before new deductible contributions in relation to the past service may be made.

Our consensus is that these two proposed changes are highly discriminatory and not well conceived. We recommend that they be withdrawn and rescinded. Our recommendations and rationale are outlined in the 1-page Executive Summary immediately following this letter.

In the Exhibit attached, Section A (Page 1 to 3) summarizes the impact of these proposed budget changes. Section B (Pages 4 to 12) contains detailed reasoning, justifications and analyses in support of our recommendations.

It would seem counter productive, in a time when all levels of government are concerned with the level of retirement savings by Canadians being inadequate, that the federal government would want to bring in extremely complicated rules to prevent or restrict the retirement savings of the one sector of the public that is actually prepared to save. These taxpayers, besides being a large part of the engine that makes our economy go, are simply trying to prepare themselves for retirement at a level that is routinely available to employees of large corporations and civil servants.

In the attached Exhibit, we have clarified that the existing funding opportunities available to IPPs are actually "intended pension funding opportunities" rather than "unintended tax deferral opportunities" as claimed in the budget IPP proposals. An IPP is a tax deferral plan and it is not a tax evasion plan. The tax deferral is the government's way of encouraging Canadians to prepare to look after themselves in retirement. In fact, we should change the name from IPP to GIPP (Government and Individual Pension Plan) as it will result in income for both the government and the individual when the individual retires.

We trust you will find our submission to be in order. We are hopeful that you will agree with our positions and accept our recommendations after your review and deliberation. If further information or consultation is required, we will be more than pleased to meet with your staff at their convenience for further discussions.

Respectfully submitted,

**Note – original list submitted April 13, 2011 and subsequently updated May 9, 2011**



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The Honourable James M. Flaherty &  
The Honourable Ted Menzies  
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Proposed Changes to IPPs  
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**Executive Summary**  
**Joint Submission on March 22, 2011 Federal Budget**  
**Proposed Changes to Individual Pension Plans (IPPs)**

We hereby request that the proposed changes to IPPs in the March 22, 2011 federal budget be withdrawn and rescinded for the reasons below. The number in brackets at the end of each point refers to the section and page number in the Exhibit with detailed reasoning, rationale and justifications for our statement and position.

- **Rules Unfair and Highly Discriminatory** - Sound tax policies and rules should promote good behavior and deter bad behavior. The proposed rule on past service contributions to IPPs is unreasonably punitive to taxpayers who have accumulated a significant amount of personal RRSP funds; the more RRSP funds they have, the lesser the past service contribution amount to an IPP. A taxpayer's high personal RRSP balance is likely attributable to the individual making RRSP contributions diligently as well as making sound and prudent investment decisions in the past. These are "good" behaviors the government should promote and reward but the proposed budget rules would penalize them for having past success with their RRSP funds. **(B1 – Page 4 of Exhibit)**
- **No Unintended Tax Deferral Opportunities Exist** - The current rules for tax-assisted retirement savings were introduced by the Conservative government twenty years ago. These are solid rules and policies that have been around for a long time and have been thoroughly tested. There are no existing "unintended tax deferral opportunities" for IPPs as stipulated in the budget paper. **(B2 – Page 8 of Exhibit)**
- **Significantly More Red-Tape Without Any Meaningful Purpose** - There is already in place in the existing tax legislation a solid set of maximum funding valuation rules under Income Tax Regulation 8515 to prohibit excessive funding of "designated plans" – pension plans that are primarily for the benefit of shareholder and highly compensated employees. IPPs as proposed in the budget are a subset of "designated plans". Having another set of new regulations for IPPs would make the rules overly complex and impossible to administer. This is equivalent to introducing significantly more red-tape without any meaningful purpose. **(B3 – Page 10 of Exhibit)**
- **Hurting Our Fragile Economic Recovery** - Finance will spend months and potentially years drafting Notices of Ways and Means Motion to implement these proposed changes, effectively putting important business and financial planning of the small businesses on hold during this entire period. Small businesses are the main engines of our economic growth. Putting so much uncertainty into their business and financial planning would undoubtedly hinder the recovery of our fragile economy to a significant degree. **(B4 – Page 12 of Exhibit)**

