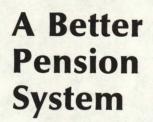
A Better Pension System

Saving for Retirement



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Preface

Canadians have waited a long time for the promise of pension reform to be fulfilled. During the protracted public debate that spanned more than a decade, it became increasingly urgent to translate the long years of study into positive action to help Canadians build greater security for their retirement years.

More than anything else, what was needed was both the commitment and the will of the Canadian government.

Since coming to office the Progressive Conservative government has demonstrated that commitment and will. It has moved decisively to put in place a comprehensive program of pension reform that will ensure a more responsive, more equitable retirement income system for Canada and Canadians.

This publication outlines major changes already legislated and important further measures that will be implemented to improve the tax treatment of retirement saving.

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Table of Contents

Introduction A Diversified Pension System The Need for Comprehensive Reform A Record of Progress Further Reform: More Equitable Tax Treatment	1 1 2 3 4
A Comprehensive Action Program Improved Minimum Standards for Private Pension Plans A Strengthened Canada Pension Plan New Flexibility for the Withdrawal of RRSP Savings An Improved System of Tax Treatment for Retirement Savings	7 7 9 10 10
The Next Step: More Equitable Tax Treatment for Retirement Saving Retirement Saving and the Tax System The Private Pension System Current Tax Treatment of Retirement Savings Improved Tax Treatment A Fairer RRSP Limit One Set of Maximum Limits for All RRSP Contribution Limits	13 13 14 15 15 16 17
An Improved System for Taxpayers Taxpayers Contributing Only to RRSPs Members of Money Purchase Pension Plans Members of Defined Benefit Pension Plans Partial-Year Pension Plan Membership	19 19 20 21 22
The Role of Employers	23
Other Related Issues Pension Registration Rules Additional Rules for DPSPs Supplementary Retirement Compensation Arrangements Additional Voluntary Contributions (AVCs) Transfer of Pension Income to an RRSP	25 25 25 26 26 26
Conclusion	27
Glossary of Terms	29

Introduction

A Diversified Pension System

Canada's retirement income system rests on a diversified base made up of four complementary parts:

• Basic income support for the elderly:

and the broad area of contributory pensions and retirement savings with three major components:

- the Canada Pension Plan (CPP) and Quebec Pension Plan (OPP):
- public and private sector employee pension plans; and
- a variety of tax measures to encourage retirement saving.

Important steps have been taken to assist those who need help most through basic income programs – the elderly poor. Shortly after taking office, the government acted to extend eligibility for the spouse's allowance to all widows and widowers aged 60-64. At the same time, steps were taken to make veterans' pensions more equitable and generous.

In the actions it has taken to improve the total pension system, the government seeks to balance the collective social responsibility of Canadians to ensure basic levels of income for the needy elderly with the equally important responsibility of Canadians to provide for their own retirement through the exercise of individual initiative and self-reliance.

Canadians believe, and the government concurs, that the opportunity for citizens to take personal decisions about how, and to what extent, they want to provide retirement income for themselves is at the heart of a free and democratic society.

That is why the government believes that saving for retirement should be encouraged by the tax system under a basic principle: within clear limits, retirement income should be subject to tax when it is received, not when it is set aside for retirement.

The Need for Comprehensive Reform

In recent years social, demographic and economic trends such as the aging of the population and the emergence of women as full participants in the work force have underscored the need for change in Canada's retirement income system. For example:

- The benefit structure of the Canada Pension Plan and the Quebec Pension Plan needed revision to recognize modern social reality.
- Many private pension plans provided inadequate or no survivor benefits.
- Many part-time workers have been unable to join pension plans despite long service with the same employer.
- Many members of private pension plans who change jobs frequently have ended up with very little pension income because they have not worked long enough in any one plan to acquire a vested right to pension benefits.
- Many workers have permanently lost the opportunity of tax assistance for retirement saving because more immediate financial pressures prevented maximum contributions in a given year.
- The annual dollar limits on contributions to registered retirement savings plans (RRSPs) and other money purchase plans have provided substantially less tax assistance than provided under the limits on defined benefit plans. For many taxpayers not in pension plans, maximum contributions to an RRSP would purchase only one-third of the maximum pension that could be earned through a defined benefit plan.

This is not only unfair; it can also act as a disincentive to self-employment and small business creation.

 Rules governing the withdrawal and investment management of funds in RRSPs and registered retirement income funds (RRIFs) were unduly restrictive.

The need for change in the retirement income system – comprehensive, far-reaching change – became overwhelming.

Pension reform is a massive undertaking. It has required not a collection of changes for the sake of change, but a careful, co-ordinated strengthening of each component of the system.

The government is proceeding with comprehensive pension reform because the quality of retirement life for countless Canadians, now and in the future, depends on it.

Today's reforms will enable this and future generations to grow old in the assurance of a better, more secure life in retirement.

They will bring the pension system into better accord with the needs of a more mobile labour force in a rapidly-evolving economy.

And they will help ensure a growing pool of capital for investment in the growth Canada needs to create jobs and build greater economic security for future generations.

A Record of Progress

The government has already made considerable headway. A comprehensive program of pension reform designed to bring greater equity and flexibility to Canada's retirement income system is substantially in place.

As part of this co-ordinated program of action, the financing of the Canada Pension Plan has been put on a sound, long-term basis and significant improvements in benefits will take effect January 1, 1987.

Landmark changes to the *Pension Benefits Standards Act* (PBSA) governing minimum standards for private pension plans under federal jurisdiction will also come into effect January 1, 1987. The changes, which represent a dramatic breakthrough in pension fairness, will be particularly beneficial to part-time workers, women in the work force and spouses of pension plan members.

New flexibility for the management of retirement savings has also been provided.

While the federal government can show direction and leadership in the pension field, provincial governments share the responsibility for the Canada Pension Plan and have considerable responsibility for implementing the reform of private pension plans. The co-operation of the provinces has been a vital element in the progress made to date.

Many provinces have agreed to enact changes parallel with the federal PBSA reforms. Harmonized provincial action will affect the millions of Canadians who come under the provincial pension umbrella. It will help ensure a high degree of uniformity in pension standards across the country so that Canadians have the same pension-building opportunities wherever they live and work.

Further Reform: More Equitable Tax Treatment

A further major step in the pension reform agenda undertaken when the government came to office is now being taken with the implementation of more equitable and enhanced tax treatment for retirement saving. In the May 1985 budget the government proposed a thorough overhaul of the system of tax treatment for contributions to registered pension plans (RPPs), deferred profit sharing plans (DPSPs) and registered retirement savings plans (RRSPs).

The proposals provide for substantial improvement in the fairness of tax treatment for retirement saving and in the flexibility Canadians will have to provide for their retirement income security.

Although the proposals are complex, they are based on three simple principles:

- 1. The amount of tax assistance available should be comparable for individuals with the same income, regardless of whether they belong to a defined benefit plan, an employer-sponsored money purchase plan, or make their own retirement savings arrangements through RRSPs. The maximum dollar contribution limits for money purchase plans are therefore being raised to a level that will provide tax assistance comparable to that now available through defined benefit plans.
- 2. No more tax assistance than this should be available. Equitable treatment also requires tightening the rules to preclude opportunities that have existed to obtain tax assistance for retirement savings in excess of the maximum limits.
- 3. Individuals should have greater flexibility in timing their pension contributions. Extraordinary circumstances may make it impossible to take full advantage of available tax assistance in any given year. The opportunity to build a reasonable pension should not be permanently lost.

Having made its proposals public, the government consulted extensively with employers, employees, union representatives and the pension industry. These consultations confirmed that the proposals substantially improve the tax treatment of retirement saving in a fairer, more flexible system.

