

When a 'pension' is not a pension

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We normally take for granted the fact that registering a pension plan, even for a very small company, is a routine matter. But two decisions of the Federal Court of Appeal show that such plans can be attacked if they are not for "valid" purposes.

In one case, workers near normal retirement age left large public-sector employers and established their own corporation. One person was hired by the corporation, and it sponsored an individual pension plan (IPP) for him that recognized the prior service under the public-sector pension plan. Once the IPP was established, the full commuted value of the worker's prior pension was transferred to the IPP, as the transfer rules of the Income Tax Act do not limit transfers from one defined-benefit plan to another.

In published documents, the CRA said the agency is concerned that while many of these IPPs may be acceptable, others may not meet the requirements for registration under the act.

"The primary purpose of every registered pension plan must be to provide retirement benefits to individuals in respect of their service with the employer who has established the plan. This requirement is reflected in the Act as a condition of registration. If it is subsequently determined that a plan is established for a reason other than this primary purpose, it will cease to qualify for registration under the Act."

The CRA took the position that there was no actual employment relationship between the worker and the company that set up the plan. Without employment, there can be no basis for a pension plan, which is by definition linked to the earning of employment income.

In both cases, the "employee" reported low earnings and on the basis of this, large amounts of income of the plans were characterized as an actuarial surplus.

The CRA determined that the main purpose of establishing the IPP was to transfer funds from the worker's earlier pension plan. After the transfer, the IPP held significant surplus assets

Said the CRA: "As mentioned earlier, if the primary purpose of a plan is for any reason other than providing retirement benefits with respect to the individual's service as an employee with the current employer, the plan will fail to qualify for registered status."

The Court of Appeal issued two judgements going over the facts in great detail and finally concluded in both cases that the primary purpose was to access pension capital that would be under the control of a giant pension plan and move it to a private plan where the funds could be accessed essentially without rules.

In both cases, a particular pension advisor was behind the plan, which certainly looked effective on paper but didn't take into account the CRA's interpretation of the rules. Just because a pension plan is initially registered does not prevent the agency from taking another look. In these cases, the second look cost the individual heavily as the inappropriate transfer ended up being fully taxed to them as a one-time distribution from a pension plan? the original public-service plans to which they belonged.

Like many other tax plans, if the result looks almost too good to be true, it makes sense to consult somebody who is independent for a second opinion.

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