**Exhibit to Joint-Submission to Mr. Flaherty & Mr. Menzies**  
**On March 22, 2011 Federal Budget**  
**Proposed Changes to Individual Pension Plans (IPPs)**

The two proposed changes in the 2011 Federal Budget tabled on March 22, 2011 with respect to the tax rules for Individual Pension Plans (IPPs) are as follows:

1. Annual minimum amounts will be required to be withdrawn from IPPs, similar to current minimum withdrawal requirements from Registered Retirement Income Funds (RRIFs), once a plan member attains the age of 72; and
2. Contributions made to an IPP that relate to past years of employment will be required to be funded first out of a plan member's existing Registered Retirement Savings Plan (RRSP) assets or by reducing the individual's accumulated RRSP contribution room before new deductible contributions in relation to the past service may be made.

**Section A - Impact of Proposed IPP Changes**

***Proposed Change #1***

In addition to the defined benefit pension payout which is calculated based on the pensioner's years of service and employment income history with the employer, the new proposed rule would also require a minimum payout of IPP assets equal to the current minimum withdrawal requirements from Registered Retirement Income Funds (RRIFs) once the IPP member has attained the age of 72.

***Proposed Change #2***

The wording in the budget seems to suggest that if the individual has personal RRSP funds and unused RRSP room accumulated in aggregate more than the value of the IPP past service pension, the potential IPP past service funding room is reduced.

Since there were no draft changes to the tax legislation in the Notices of Ways and Means Motions in the budget related to these proposed IPP changes, we do not know how the proposed changes in the budget are going to work exactly. We can only base our interpretation on the literal meanings of the budget wording.

### **Section A - Impact of Proposed IPP Changes (cont'd)**

Below is an example to illustrate our interpretation of the impact of the 2011 Federal Budget on IPPs:

In the example below in respect of the establishment of a new IPP, it is assumed that:

- ◆ The IPP member is age 60 and has twenty years of past service with the employer from 1991 to 2010;
- ◆ For each year of past service the individual had maximum T4 employment income for pension purposes, his pension entitlement would be at the Maximum Pension Limit (MPL) for defined benefit pension plans;
- ◆ The total Past Service Pension Adjustment (PSPA) is \$406,000 for all twenty years of past service, which is satisfied through a qualifying transfer from the member's personal RRSP;
- ◆ The past service actuarial liability (i.e. value of the IPP pension) attributable to the twenty years of past service is \$675,000; and
- ◆ The member has \$750,000 in RRSP funds.

#### Exiting IPP Past Service Tax Rules – i.e. Pre-Budget

The IPP member can transfer \$406,000 from the personal RRSP to the IPP as a Qualifying Transfer (QT) and that would qualify either the member or the employer to make a past service contribution of \$269,000 (\$675,000 of past service actuarial liability less \$406,000 of assets which came from the IPP member's personal RRSP) to cover the funding deficit of the IPP. The IPP member will have \$344,000 funds left (\$750,000 less \$406,000) in the RRSP after IPP implementation.

#### Proposed Changes in March 22, 2011 Federal Budget

The wording in the 2011 Federal Budget is:

"To limit these unintended tax deferral opportunities, Budget 2011 proposes to require that the cost of past service under the terms of an IPP first be satisfied by transfers from RRSP assets belonging to the IPP member or a reduction in the member's accumulated RRSP contribution room before new past service contributions are permitted."

**Section A - Impact of Proposed IPP Changes (cont'd)**

Our interpretation is that since the IPP member has \$750,000 of RRSP funds, more than the \$675,000 required to fund the IPP past service pension, the member must now transfer \$675,000 from the RRSP to pay for the full cost of the IPP past service pension and there would not be any IPP past service contributions permitted. There would only be \$75,000 left in the RRSP after IPP implementation (\$750,000 less \$675,000) instead of the previous \$344,000 amount pre-budget. Effectively, the difference between \$344,000 and \$75,000, i.e. \$269,000 of RRSP funds has been applied against the past service costs instead of \$269,000 of new member or employer tax-deductible pension contributions.