The government has responded to private sector requests for further refinement in the interests of even greater fairness. The result is a revised method of calculating RRSP contribution limits for members of defined benefit plans.

This publication outlines major improvements being made in the total retirement saving system and gives a general description of the new rules for more equitable tax treatment, including key improvements made following consultations with the pension industry. A more detailed description can be found in the document entitled *Improved Tax Treatment: Detailed Rules and Procedures*.

A Comprehensive Action Program

Improved Minimum Standards for Private Pension Plans

Strengthened minimum standards for private pension plans form a key part of the government's comprehensive approach to improving the fairness and flexibility of the pension system in Canada.

Effective January 1, 1987, a number of important changes come into effect for pension plans in federal jurisdiction. Provincial governments are considering parallel reforms at an early date.

Among the key changes:

Vesting and Locking-In: Under the old standards, an employee's right to pension benefits is acquired – "vested" – only after 10 years of service or membership in a plan and at age 45. With the new standards, an employee's right to pension benefits, including any part financed by the employer's contributions, will be vested and locked in after two years of participation in a pension plan. This will ensure that workers who change jobs will be able to save more effectively for retirement.

Improved Portability: A major shortcoming of the pension system has been that workers who change jobs often are prevented from taking their pension entitlements with them to their new employment. As of January 1, 1987, workers who change jobs will have a number of options. They may leave pension entitlements with their former employer. They may opt to transfer them to their new employer's pension plan with that employer's consent. Or they may transfer them to a locked-in RRSP.

Employer Contributions: In some pension plans, employers contribute little or nothing to workers' pensions until after many years of service. This has meant that workers who change jobs can end up paying most or all of the cost of their pensions. Under the new standards, employers will be required to pay at least half the value of a pension earned when a worker changes jobs or retires. Alternatively, the employer will have the option to index a worker's deferred benefits. Minimum employer contributions will ensure that costs are shared fairly between employees and employers and that both short- and long-service workers are treated fairly.

Refunding Provisions: The present system of standards contains no provisions for refunding employee contributions. The new standards require pension plans to refund the contributions of employees whose benefits are not vested when they leave. Employers will also be required to pay reasonable interest on employee contributions.

Eligibility for Plan Membership: Under the old standards, even where employer-sponsored plans are available, restrictions may prevent some full-time workers from joining the plan. As a general rule, part-time workers are not eligible. Effective January 1, 1987, pension plans will be open to all workers. Full-time workers will be eligible to join a pension plan after two years of service with their employer. Part-time workers will be eligible if they earn more than 35 per cent of the average industrial wage in each of two consecutive years.

Early Retirement: Members of a pension plan wishing to retire early have been eligible for a pension only if their plan has an early retirement provision. Under the new standards, pension plan members will be able to opt for early retirement 10 years before normal retirement age.

Improving Pensions for Women: Working women will benefit from the government's proposals to improve pension plans by strengthening the requirements relating to vesting, portability and membership eligibility. A number of other pension reform measures will be of particular benefit to women.

Survivor Benefits: Few pension plans have provided a pension or pension benefits to the spouse of a plan member who dies. Where survivor benefits have been paid, these have usually been terminated if the survivor remarries. To provide greater financial security for spouses of pension plan members, most of whom are women, the new standards will require that pension plans:

- provide benefits to surviving spouses of pensioners amounting to at least 60 per cent of the full pension that was being paid;
- provide the full value of the pension earned by a plan member who dies prior to retirement;
- continue to pay survivor benefits if a surviving spouse remarries.

Splitting of Pension Benefits on Marriage Breakdown: Pension standards have not generally required pension credits or pensions already being paid to be split upon marriage breakdown. The new standards allow the value of pension entitlements to be divided on marriage breakdown.

Equal Pension Benefits for Women and Men: Some pension plans have paid lower periodic benefits to women than to men even though they have retired under identical circumstances. Under the new standards, pension plans must provide equal pensions to women and men retiring under the same circumstances.

Inflation Protection: The government recognizes the need to maintain the purchasing power of pensions. However, a consensus on inflation protection standards has not been reached with the provinces and the private sector.

Therefore, the government will encourage pension plans to build upon the voluntary approach used by a majority of large employers. All pension plans under federal jurisdiction will be encouraged to provide voluntary benefit increases to pensioners and workers with deferred benefits and to report information on voluntary inflation adjustments and on the source of funds used to make these increases. Statistical information will be made public. The government will monitor the response of pension plans to this approach and will continue discussions with provincial governments and other interested parties in the light of these responses.

Information Disclosure and Employee Participation: Current requirements for pension plans to disclose information to plan members are minimal. With the new standards, pension plans will be required to disclose information about earned benefits and accumulated contributions to plan members and their spouses every year. Representation by plan members and pensioners on pension management committees will also be required, if requested by a majority of members.

A Strengthened Canada Pension Plan

Safeguarding the Plan's Financial Health: An aging population and the maturing of the Canada Pension Plan mean that more pensioners will be drawing benefits in the future than in the past. There had been concern for some years that the fund would be totally depleted by the year 2003 if current premium rates were not increased and benefits remained unchanged. With the necessary support of provincial governments, a new financing arrangement is being put in place to ensure the financial health of the CPP in the decades to come. These changes will result in each generation of working Canadians contributing more fairly to the cost of the benefits they themselves eventually receive.

Important Improvements in Benefits: A number of benefit improvements are being implemented, including measures to parallel and complement improved minimum standards for private pensions. The changes include:

• flexibility to start drawing CPP pensions between age 60 and 70, with appropriate actuarial adjustments;

- enhanced disability benefits and easing of eligibility requirements;
- changes of particular interest to women, including new rules for credit splitting on marriage breakdown and pension splitting on retirement;
- continued survivor benefits if a widow or widower remarries, and restoration of the right to receive such benefits for those who have lost them.

These changes come into effect January 1, 1987.

New Flexibility for the Withdrawal of RRSP Savings

Greater flexibility has been provided for the management of retirement savings and their disposition on withdrawal from RRSPs, including more flexible rules governing registered retirement income funds (RRIFs).

The maximum limit on annual RRIF payouts has been removed. An individual is now allowed to withdraw any amount in excess of the current yearly minimum. The new rule requires only that the RRIF holder withdraw each year a minimum amount equal to the amount in the plan at the beginning of the year divided by the number of years to age 90 of the individual or his or her spouse. Annual withdrawals are included in taxable income.

The limit of one RRIF per individual has been eliminated, permitting greater diversification of investments.

Payments from an RRIF will be allowed to start at any time after purchase of the RRIF, instead of the next calendar year.

An Improved System of Tax Treatment for Retirement Savings

In the May 1985 budget the government proposed a number of measures to reform the system of tax treatment for contributions to registered pension plans, deferred profit sharing plans and registered retirement savings plans.

The proposals included:

- a phased-in system of increased limits for RRSPs and other money purchase plans to put them on a par with defined benefit plans;
- a seven-year carry-forward provision for individuals who do not use their allowable RRSP contribution fully in any one year, a major improvement in flexibility and pension-building capacity; and

• a \$2,000 limit on RRSP contributions by members of defined benefit pension plans, to recognize that not all such plans provide maximum benefits.

Extensive consultations with employers, employees, union representatives and pension industry professionals confirmed that the system of tax treatment for retirement saving would be greatly improved as a result of implementing these proposals. The consultations also made clear, however, that the proposed \$2,000 limit on RRSP contributions by members of defined benefit plans should be modified to reflect the differences in benefit rates among such plans.

In response to these representations, the government delayed full implementation of its pension reform proposals while new options were considered in further consultation with the pension industry.

