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A Better Pension System

Saving for Retirement: A Guide to the Tax Legislation

March 1988

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Saving for Retirement: A Guide to the Tax Legislation

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I. Introduction and Overview

This guide describes the draft legislation dealing with the new system of tax assistance for retirement saving. The legislation has been prepared to implement the proposals announced by the Minister of Finance on October 9, 1986 and modified in the process of tax reform. This guide is intended primarily to assist employers, pension plan administrators and others who require a detailed working knowledge of the new rules governing tax-assisted retirement saving.

The legislation includes the codification of many of the pension plan registration rules currently found in Revenue Canada's Information Circular 72-13R7. This change has been made to adapt the registration rules to the new system of contribution limits. Codifying the registration rules requires that they be set out with more precision than is required in the Information Circular. Thus, it is important that plan sponsors, employees, union representatives and pension industry professionals have a full opportunity to examine and comment on them. For this reason, the legislation is being released in draft form before its formal introduction in Parliament.

The aim of the legislation is to provide fairer and more flexible limits on tax assistance for retirement saving. The basis of the new system is a uniform, comprehensive limit on tax-assisted saving of 18 per cent of an individual's earnings. The limit is comprehensive in two senses. It applies (directly or indirectly) to contributions both by taxpayers and by their employers. Also, it applies to contributions to all types of registered savings plans: registered pension plans (RPPs), deferred profit sharing plans (DPSPs) and registered retirement savings plans (RRSPs). Providing a uniform limit on saving in different types of plans is important because individuals in different employment situations do not have equal access to the types of plans which, under the existing rules, can provide the most generous benefits. Even within a given type of plan, the access of individuals to tax-assisted saving under the existing system varies significantly according to the generosity of the plans provided by their employers. The new system takes into account variations in employer-provided retirement benefits and allows taxpayers to supplement them by making RRSP contributions up to the uniform contribution limit.

The contribution limit of 18 per cent of earnings was chosen because it is consistent with the existing limit of 2 per cent of earnings per year of service that applies to pension benefits provided under defined benefit RPPs. That is, contributions of 18 per cent of earnings made over an individual's career should be sufficient to provide for a pension of 2 per cent of pre-retirement earnings per year of service. The 2-per-cent pension limit is considered to be an appropriate limit for

tax-assisted retirement saving. Over a career of 30 to 35 years, it permits the build-up of a pension of 60 to 70 per cent of pre-retirement earnings. For most individuals, such a pension will replace sufficient earnings to avoid any significant drop in living standards upon retirement. At lower income levels, where less earnings replacement at retirement is needed from private sources because of the relatively greater role played by retirement benefits under the Old Age Security program and the Canada and Quebec Pension Plans, the limits should be more than adequate to meet this objective.

Providing a consistent treatment of savings in different types of plans also means increasing the limits on contributions made on a money purchase basis (through RRSPs, DPSPs and some RPPs) to make them consistent with the dollar limit on pensions provided on a defined benefit basis. As adjusted under tax reform, these limit increases will be phased in over a period ending in 1994 for employer-sponsored plans and 1995 for RRSPs. At the end of the phase-in period the dollar limit on contributions will be $15,500. Annual contributions at this level over a full career should provide for a pension comparable to the maximum defined benefit pension of $1,722.22 per year of service. Beginning in 1995, both the contribution and pension limits will be adjusted each year in accordance with the increase in the average wage in the same manner as the maximum pensionable earnings under the Canada and Quebec Pension Plans are adjusted. Under the mature system, these limits are expected to provide full tax assistance on savings out of individual earnings up to 2.5 times the average wage. Retirement benefits in excess of the limits can be provided, but not on a tax-assisted basis. Any arrangement for funding such benefits will be subject to the rules of the Income Tax Act regarding retirement compensation arrangements (RCAs). Contributions to, and earnings in, an RCA are subject to a special refundable tax which assures that no tax deferral advantages are gained through such arrangements.