We have prepared Chart #1 attached to illustrate the impact of this new budget proposal. When the member has less than the \$406,000 required transfer amount, past service contribution room is proportionately reduced. Under existing pre-budget rules, if the member has more than the required transfer amount in personal RRSP assets, the past service contribution room is not being affected at all. With the new budget past service contribution proposed rule, any RRSP funds in excess of the \$406,000 amount required would reduce the amount of past service contribution available.

## **Section B - Detailed Reasoning, Justifications and Analyses**

### **Section B1 – Rules Are Unfair and Highly Discriminatory**

#### ***Proposed Change #1***

This proposed rule requires a minimum payout equal to the RRIF percentages as applied to the amount of IPP assets. The potential problems are:

- IPP is a trust arrangement to deliver a defined benefit promise to the employee. The residual assets may revert to the employer or the pension plan sponsor upon wind-up of the plan after all defined benefit obligations have been fulfilled. Hence the residual beneficiary of the pension trust quite often is not the same as the IPP member. Within the proposed definition of IPP, an IPP member “related” for tax purposes to an employer that participates under the pension plan does not mean that the person or a related person owns 100% of the employer and thus is entitled to 100% of the residual surplus. By mandating such a RRIF minimum payment after an IPP member has attained age 72, the government is effectively forcing payment of IPP trust assets to someone who is not even entitled to such trust assets – definitely a violation of pension trust law.
  
- RRIF minimum payouts are intended for Defined Contribution (DC) schemes and are not suitable for Defined Benefit (DB) pension plans such as IPPs. Mixing DC and DB plan rules would only lead to further problems. This proposed rule is intended to prevent the abusive use of an IPP whereby the member’s entitlement under a former employer’s defined benefit pension plan is transferred to the IPP. A better alternative rule would be to require the payment of pension benefits attributable to the former employer service to be based on the same rules as the former employer pension plan, except that if the pension amount is based on final average earnings of the member, the pension amount is to be determined using the pensionable income history with the former employer and indexed to increases in the Aggregate Industrial Wage (AIW) Index between the date of termination from the former employer and the eventual retirement date.

## **Section B1 – Rules Are Unfair and Highly Discriminatory (cont'd)**

- RRIF withdrawal rules were designed at a time when interest rates were much higher and they are quite unrealistic in the current lower yield environment. The withdrawal rate of 7.4% at age 71 is much too high as compared to a rate of 5% at age 70. The whole RRIF required withdrawal rule is antiquated as people currently live longer and their retirement savings must also last longer. Having RRIF rules that significantly deplete the capital base when people have many years left in their life expectancy imposes significant financial risks to their retirement savings and future pension adequacy. Requiring an IPP, a defined benefit pension plan to pay out pension benefits based on RRIF minimum withdrawal percentages on pension assets also breaches the security of the pension promise provided to the member, the main reason why the individual desired and elected defined benefit pension coverage to begin with.
- Enforcing RRIF minimum payouts after age 72 will likely be contravening federal or provincial pension legislation as premature withdrawal of funds would impair the ability of the pension plan to fulfill its defined benefit obligation in the future.

### ***Proposed Change #2***

- The rule is highly discriminatory against individuals who have a significant balance in their personal RRSP. These are the individuals who are most adversely affected by the new proposed IPP past service contribution rule in the budget as any amount of RRSP funds they have in excess of the PSPA amount will cut into their past service contribution room. However, the government must understand where these excess RRSP funds originated.
  - The current pension tax legislation was introduced in 1990. The requirement to meet the PSPA requirement prior to the provision of past service benefits by the employer only started with the 1990 year. It would be highly unfair to penalize the IPP past service funding opportunities for an individual if these “excess” RRSP funds originated from their pre-1990 RRSP contributions.