The measures now being announced reflect the results of this consultation. They constitute a further major step in the improvement of Canada's total pension system undertaken by the government since coming to office.

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The Next Step: More Equitable Tax Treatment for Retirement Saving

Retirement Saving and the Tax System

Saving for retirement is encouraged by the tax system through the application of a simple principle:

Within clear limits, income set aside for retirement should be taxed when it is received, not when it is saved. The effect is to defer taxation on both the original amounts saved and on the growth of those savings in the years prior to retirement.

The benefits to individuals of saving for retirement in this way are obvious. By building adequate retirement incomes, Canadians build a stronger sense of personal financial security and self-reliance for the years when their income from employment has ended.

Encouraging retirement saving in this way has equally important benefits to Canadian society as a whole. Canada will be better able to meet the challenge of caring for a rapidly aging population in the coming decades if more and more of its citizens are able to provide for their retirement needs.

Canada is still a capital-intensive country with a strong need for a high personal savings rate to support economic progress. Increased retirement savings will expand the pool of domestic capital needed to finance the economic growth that will ultimately determine Canada's capacity to meet the needs of its future populations – young and old alike.

The Private Pension System

For the most part, Canadians save for retirement through two types of plans: registered pension plans (RPPs) and registered retirement savings plans (RRSPs). Tax assistance is also provided where retirement benefits are provided through deferred profit sharing plans (DPSPs) and retiring allowances.

There are two basic types of registered pension plans: defined benefit plans and money purchase plans.

Under a defined benefit plan the employer or plan sponsor promises a certain level of pension, specified as a flat dollar amount or as a set percentage of income earned for each year of pensionable service. For example, a 2-per-cent defined benefit plan with a 35-year maximum contribution period would yield a pension equal to 70 per cent (2 per cent \times 35 years) of the income level on which the pension is based. Most Canadian workers in RPPs belong to defined benefit plans.

A money purchase plan provides whatever pension income the accumulated contributions and return on investment in the plan will buy at retirement. Money purchase plans may be employer-sponsored RPPs or DPSPs, or they may be individual RRSPs.

Current Tax Treatment of Retirement Savings

In order to qualify for tax assistance, an employer-sponsored pension plan must be registered with Revenue Canada. A condition of registration is that the pension payable under the plan must be limited to 2 per cent of earnings per year of service to a maximum of \$1,715 per year, which equals \$60,025 for a 35-year career. These are two consequences of this condition.

- 1. The average annual contribution required over a career to purchase a \$60,000 pension is about \$15,500. This upper limit for registered defined benefit plans is therefore comparable to an annual contribution limit of \$15,500 for some employees, whereas annual limits on RRSPs and other money purchase plans are currently \$7,500 or less.
- 2. In cases where registered plans result in tax assistance for pensions of some members that exceed \$60,000, there is no effective way of denying tax assistance to such high income individuals short of deregistering the entire plan, which would penalize all employees.

Both these consequences have led to inequities that need to be addressed.

In the past, contributions by individuals to a defined benefit RPP could be deducted from taxable income only to the limit of \$3,500 a year. As part of the transition to the more equitable system proposed in May 1985, this limit was removed beginning with taxation year 1986.

Contributions to RRSPs by participants in RPPs have been limited to \$3,500 minus the amount contributed to the RPP during the year – with the total not to exceed 20 per cent of earnings.

Prior to 1986, Canadian workers who were not members of an RPP were permitted to contribute up to \$5,500 to an RRSP, subject to the 20-per-cent limit. The maximum allowable contribution was raised to \$7,500 for the 1986 taxation year as part of the transition to a more equitable system.

Canadians not in employer-sponsored plans are at a particular disadvantage under the current rules. The \$5,500 ceiling for those not in RPPs or DPSPs had remained unchanged for 10 years until it was increased in 1986. In recent years, this ceiling provided as little as about one-third of the tax-assisted pension-building capacity available to persons in defined benefit plans.

Improved Tax Treatment

The new system of tax treatment for retirement savings will ensure equitable tax treatment among contributors to different kinds of retirement savings plans. It will also greatly enhance flexibility in retirement saving, particularly by permitting the carry-forward of unused deduction entitlements.

For various reasons, taxpayers may not be able to use allowable RRSP contribution room in any given year. For example, younger taxpayers, saving for homes or other major purchases, may have to wait for several years before beginning to save for retirement. Individuals with fluctuating incomes may also be unable to make full use of allowable contribution room in a given year.

The May 1985 proposal to permit the carry-forward of unused RRSP contribution room for seven years continues without change. Unused RRSP contribution room from 1988 and beyond will be usable in the following seven years.

This represents a major increase in flexibility for retirement saving and will result in effectively more generous contribution limits for millions of Canadians who would otherwise lose available RRSP contribution room that they will need to build adequate retirement income.

A Fairer RRSP Limit

A revised method of calculating RRSP contribution limits for members of defined benefit pension plans has been incorporated into the new rules. The new limit will vary with the benefit rate – that is, with the pension-building capacity of the pension plan – to ensure equitable access to tax assistance.

The result will be that defined benefit plan members with similar incomes but different pension benefit rates will have access to comparable levels of tax assistance. This will help them build comparable retirement incomes.

To make it easier for individuals to know their RRSP contribution room, Revenue Canada will calculate the RRSP limit for each taxpayer, using information provided by employers and available on individual tax returns. A personalized statement of available contribution room, including carryforward amounts, and showing the calculation, will be sent to each taxpayer before the end of each year, beginning in 1988.

To permit the government to provide this important service, beginning in 1988 allowable RRSP contributions will be based on the previous year's earnings. Taxpayers will receive a notice of available RRSP contribution room, based on 1987 income and pension data, in the latter part of 1988. They will have until the usual end-of-February deadline in 1989 to make RRSP contributions for the 1988 taxation year.

The new method of calculating RRSP contribution room also permits a number of other improvements in tax assistance provisions:

- All taxpayers will have access to tax assistance up to the same comprehensive limit of 18 per cent of earnings.
- All unused room under the 18-per-cent limit can be carried forward for up to seven years.
- Individuals who belong to a pension plan for only part of a year will no longer be placed at a disadvantage.
- The deduction limits will accommodate in an equitable manner a wide variety of employer-sponsored pension, profit-sharing and thrift arrangements.

The granting of some credits for past service will be tested against contribution room available under the carry-forward provision to ensure that individuals do not obtain tax assistance in excess of the limits.

Under a new provision, contribution room may be restored in some instances where employees leave a plan without retaining rights to pension benefits.

One Set of Maximum Limits for All

One set of maximum limits for tax assistance for retirement saving – 18 per cent of earned income to a dollar limit – will be phased in over the balance of the decade. This limit will apply to total contributions or benefits accrued under all registered retirement savings vehicles. To the extent this room is not fully used with an employer-sponsored pension plan, an individual will be able to contribute the balance to an RRSP.

This comprehensive new system of maximum limits on tax assistance for retirement saving will ensure that all employees at comparable income levels have access to comparable tax assistance, regardless of what type of pension plan they belong to.

To permit an orderly phase-in of the new system of calculating RRSP contribution room for taxpayers, the contribution limits for employer-sponsored plans in 1987 will continue at 1986 levels.

From 1988, the phase-in of higher maximum limits for total pension plan tax assistance will proceed as set out in the May 1985 budget proposal, with a limit of 18 per cent of earned income to the prescribed dollar maximum, as follows:

1988	1989	1990
\$11,500	\$13,500	\$15,500

The 18-per-cent limit was chosen because it is the percentage of earnings required to be set aside each year to build a pension of 60 to 70 per cent of income – a level appropriate for the tax system to support.