To implement the new comprehensive limit, employers who sponsor RPPs or DPSPs will be required to report a pension adjustment (PA) for each plan member each year. The PA reflects the pension benefit accruing to the plan member during the year under employer-sponsored plans, and this amount is subtracted from the contribution limit to determine the maximum RRSP contribution the individual may make for the year. For money purchase plans, under which retirement benefits are based directly on the level of contributions plus associated investment earnings, the PA will simply be the total of the employer's contribution in respect of the employee plus any contribution by the employee. For defined benefit plans, under which benefits are determined according to a formula and do not depend on the contributions made in a particular year, the PA for a plan member will be determined directly from the benefit formula and, where applicable, the member's pensionable earnings in the year. A 2-per-cent defined benefit plan will use up most of the plan member's 18-per-cent contribution limit while a less generous plan will use up proportionately less, thus leaving more RRSP contribution room. For administrative reasons, employers participating in certain multi-employer defined benefit plans will be permitted to report PA based on contributions made in the year as is the case for money purchase plans.

The reporting of PAs will be the responsibility of the employer and will be part of the T-4 reporting process. (Reporting by plan administrators is provided for in two particular circumstances involving multi-employer plans.) The first PA report is due by the end of February 1989 based on pension or DPSP accruals in 1988. The methods of calculating PAs for different plan types were described in the proposals released on October 9, 1986, and the draft regulations embodying these methods are included with this legislation. Revenue Canada is prepared to assist employers in determining an acceptable PA formula for particular plans and in resolving any other problems associated with the reporting requirements.

As RRSP contribution limits will now depend on the PA amounts, Revenue Canada will issue statements to individual taxfilers each year informing them of their RRSP limits for the year. The first such statement will be issued towards the end of 1989 and, as under the current rules, taxpayers will have until 60 days after the end of 1989 to make RRSP contributions for that year. To enable Revenue Canada to provide this information to taxpayers, the RRSP limit for each taxation year will be based on earnings and PAs for the preceding year. Thus, the RRSP limit for 1989, for example, will be based on earnings and pension accruals in 1988.

The legislative changes also include measures designed to improve the fairness and flexibility of tax assistance in relation to prior years of service. Under the current system, the ability of individuals to make up for missed saving opportunities is generally quite restricted. At the same time, opportunities exist for some individuals to obtain past service pension credits in excess of the intended limits.

The new system will provide for a seven-year carry-forward of RRSP contribution room not used in a year. This will permit all those saving for retirement to make up for contributions they missed making in prior years. It will also provide considerable scope for individuals to adapt the pattern of their retirement saving to their other financial needs. The first opportunity for carry-forward contributions will come in 1990 based on contribution room unused in 1989.

Under the new system of comprehensive limits, RRSP contributions are regarded as an alternative to pension benefit accruals as a means of saving for retirement. Consequently, additional pension benefits in respect of past service (after 1987) can be credited to an individual only to the extent that the individual has not taken full advantage in prior years of the opportunity to make deductible RRSP contributions. A procedure for the certification of additional past service benefits is being introduced to co-ordinate the provision of such benefits with the use made of RRSPs. An employer proposing to provide such benefits must calculate an amount called a past service pension adjustment (PSPA) in respect of the benefits and submit the PSPA to Revenue Canada. If the PSPA does not exceed an individual's RRSP contribution room carried forward from prior years, Revenue Canada will provide a certification. The certification permits the past service benefits to be paid and results in a reduction of the individual's RRSP limit by the amount of the PSPA. This procedure does not apply to past service upgrades that simply involve benefit increases in line with wage or price growth. Such increases will generally give rise to a PSPA of nil and so are not subject to the certification requirement.

Where a taxpayer leaves an RPP and retains no right to future benefits, the employer will often be required to report a pension adjustment reversal (PAR). In general terms, PAR is the difference between the PAs reported in respect of the taxpayer and any payments made for his or her benefit by the plan. The PAR will increase the taxpayer's RRSP limit. Both these adjustments in respect of past service – PSPA and PAR – will increase the fairness of the system by making the RRSP limit better reflect the benefits actually earned under employer-sponsored plans.

To ensure that the tax-assistance limits are maintained where a taxpayer moves from one plan to another, new provisions governing inter-plan transfers of funds and pension accruals are being introduced. An important feature of these rules is that, beginning in 1989, the transfer of lump sum amounts from one plan to another on a tax-free basis will be permitted only if the amounts are transferred directly. Transfers from defined benefit plans to money purchase RPPs or RRSPs will be subject to limits. The existing rules that permit deductions in respect of amounts transferred between registered plans, whether directly or indirectly, will no longer apply.