## **Section B1 – Rules Are Unfair and Highly Discriminatory (cont'd)**

- The current tax legislation mandates that the PSPA qualifying transfer amount from RRSP to the IPP must come from the individual's personal RRSP, and cannot come from a spousal RRSP. If making personal RRSP contributions rather than spousal RRSP contributions in the past resulted in excess RRSP funds currently relative to the required PSPA transfer amount, this new budget rule is effectively punishing the individual who in the past made a conscious decision to contribute to a personal RRSP and not a spousal RRSP.
- A taxpayer's high personal RRSP balance is likely attributable to the individual making RRSP contributions diligently as well as making sound and prudent investment decisions in the past. These are "good" behaviors the government should promote and reward but the proposed budget rules would penalize them for having past success with their RRSP funds.
- Defined benefit pension payouts are very rigid and do not offer any flexibility other than the inflation adjustment based on increases in the Consumer Price Index (CPI) each year. People do need the flexibility of the RRSP/RRIF funds to supplement the flexibility in their post-retirement consumption. Forcing these individuals to give up all their RRSP funds into a locked-in pension environment is effectively taking away their much needed post-retirement consumption flexibility.
- Under the proposed new rule, the government can now dictate how much pension funding an IPP member deserves based on their personal RRSP balance. This would establish a very dangerous precedent in setting tax legislation as the application of a new tax rule is highly sensitive to what the taxpayer did in the past without taking into due consideration how the taxpayer got into that position. For example, under the proposed budget past service rule, the following three separate classes of IPP citizens are created based on what they have done with their personal RRSP funds in the past which have no relevance at all to whether they should be eligible for past service pension funding:

**Section B1 – Rules Are Unfair and Highly Discriminatory (cont'd)**

- For a diligent saver who started RRSP savings early and made wise and prudent investment decisions to grow an RRSP portfolio to a significant amount, such an individual will get penalized the most because the government is saying they don't need any more pension funding.
- For a person who started RRSP savings late or potentially even made some questionable or unwise investment decisions, or someone who was fortunate to decide to make spousal RRSP contributions rather than personal RRSP contributions in the past in anticipation of this budget proposal, this person will benefit the most as they just barely have enough to meet the PSPA Qualifying Transfer requirement so the government will give this person the maximum IPP past service deduction.
- People who lost their lifetime RRSP savings through bad investment decisions are the most unfortunate as they will not be able to meet the PSPA requirement to qualify for any past service funding at all.

## **Section B2 – No Unintended Tax Deferral Opportunities Exist**

It is important that the government can truly differentiate between “intended” pension funding opportunities and “unintended” tax deferral opportunities under an IPP. Having funding room available under an IPP is due to the nature of the promised defined benefits and the funding requirements of the plan based on the age and income profile of the IPP member. This is the difference between the actuarial value of the promised pension as compared to the amount of assets available as certified by an actuary. It is not related to any “unintended tax deferral opportunities” as claimed in the budget paper.

In the example presented in the previous section, the past service contribution of \$269,000 available to a 60-year old member with 20 years of eligible past service under an IPP is not any different from a defined benefit pension plan in Canada recognizing past service for a member with such age and income profile and funding for such promised pension. If this “unintended tax deferral opportunities” claim put forth by the government has any merit, then the huge deficits under any defined benefit pension plans in Canada as a result of the underperformance of pension fund assets in recent years must be recognized as “unintended tax deferral opportunities” also.

Within the current tax legislation prior to the budget, there already exists a definition for “Designated Plans” – pension plans that are primarily for the benefit of connected persons and highly compensated employee. An IPP is by definition a Designated Plan and so subject to the maximum funding valuation rules in Income Tax Regulation 8515 for Designated Plans. ITR 8515 prescribes actuarial assumptions that the actuary must use for valuation purposes for Designated Plans, the contributions to these Designated Plans are already substantially controlled and suppressed as compared to a defined pension plan for regular employees.