By 1990, the maximum dollar contribution limit will have reached the level required to purchase a \$60,000 pension at retirement. The adjustment of the dollar limits on contributions and pensions beyond 1990 is being reviewed in the broader context of tax reform.

RRSP Contribution Limits

The RRSP contribution room for a year for all taxpayers will be 18 per cent of previous year earnings minus a "pension adjustment" amount representing the proportion of the total contribution limit used up by pension or DPSP benefits in the year.

In 1987, RRSP contribution limits will continue at 1986 levels. Beginning in 1988, RRSP contribution limits will lag one year behind total pension contribution limits in order to accord with the earnings on which they are based. The limits for RRSP contributions will rise as follows:

1988	1989	1990	1991
\$9,500	\$11,500	\$13,500	\$15,500

For taxpayers contributing only to RRSPs and accruing no RPP benefits during the previous year, no pension adjustment will apply – contribution room will be 18 per cent of the previous year's earnings up to the maximum.

For participants in money purchase pension plans and DPSPs, RRSP contribution room will be 18 per cent of earned income to the prescribed maximum minus a pension adjustment amount which will simply be the total of the employee and employer contributions to the money purchase plan or DPSP in the previous year.

For defined benefit plan members, RRSP contribution room will be 18 per cent of earned income to the prescribed maximum minus a pension adjustment amount which reflects the benefits accrued in the preceding year under the defined benefit plan.

Employers will be required to report this pension adjustment amount annually to Revenue Canada, which will use it and earnings information from individual tax returns to make the calculation of RRSP contribution room for each taxpayer.

An Improved System for Taxpayers

Taxpayers Contributing Only to RRSPs

The new system of rising contribution limits redresses the fundamental unfairness that has existed for those without access to employer-sponsored plans.

Now instead of losing pension contribution room, such individuals will have the same scope for building a retirement income as under an employersponsored plan.

Example: Under the pre-1986 rules, an individual who earned \$45,000 and who was not a member of an RPP or DPSP would have been limited to \$5,500 in RRSP contributions. In 1988, based on earnings of \$45,000 in 1987 and the same pension situation, the same individual would be entitled to an RRSP contribution of \$8,100 - 18 per cent of \$45,000 - for an increase of \$2,600 over the pre-1986 system of limits.

An individual with \$52,778 or more in earnings would be entitled to RRSP contribution room of \$9,500 - the maximum for the year.

The seven-year carry-forward rule will effectively increase contribution room for all taxpayers who are unable to contribute the allowable amount in any given year.

Example: Under the old rules, an individual earning \$30,000 and not a member of an RPP or DPSP would have been limited to an RRSP contribution of \$5,500 - the maximum dollar amount. In the event that other financial priorities prevented a full contribution, the taxpayer would have permanently lost the unused room. Under the new rules, the same taxpayer in 1988 would be allowed an RRSP contribution of \$5,400 - 18 per cent of \$30,000 - which, to the extent not used, would be added to contribution room available in 1989. It would continue to be available until 1995. Likewise, unused contribution room in 1989 could be carried forward to 1996.

The result is a major increase in fairness and flexibility for those whose financial circumstances do not permit full use of RRSP entitlements in any given year.

The rising limits, in combination with new portability provisions under the *Pension Benefits Standards Act*, will remove a major hindrance – sometimes called the "golden handcuffs" – to employees moving to a better job or starting a business of their own.

Instead of giving up a substantial share of the pension rights built up in a company plan, individuals will have, after two years in the plan, the option of taking the full amount of employee and employer contributions plus interest and placing it into a locked-in RRSP.

The new pension system is clearly an important element in building the positive framework for entrepreneurial activity that a dynamic, expanding economy requires.

While Revenue Canada will be notifying all taxpayers of their RRSP contribution limits late in the year, those contributing only to RRSPs will be able early in the year to calculate their entitlements in a straightforward way. RRSP contributions for a given taxation year may continue to be made early in the year and within 60 days after the end of the year, as under the existing rules.

Members of Money Purchase Pension Plans

Rising contribution limits will also ensure equitable tax treatment for participants in money purchase RPPs who have been at a disadvantage in relation to members of defined benefit plans.

In 1988, the limit on total employee and employer contributions to employer-sponsored money purchase plans will be 18 per cent of earnings to a maximum of \$11,500, rising to \$13,500 in 1989 and \$15,500 in 1990.

Additional RRSP contribution room for money purchase RPP members in 1988 will be 18 per cent of 1987 earnings to a maximum of \$9,500 minus the pension adjustment amount which will be the total of 1987 employee and employer RPP contributions.

Example: In 1988, an employee with 1987 earnings of \$40,000 whose \$2,000 in money purchase RPP contributions is matched by \$2,000 in employer contributions would be able to put an additional \$3,200 into an RRSP – \$7,200 (18 per cent of \$40,000) minus the \$4,000 in combined contributions.

Under the old rules, the RRSP contribution room in this case would have been \$1,500 - the \$3,500 maximum minus the employee's \$2,000 pension contribution.

Since the majority of money purchase plans are in small- and medium-sized businesses, the new system should assist this expanding, innovative sector to attract and hold the talent it needs to keep growing.

The improved vesting and portability provisions under the PBSA are also particularly beneficial to the same sector of the economy in which job changes – either voluntary or through failures of high-risk enterprises – are not uncommon.

The price of this kind of financial instability for employees in volatile sectors of the economy has been high enough without the added cost of serious pension system inequities.

Members of Defined Benefit Pension Plans

Members of employer pension plans stand to benefit from improved minimum standards for federally-regulated plans on January 1, 1987, and from parallel measures now being considered by provincial governments.

These improved standards directly address fundamental questions of fairness and adequacy of pension-building opportunities for millions of Canadians.

Under the old system, to use a worst-case example, it was possible for an individual to work for a full career in companies with pension plans but end up retiring with no private pension at all.

Under the improved minimum standards, with two-year vesting of pensions and options for portability, an individual could change jobs frequently during a career while building an adequate retirement income through the wide variety of options available at any given time.

But further change was necessary in the area of tax treatment to deal with another basic unfairness for many members of defined benefit plans.

Relatively small variations in the benefit rates of defined benefit pension plans can mean large differences in pensions earned and received in retirement. However, under the old rules, the pension system often did not permit members of lower-rate plans to make up the full difference through contributions to RRSPs.

Under the new system, additional RRSP contribution room for defined benefit plan members is to be calculated on the basis of a pension adjustment amount which reflects the benefits accrued during the year in the pension plan. The result will be RRSP contribution room tailored to the supplementary pension-building needs of the plan member.

Example 1: In 1988, an individual with 1987 earnings of \$40,000 who belongs to a defined benefit plan with a benefit level of 2 per cent, where benefits are offset by C/QPP benefits on earnings up to an assumed C/QPP maximum of \$26,000, would be able to contribute \$2,238 to an RRSP. This amount is equal to \$7,200 (18 per cent of \$40,000) minus a pension adjustment amount of \$4,962.

Example 2: In 1988, an individual with 1987 earnings of \$40,000 who belongs to a defined benefit plan with a benefit level of 1.5 per cent, where benefits are integrated with C/QPP benefits (for earnings up to \$26,000), would be able to contribute \$4,038 to an RRSP.

The difference in RRSP contribution entitlements between these two cases illustrates the need for the more equitable calculation that the new pension adjustment approach makes possible.

Over an extended period of retirement saving, an additional \$1,800 of contribution room would make a substantial difference to the retirement income that could be generated for the individual in the less generous registered pension plan.

In addition, the carry-forward provision means that those unable to use their expanded RRSP contribution room fully in any given year will have a further seven years to use it.

These changes, in combination with the comprehensive improvement in minimum standards for registered pension plans, will ensure the fairness and flexibility that employees need to build adequate retirement incomes.

Partial-Year Pension Plan Membership

For taxpayers who belong to pension plans for only part of the year, the pension adjustment amounts will be proportionately reduced and the RRSP limits correspondingly higher.

As a result, taxpayers will not lose out on tax assistance for retirement savings, as they did in the past, on account of moving, for example, from a defined benefit pension plan to self-employment during the year. This will remove a further disincentive for employees wishing to start and run their own businesses.

The new system will work equally well in producing appropriate RRSP contribution entitlements regardless of the employment and pension situation of the taxpayer during the year.

The Role of Employers

The uniform limit on tax assistance will provide greater freedom in the design of pension and other retirement savings arrangements to meet the needs of employers and their employees.

To achieve these gains, employers who sponsor pension plans or DPSPs will be required to report annually a pension adjustment amount for each plan member. Additional reporting will be required in some instances where past service credits are granted or employees leave a plan.

The pension adjustment indicates the amount by which plan members' RRSP contribution limits will be reduced on account of benefits accrued in the employer-sponsored plan during the year.

The adjustment for money purchase plans and DPSPs will be simply the sum of employee and employer contributions.

For defined benefit plans, the amount will be determined directly from the plan benefit rate and the employee's pensionable earnings in the year.

The calculation of the adjustment has been designed to be as straightforward as possible. Nevertheless, the government recognizes that its calculation and reporting will impose a new compliance burden on employers, particularly in the early years of the system when amendments to payroll reporting systems will have to be made.

Revenue Canada will work with employers in the setting up of appropriate reporting arrangements.

The calculation of the adjustment is described in the paper, *Improved Tax Treatment: Detailed Rules and Procedures*.

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Other Related Issues

In keeping with the comprehensive nature of the pension changes being implemented, a number of other complementary measures are necessary to reinforce the emphasis on greater fairness and flexibility throughout the total pension system.

Among other things, these changes reflect the need to ensure that unintended tax assistance is not available beyond maximum limits.

Pension Registration Rules

New pension registration rules will be released to replace those set out in Revenue Canada's Information Circular 72-13R7. The present rules will be adjusted to accord with the new contribution limits described above and, where appropriate, with federal and provincial pension benefits regulations. Otherwise, there will be little substantive change in the rules.

To ensure an even application of the maximum pension limits, some important rules will be codified in the *Income Tax Act or Regulations*; others will remain in a revised information circular.

The rules will come into force for all money purchase provisions and new or amended defined benefit provisions on January 1, 1988. Existing defined benefit provisions will be required to comply with the registration rules for service beginning on January 1, 1990. This should provide sufficient time for the adjustment of pension and compensation arrangements in these cases.

Additional Rules for DPSPs

As proposed in the May 1985 budget, the dollar limits on DPSP contributions by employers will be increased. Contributions will be permitted up to the lesser of 18 per cent of earnings and dollar limits of \$5,750 in 1988, \$6,750 in 1989, and \$7,750 in 1990. As in the May 1985 budget proposals, investment of new contributions, per employee, in shares of the employer will be limited to the greater of \$3,500 or one-half the amount of the contribution. To parallel the vesting requirements for pension plans under the *Pension Benefits Standards Act*, contributions will be required to be vested in plan members once they have two years of participation in a plan.

Supplementary Retirement Compensation Arrangements

New tax rules will apply to funded plans set up to provide retirement compensation supplemental to that available under registered plans. These rules provide tax-neutral treatment of such benefits without taxing unrealized benefits in the hands of employees. These rules come into effect on October 9, 1986 for new arrangements and on January 1, 1988 for existing arrangements.

Additional Voluntary Contributions (AVCs)

The government feels that there will be no need for AVCs under the new contribution limits system and is concerned about their use to obtain tax assistance in excess of the limits. Accordingly, no deduction will be provided for AVCs made after October 8, 1986 or AVCs made before October 9, 1986, but not deducted by the end of the 1986 taxation year. Undeducted AVCs will be permitted to be withdrawn tax-free up to the end of 1988. The revised registration rules will preclude the acceptance of AVCs by pension plans from January 1, 1988.

Transfer of Pension Income to an RRSP

As proposed in the May 1985 budget, tax-free transfers of pension income to RRSPs (in excess of available contribution room) will no longer be permitted under the new system. To assist those now at or near retirement, however, there will be a transition period to December 31, 1994 before the measure takes full effect. For the period up to the end of 1989, there will be no restriction on the transfer of pension income to an RRSP.

Up to the end of 1989, pension income will also continue to be a component of earned income. This will permit contributions to spousal RRSPs out of pension income to continue during this transition period. For the years 1990 to 1994, a further transition measure will permit transfers of income from an RPP to a spousal RRSP, up to a limit of \$6,000 per year. This will assist those whose retirement pensions do not provide survivor benefits.

Conclusion

With these changes, Canada's pension system will be one of the best, most modern and most comprehensive in the world.

Canadians will be able to make effective use of its opportunities to build for the future in a far-sighted, self-reliant way.

The improved system of tax treatment for retirement savings will treat all taxpayers equitably, regardless of their employment and pension situations.

These measures, in combination with improvements under the *Pension Benefits Standards Act* and parallel provincial action, will give millions of Canadians the opportunity to provide themselves with greater financial security in retirement.

They will better enable the nation to meet the growing needs of an aging population in the years ahead.

The improved pension system will better reflect the needs of a more mobile labour force in a rapidly-evolving modern economy, and a labour force in which women have become increasingly active.

It will encourage the entrepreneurial dynamism and risk-taking that help keep the economy strong and resilient.

It will help ensure a growing pool of personal savings for investment in job creation, growth and prosperity.

These comprehensive improvements in pension policy, carefully designed to complement each other, are the outcome of many years of effort and co-operation by government and the private sector. As a result of these improvements, Canadians will be better able to invest in their own futures and the future of Canada.

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Glossary of Terms

Additional Voluntary Contribution (AVC)

 An optional contribution by an employee under a money purchase provision of an RPP.

Annuity

 A payment of a regular pension or similar benefit for a specified number of years or for the lifetime of the beneficiary or the beneficiary's spouse.

Benefit Rate

The annual rate at which benefits accrue in a defined benefit RPP.

Canada Pension Plan (CPP)

 A national, mandatory, earnings-related pension plan, introduced together with the Quebec Pension Plan (QPP) in 1965, for all working Canadians between the ages of 18 and 70.

C/QPP Maximum Earnings

• The yearly maximum pensionable earnings amount under the C/QPP which sets an upper limit on premiums and benefits.

Deferred Profit Sharing Plan (DPSP)

• A money purchase plan, defined in the *Income Tax Act*, to which an employer makes contributions out of annual profits for the benefit of employees.

Defined Benefit Pension Plan

 A type of RPP which promises a certain level of pension usually based on the employee's earnings and years of service. Most Canadian workers who belong to an RPP belong to defined benefit plans.

Money Purchase Pension Plan

• A type of RPP which provides whatever pension income the accumulated contributions and return on investment in the plan will buy at retirement.

Pension Adjustment (PA)

 An annual amount calculated on the basis of contributions made or pension benefits earned during the year under an RPP or DPSP. The PA amount is used in calculating the maximum annual RRSP contribution for individual Canadian taxpayers.

Pension Benefits Standards Act (PBSA)

• An act of Parliament which establishes minimum standards for federally-regulated pension plans.

Portability

• Arrangements for the transfer of an employee's pension credits to another pension plan or locked-in RRSP when the employee changes jobs.