The main prescribed assumptions are as follows:

- Interest rate is 7.5% per annum;
- Retirement is at age 65;
- Maximum post-retirement indexing is at annual increases in the Consumer Price Index (CPI) less 1%; and
- Spouse is the same age as the member (this rule is effectively saying that even if the member has a much younger spouse, the plan is not allowed to reflect the significant cost of the survivor pension until pension benefits have commenced).

**Section B2 – No Unintended Tax Deferral Opportunities Exist (cont'd)**

Some of these prescribed assumptions are already highly discriminatory and result in these Designated Plans not being as adequately funded vis-à-vis regular defined benefit pension plans. The funding opportunities for IPPs are restricted by the Designated Plan funding restrictions in Income Tax Regulation 8515. As a result, no unintended tax deferral opportunities exist. The government should not present “intended funding opportunities under defined benefit pension plans” to the public as “unintended tax deferral opportunities” for IPPs.

### **Section B3 – Significantly More Red-Tape Without Any Meaningful Purpose**

To begin with, the proposed budget changes came up with a new definition for an IPP to differentiate it from a Designated Plan. In the budget paper, it is presented as:

“For this purpose, an IPP will be a defined benefit RPP (i.e. Registered Pension Plan):

- With three or fewer members, if at least one member is “related” for tax purposes to an employer that participates under the pension plan; or
- That is a Designated Plan, if it is reasonable to conclude that the rights of one or more members under the plan exist primarily to avoid this new definition.”

Pension rules are now so complex and in adding another layer of complexity with a new definition for IPP, there would be a significant increase in the red-tape without accomplishing any meaningful purpose. There are many challenges and obstacles for the government to implement the proposed budget changes, which may include but are not limited to the following:

- ◆ Obtaining RRSP account information which the government does not currently have on record. The taxpayers would not disclose such sensitive, confidential information to CRA voluntarily. The government likely will have to rely on the IPP member to come forth with complete honesty to provide them with accurate information on how much RRSP funds the IPP member has.
- ◆ There is no requirement that the employer must recognize all years of past service at implementation. How are Finance and CRA going to set the rules? Take a proportionate amount of the existing RRSP based on the ratio of years of past service being recognized vs. all remaining years of past service eligible but not yet recognized? Bear in mind that the RRSP value could be highly volatile and having enough RRSP funds currently to have all years of past service recognized offers no assurance that there will be sufficient RRSP funds to have the remaining years recognized in the future if the employer decided not to recognize all years of eligible past service now. This will further lead to a lot of administration complexity in the future.

**Section B3 – Significantly More Red-Tape Without Any Meaningful Purpose  
(cont'd)**

- ◆ The RRSP may be worth a million dollars one day but much less (or even \$0 in some extreme cases) shortly thereafter. It is not realistic for the government to assess whether the person's pension has been sufficiently covered based on their current RRSP balance so no further IPP contribution room is needed. It should also be noted that the ITR 8515 maximum funding valuation actuarial liability often is not sufficient to properly fund a defined benefit pension as it is significantly less than the cost of purchasing an annuity.

In all previous federal budgets, all the draft legislative changes were ready and available in the budget paper. This time they only have the following in the Notices of Ways and Means Motions:

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**Individual Pension Plans**

(22) That the provisions of the Act relating to registered pension plans be modified in accordance with the proposals related to Individual Pension Plans described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

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This is more a reflection of the complexity of the existing pension tax legislation as the Department of Finance was not able to draft the legislative changes in time for this budget. This would likely take the Department of Finance months or even years to draft the legislative changes. Given the fact that there are no real "unintended tax deferral opportunities", this may be too much red-tape to be introduced for no apparent and meaningful purpose.

#### **Section B4 – Hurting Our Fragile Economic Recovery**

The Department of Finance will spend months and potentially years drafting legislative changes for the IPP proposals, effectively putting important business and financial planning of the small businesses on hold during this entire period. Small businesses are the main engines of our future economic recovery and growth. Putting so much uncertainty into their business and financial planning would undoubtedly hinder the fragile recovery of our economy significantly.

**IPP Past Service Funding Room Pre-Budget v. Post-Budget  
For an individual age 60 with past service from 1991 at MPL**