Quebec Pension Plan (QPP)

A parallel version of the CPP offered in Quebec.

Registered Pension Plan (RPP)

• An occupational pension plan to which an employer contributes and which is accepted for registration under the *Income Tax Act*.

Registered Retirement Income Fund (RRIF)

• A vehicle which may be used, as an alternative to an annuity, to provide for the payout of RRSP funds during retirement.

Registered Retirement Savings Plan (RRSP)

 A retirement savings vehicle to which Canadian taxpayers may make tax-deductible voluntary contributions up to specified annual limits.

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Retirement Compensation Arrangement (RCA)

• An arrangement, to be defined in the *Income Tax Act*, which is not a registered plan, under which an employer makes payments to a custodian in order to provide retirement benefits to an employee.

Retiring Allowance (Severance Pay)

 An amount received on or after retirement from an employer in recognition of long service or in respect of a loss of office or employment.

Seven-Year Carry Forward

• A provision whereby contributors to an RRSP who do not fully use their allowable RRSP contribution in any one year may retain the right to use that contribution room for a period of up to seven years.

Survivor Benefits

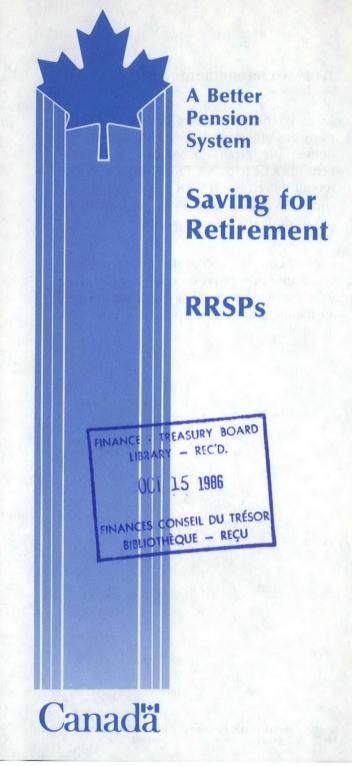
• Pension benefits which are transferred to the spouse of a plan member who dies.

Thrift Arrangements

 Employer-sponsored savings arrangements under which employee contributions are matched, according to a formula, by employer contributions. RPPs, DPSPs and RRSPs are the usual vehicles for these arrangements.

Vesting

• An employee's right, on termination of employment before retirement, to benefits accrued under a pension plan or deferred profit sharing plan (DPSP).



The government is acting to give Canadian workers better opportunities to build an adequate retirement income. These changes are part of a comprehensive, co-ordinated overhaul of the country's retirement income system.

- The Canada Pension Plan (CPP) has been put on a sound financial footing and many of its benefits improved beginning January 1, 1987. Improved disability and survivor benefits and a flexible retirement age are among the key changes.
- Minimum standards for federallyregulated private pension plans are being raised beginning January 1, 1987. Provincial governments are considering parallel action. Greater pension portability, earlier vesting, wider membership eligibility and improved survivor benefits are among the key benefits.
- · A fairer and more flexible system of tax assistance for retirement saving is being phased in over the next five years.

This publication outlines important changes in the tax treatment of retirement saving of particular interest to selfemployed persons and employees who are not members of an employer-sponsored registered pension plan (RPP).

Greater Fairness and Flexibility

Currently, those building retirement savings only through RRSPs have less generous tax treatment than those in pension plans. Canadians will now be able to build better pensions as a result of more equitable tax treatment for members of different kinds of retirement savings plans.

- One comprehensive set of limits for tax assistance for retirement saving will apply to all taxpayers, regardless of their employment or pension situations.
- People building pensions through registered retirement savings plans (RRSPs) only will have the same

access to tax assistance as members of employer-sponsored plans.

• All taxpayers will have the right to carry forward unused RRSP contribution room for seven years.

Rising Contribution Limits

Prior to 1986, individuals who were not members of an RPP or a deferred profit sharing plan (DPSP) were permitted to contribute up to an annual maximum of \$5,500 to an RRSP.

This ceiling, unchanged for 10 years, provided a lower level of tax-assisted pension-building capacity than that available to employees who belong to employer-sponsored plans.

A new system of substantially higher RRSP contribution limits is being phased in to ensure that all those who do not belong to pension plans, including selfemployed professionals, small business owners and many employees, are treated equitably.

The contribution ceiling for the 1986 and 1987 taxation years will be \$7,500. The limits will then rise as follows:

1988	1989	1990	1991
\$9,500	\$11,500	\$13,500	\$15,500

As announced in May 1985, contribution limits will be 18 per cent of earned income to the maximum.

Beginning in 1988, people who do not use their allowed RRSP contribution fully in a given year will be able to carry forward the unused portion for seven years - a major gain in flexibility and an effective increase in contribution room for millions of taxpayers.

A More Equitable System for All

These changes form part of a broader improvement in the rules governing tax assistance for retirement savings - rules that will mean equal treatment for taxpayers regardless of their employment and pension situations.

To make it easier for taxpayers to know their RRSP contribution room, Revenue Canada will send notices of exact RRSP contribution limits to taxpavers toward the end of each year. To provide this service, it will be necessary to base RRSP contributions on the previous year's earnings and pension information.

Although they will receive a notice from Revenue Canada, taxpavers using only RRSPs as a retirement savings vehicle will be able to calculate their own contribution room in a straightforward way and, if they wish, make contributions to RRSPs earlier in the taxation year.

Example: Under the pre-1986 rules, an individual earning \$45,000 who was not a member of a registered pension plan would have been limited to \$5,500 in RRSP contributions. In 1988, based on earnings of \$45,000 in 1987 and the same pension situation, the same individual would be entitled to an RRSP contribution of \$8,100 - 18 per cent of \$45,000. That is an increase of \$2,600 over the pre-1986 system of limits.

Other Recent Changes

The government is proceeding with the February 1986 budget proposals to give retired Canadians who have RRSPs or a registered retirement income fund (RRIF) greatly increased flexibility in the investment management and withdrawal of retirement savings.

The prohibition against commutation of life or term annuities payable under an RRSP has also been removed, in line with the increased flexibility provided for RRIF withdrawals.





A Better Pension System

Saving for Retirement

Employer-Sponsored Pension Plans



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The government is acting to give Canadian workers better opportunities to build an adequate retirement income. These changes are part of a comprehensive, co-ordinated overhaul of the country's retirement income system.

- The Canada Pension Plan (CPP) has been put on a sound financial footing and many of its benefits improved beginning January 1, 1987. Improved disability and survivor benefits and a flexible retirement age are among the key changes.
- Minimum standards for federallyregulated private pension plans are being raised beginning January 1, 1987.
 Provincial governments are considering parallel action. Greater pension portability, earlier vesting, wider membership eligibility and improved survivor benefits are among the key benefits.
- A fairer and more flexible system of tax assistance for retirement saving is being phased in over the next five years.

This publication outlines important changes in the tax treatment of retirement saving of particular interest to members of employersponsored registered pension plans (RPPs).

Greater Fairness and Flexibility

Currently, those building retirement savings only through RRSPs have less-generous tax treatment than those in pension plans. Canadians will now be able to build better pensions as a result of more equitable tax treatment for members of different kinds of retirement savings plans.

- One comprehensive set of limits for tax assistance for retirement saving will apply to all taxpayers, regardless of their employment or pension situations.
- Many members of RPPs will gain additional registered retirement savings plan (RRSP) contribution room.
- All taxpayers will have the right to carry forward unused RRSP contribution room for seven years.

Employer-Sponsored Plans

Employer-sponsored pension plans (RPPs) may be of the defined benefit or money purchase type.

A defined benefit plan promises a certain level of pension, specified as a flat dollar amount or as a set percentage of pensionable earnings for each year of service under the plan. For example, a 2-per-cent defined benefit plan would pay a pension of 70 per cent of income $(2\% \times 35 \text{ years} = 70\%)$ to a plan member with 35 years of service.

A money purchase plan provides whatever pension income the accumulated contributions and return on investment in the plan will buy at retirement.

Rising RPP Contribution Limits

Prior to 1986, employee contributions to employer-sponsored defined benefit plans could be deducted to a limit of \$3,500. This

limit was removed in 1986 as part of the transition to a more flexible and equitable system of tax assistance.

Tax assistance for members of generous defined benefit pension plans is currently available to help build pensions of up to \$60,000 a year – or the equivalent of \$15,500 a year in contributions. This limit will remain during the phasing-in of more equitable retirement-saving tax treatment for taxpayers who do not have access to the same level of pension benefits.

For money purchase pension plans, the employer and employee can contribute up to \$3,500 each. Beginning in 1988, these limits will be replaced by a higher comprehensive contribution limit of 18 per cent of earned income, phased in as follows:

1988	1989	1990	
\$11,500	\$13,500	\$15,500	

More Equitable RRSP Contribution Limits

Currently, members of employer-sponsored plans are allowed annual RRSP contributions to a maximum of \$3,500 minus their RPP contributions. These limits also apply for 1987.

Beginning in 1988, more equitable RRSP contribution limits for members of defined benefit pension plans will mean that persons with similar incomes but different pension situations will have access to the additional tax assistance needed to help build comparable pensions.

For most members of 2-per-cent defined benefit plans, RRSP contribution room will be approximately \$2,000 a year beginning in 1988. Those in plans with lower benefit rates will gain more RRSP contribution room – for example, the RRSP limit for a \$40,000 earner who belongs to a 1.5-per-cent plan will be about \$4,000 in 1988.

Beginning in 1988, unused RRSP contribution room can be carried forward for seven years – a major gain in flexibility and an effective increase in contribution room for millions of taxpayers. The dollar limits on RRSP contributions will rise as follows:

1988	1989	1990	1991
\$9,500	\$11,500	\$13,500	\$15,500

For members of employer-sponsored pension plans, RRSP contribution room will be 18 per cent of previous-year earnings to the dollar maximum, minus a pension adjustment amount reported by the employer. The use of previous-year earnings will enable Revenue Canada to calculate RRSP contribution room and notify each taxpayer of the amount, beginning in the 1988 taxation year.

For defined benefit plans, the adjustment will reflect the benefits earned in the year.

For money purchase plans, the adjustment will simply be the total of the employee and employer contributions to the plan in the previous year.





A Better Pension System

Improved Standards for Pensions

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Strengthened minimum standards for private pension plans form a key part of the government's comprehensive approach to improving the fairness and flexibility of the pension system in Canada.

In conjunction with recent improvements to the Canada Pension Plan (CPP) and an improved system of tax treatment for retirement saving, the strengthened minimum standards will give millions of Canadians the opportunity to provide for greater financial security in retirement.

Effective January 1, 1987, a number of important changes come into effect for pension plans in federal jurisdiction. Provincial governments are considering parallel reforms at an early date.

Among the key changes:

Vesting and Locking-In: Under the old standards, an employee's right to pension benefits is acquired - "vested" - only after 10 years of service or membership in a plan and at age 45. With the new standards, an employee's right to pension benefits, including any part financed by the employer's contributions, will be vested and locked in after two years of participation in a pension plan. This will ensure that workers who change jobs will be able to save more effectively for retirement.

Improved Portability: A major shortcoming of the pension system has been that workers who change jobs often are prevented from taking their pension entitlements with them to their new employment. As of January 1, 1987, workers who change jobs will have a number of options. They may leave pension entitlements with their former employer. They may opt to transfer them to their new employer's pension plan with that employer's consent. Or they may transfer them to a locked-in registered retirement savings plan (RRSP).

Employer Contributions: In some pension plans, employers contribute little or nothing to workers' pensions until after many years of service. This has meant that workers who change jobs can end up paying most or all of the cost of their pensions. Under the new standards, employers will be required to pay at least half the value of a pension earned when a worker changes jobs or retires. Alternatively, the employer will have the option to index a worker's deferred benefits. Minimum employer contributions will ensure that costs are shared fairly between employees and employers and that both short- and long-service workers are treated fairly.

Refunding Provisions: The present system of standards contains no provisions for refunding employee contributions. The new standards require pension plans to refund the contributions of employees whose benefits are not vested when they leave. Employers will also be required to pay reasonable interest on employee contributions.

Eligibility for Plan Membership: Under the old standards, even where employersponsored plans are available, restrictions may prevent some full-time workers from joining the plan. As a general rule, part-time workers are not eligible. Effective January 1, 1987, pension plans will be open to all workers. Full-time workers will be eligible to join a pension plan after two years of service with their employer. Part-time workers will be eligible if they earn more than 35 per cent of the average industrial wage in each of two consecutive years.

Early Retirement: Members of a pension plan wishing to retire early have been eligible for a pension only if their plan has an early retirement provision. Under the new standards, pension plan members will be able to opt for early retirement 10 years before normal retirement age.

Improving Pensions for Women: Working women will benefit from the government's proposals to improve pension plans by strengthening the requirements relating to

vesting, portability and membership eligibility. A number of other pension reform measures will be of particular benefit to women.

> Survivor Benefits: Few pension plans have provided a pension or pension benefits to the spouse of a plan member who dies. Where survivor benefits have been paid, these have usually been terminated if the survivor remarries. To provide greater financial security for spouses of pension plan members, most of whom are women, the new standards will require that pension plans:

- provide benefits to surviving spouses of pensioners, amounting to at least 60 per cent of the full pension that was being paid;
- provide the full value of the pension earned by a plan member who dies prior to retirement;
- continue to pay survivor benefits if a surviving spouse remarries.

Splitting of Pension Benefits on Marriage Breakdown: Pension standards have not generally required pension credits or pensions already

being paid to be split upon marriage breakdown. The new standards allow the value of pension entitlements to be divided on marriage breakdown.

Equal Pension Benefits for Women and Men: Some pension plans have paid lower periodic benefits to women than to men even though they have retired under identical circumstances. Under the new standards, pension plans must provide equal pensions to women and men retiring under the same circumstances.

Inflation Protection: The government recognizes the need to maintain the purchasing power of pensions. However, a consensus on inflation protection standards has not been reached with the provinces and the private sector. Therefore, the government will encourage pension plans to build upon the voluntary approach used by a majority of large employers. All pension plans in federal jurisdiction will be encouraged to provide voluntary benefit increases to pensioners and workers with deferred benefits and to report information on voluntary inflation adjustments and on the source of funds used to make these increases. Statistical information will be made public. The government will monitor the response of pension plans to this

approach and will continue discussions with provincial governments and other interested parties in the light of these responses.

Information Disclosure and Employee Participation: Current requirements for pension plans to disclose information to plan members are minimal. With the new standards, pension plans will be required to disclose information about earned benefits and accumulated contributions to plan members and their spouses every year. Representation by plan members and pensioners on pension management committees will also be required, if requested by a majority of members.







A Better Pension System

Saving for Retirement

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Preface

Canadians have waited a long time for the promise of pension reform to be fulfilled. During the protracted public debate that spanned more than a decade, it became increasingly urgent to translate the long years of study into positive action to help Canadians build greater security for their retirement years.

More than anything else, what was needed was both the commitment and the will of the Canadian government.

Since coming to office, the Progressive Conservative government has demonstrated that commitment and will. It has moved decisively to put in place a comprehensive program of pension reform that will ensure a more responsive, more equitable retirement income system for Canada and Canadians.

This publication outlines major changes already legislated and important further measures that will be implemented to improve the tax treatment of retirement saving.

The Honourable Michael H. Willson

The Honourable Michael H. Willson Minister of Finance

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Introduction

Canada's retirement income system is composed of four complementary parts:

- Old Age Security/Guaranteed Income Supplement and provincial supplements which provide basic income support for the elderly;
- Canada/Quebec Pension Plan compulsory, earnings-related public pensions for all Canadian workers;
- Public and private sector employee pension plans – voluntary and regulated by either the federal or provincial governments;
- Other tax-assisted retirement savings vehicles such as registered retirement savings plans (RRSPs).

In recent years, social, demographic and economic trends have underscored the need for change in our pension system.

Reforming the pension system is a massive undertaking. It has required a careful, co-ordinated strengthening of each part of the system.

A Comprehensive Action Program

In seeking to improve our pension system, the government holds one principle above all others: At the heart of a free and democratic society there must be freedom for individuals to be self-reliant; to take personal decisions about how, and to what extent, they want to provide retirement income for themselves.

The government has already made considerable headway towards the goal of improving our pension system:

- The government has acted to extend eligibility for the spouse's allowance to all widows and widowers aged 60-64 and has taken steps to improve veterans' pensions;
- The financing of the Canada Pension
 Plan has been put on a sound basis for
 the longer term and significant
 improvements in benefits will take effect
 January 1, 1987. Improved disability and
 survivor benefits and a flexible
 retirement age are among the
 key changes;
- The Pension Benefits Standards Act (PBSA) which sets minimum standards for private pension plans in federal jurisdiction has been revised to improve the rules for vesting, portability and survivor benefits. Changes are effective January 1, 1987; and

 New flexibility has been provided for the management of retirement savings in RRSPs and registered retirement income funds (RRIFs).

The government is now implementing a more equitable system of tax assistance for retirement saving. First introduced in the May 1985 budget, the system has been further improved as a result of extensive consultation.

The new system enhances fairness and flexibility for Canadians building retirement income security, whether they save for retirement through registered pension plans (RPPs), RRSPs or any combination of these and other pension vehicles.

The Private Pension System

For the most part, Canadians save for retirement through two types of plans: RPPs and RRSPs.

There are two basic types of registered pension plans: defined benefit plans and money purchase plans.

A defined benefit plan promises a certain level of pension for each year of service. Most Canadian workers who belong to an RPP belong to this type of plan.

A money purchase plan provides whatever pension income the accumulated contributions and return on investment in the plan will buy at retirement.

Current Tax Treatment

Prior to 1986, non-members of an RPP were permitted to contribute up to \$5,500 to an RRSP, subject to a 20-per-cent of earnings limit. This ceiling provided as little as one-third of the pension-building capacity available to persons in generous defined benefit plans, in which tax assistance can be provided up to the equivalent of a contribution limit of about \$15,500 a year. The \$5,500 limit has been increased for 1986 and 1987 to \$7,500 as part of the phasing in of a more equitable system.

In the past, contributions by individuals to a defined benefit RPP could be deducted from taxable income to the limit of \$3,500 a year, while employers' contributions were entirely tax deductible. As part of the transition to the more equitable system proposed in May 1985, the limit on employee tax-deductible contributions was removed beginning with taxation year 1986. The maximum pension limits, which define the total tax assistance available, will remain unchanged.

Contributions to RRSPs by participants in RPPs have been limited to \$3,500 minus the amount contributed to the RPP during the year – with the total not to exceed 20 per cent of earnings. This limit continues in effect in 1987 during the transition to the new system which begins in 1988.

More Equitable Tax Treatment

The new system includes:

- a phased-in system of more equitable, comprehensive tax treatment for retirement savings, giving all taxpayers the same access to tax assistance;
- a more equitable method of calculating maximum RRSP contributions for members of defined-benefit plans to reflect differences in benefit rates among such plans; and
- a seven-year carry-forward provision for individuals who do not use their allowed RRSP contribution fully in a given year, a major improvement in flexibility and pension-building capacity.

In order to phase in the new system of calculating RRSP contribution room, the contribution limits for employer-sponsored plans in 1987 will continue at 1986 levels.

The phase-in of higher maximum limits for tax-assisted retirement savings will begin in 1988 with a comprehensive contribution limit of 18 per cent of earned income to the following dollar maximums:

1988	1989	1990
\$11,500	\$13,500	\$15,500

By 1990, the limit will provide tax-assisted saving opportunities for members of RRSPs, other money purchase plans and less-generous defined benefit plans which are comparable to those already available to members of generous defined benefit pension plans.

RRSP Contribution Limits

A key feature of the new system will benefit most members of defined benefit plans: RRSP contribution limits will vary with the benefit rate – that is, with the pension-building capacity of the plan – to ensure equitable access to tax assistance.

To achieve this new degree of fairness and to make it easier for taxpayers to know their contribution room, Revenue Canada will calculate the RRSP limit for each taxpayer, using information provided by employers and pension plan sponsors. Revenue Canada will work with employers in setting up appropriate reporting arrangements. A personalized statement of

available contribution room will be sent to each taxpayer before the end of each year, beginning in 1988.

To permit the government to provide this important service, allowable RRSP contributions will be based on previous year earnings.

RRSP contribution room for all taxpayers will be 18 per cent of previous year earnings minus a "pension adjustment" amount which indicates the proportion of the total contribution limit used up by pension benefits in the year.

The 18-per-cent limit was chosen because it is the percentage of earnings required to be set aside each year to build a pension of 60 to 70 per cent of income – a level appropriate for the tax system to support.

RRSP dollar limits will lag one year behind the comprehensive contribution limits in order to accord with the earnings on which they are based.

The dollar limits for RRSP contributions will rise as follows:

1988	1989	1990	1991
\$9.500	\$11.500	\$13,500	\$15,500

Taxpayers contributing only to RRSPs and not earning benefits during the previous year under an RPP will have no pension adjustment and will be able to contribute up to 18 per cent of previous year earnings up to the dollar limit.

For participants in money purchase plans, RRSP contribution room will be 18 per cent of earned income to the dollar maximum minus a pension adjustment amount which will simply be the total of the employee and employer contributions to the plan in the previous year.

For defined benefit plan members, RRSP contribution room will be 18 per cent of earned income to the dollar maximum minus a pension adjustment amount which reflects the benefits accrued in the preceding year under the plan.

The new system effectively addresses the basic inequity of the old system: tax treatment for retirement saving will no longer vary according to pension arrangements; all taxpayers will have the same scope for building a retirement income.

The new system of tax treatment for retirement saving, in combination with new vesting and portability provisions under the *Pension Benefits Standards Act*, will ensure the fairness and flexibility that employees need to build adequate retirement incomes.

Transfer of Pension Income to an RRSP

Tax-free transfers of pension income to RRSPs (in excess of available contribution room) will no longer be permitted after 1989. To assist those now at or near retirement, however, there will be a transition period to December 31, 1994 in which transfers of income from an RPP to a spousal RRSP will be permitted up to a limit of \$6,000 per year. This will assist those whose retirement pensions do not provide survivor benefits.

Conclusion

The improved system of tax treatment for retirement savings will treat all taxpayers equitably, regardless of their employment and pension situations.

These measures, in combination with improved standards under the *Pension Benefits Standards Act* and parallel provincial action, will give millions of Canadians the opportunity to provide for greater financial security in retirement.