As indicated above, the legislative amendments include the codification of many of the pension plan registration rules currently found in Revenue Canada's Information Circular 72-13R7. These rules are being included in the Income Tax Act to ensure their consistency with the new system of pension and contribution limits. Apart from changes made to adapt the registration rules to the new structure of contribution limits, there has been no intention to modify in any general way the level of benefits currently permitted under the provisions set out in the Information Circular. However, in a number of cases codification means that rules must be spelled out more precisely than they are in the Information Circular.

An unavoidable consequence of the introduction of the new limits and the other registration rule changes is that certain changes will be required to most pension plans. As a general rule, the new registration requirements come into effect for 1989 and subsequent years. Thus, most, if not all, plans will have to be amended as of January 1, 1989 and the amendments submitted to Revenue Canada. However, some of the provisions applying to benefits provided under defined benefit plans that were submitted for registration before March 28, 1988 will come into force only after 1990 and only in respect of service after 1990. This will provide existing plans with more time to make any necessary changes to those benefit provisions. For existing plans, the requirements of the Information Circular as administered by the Minister of National Revenue will generally continue to apply for service prior to the application of the new registration rules.

This guide to the legislation provides a summary of its main provisions and indicates where particular provisions can be found. A more detailed description of the proposed amendments is provided in the explanatory notes. The amendments are concentrated in several sections of the Income Tax Act. Deduction provisions are contained in subsections 8(1) and 20(1) and section 60 as well as in

sections 146 and 147 and new section 147.5. Section 146 contains provisions relating to the registration of RRSPs, and section 147 contains parallel provisions for DPSPs. The provisions relating to registered pension plans are contained in new sections 147.1 to 147.8.

II. Contribution Limits and Other Measures for 1988

A one-year delay in the implementation of the new system of limits on contributions to RRSPs, DPSPs and RPPs was announced on June 18, 1987 as part of the tax reform proposals. Accordingly, the contribution and deduction limits for 1988 will remain essentially unchanged from those in effect for 1987 and 1986.

1. Contributions to Registered Pension Plans

(a) Employer Contributions

Under existing law, employer contributions to registered pension plans (RPPs) are deductible under paragraphs 20(1)(q) and 20(1)(s) of the Income Tax Act. Paragraph 20(1)(q) provides for deductible contributions by employers of up to $3,500 per plan member per year. Paragraph 20(1)(s) permits a special deduction for contributions that are in excess of $3,500 or are in respect of past service where the contributions are made pursuant to an actuary's recommendation that they are required to fund a promised level of defined benefits. This special deduction must be approved by the Minister of National Revenue on the advice of the Superintendent of Financial Institutions. These provisions remain unchanged for 1988.

(b) Employee Current Service Contributions

Employee current service contributions to RPPs are deductible up to a maximum contribution limit of $3,500 under subparagraph 8(1)(m)(i). In addition, paragraph 8(1)(m.1) permits the deduction of amounts in excess of $3,500 contributed to purchase defined benefits in respect of current service. These provisions remain unchanged for 1988.

(c) Current Service AVCs

The amendments to the Act will continue to allow a deduction in respect of current service additional voluntary contributions (AVCs) to an RPP in 1988 provided that these AVCs, plus any required employee contributions to the plan, do not exceed $3,500 in total. In addition, new subsection 7701(3) of the Income Tax Regulations specifically excludes AVCs made in 1988 from the pension adjustment (PA) amounts reported in respect of 1988. This provision prevents AVCs that substitute for 1988 contributions to RRSPs from also reducing the taxpayer's RRSP limit in 1989.

(d) Past Service AVCs

Several amendments are proposed to implement the changes announced with respect to past service AVCs to pension plans. No deduction is allowed for past service AVCs made on or after October 9, 1986 – the date on which the new rules relating to pension contributions were first announced. The denial of the deduction is provided for in the amendments to subparagraphs 8(1)(m)(ii) and (iii), which have effect in taxation years 1986, 1987 and 1988, and in new paragraphs 147.5(4)(b) and (c) which apply in 1989 and subsequent taxation years.
For the purpose of applying the rule in respect of the 1986 taxation year, new subsection 8(1.1) provides that any part of an AVC made in 1986 prior to October 9 may be considered to be a past service AVC. An amendment to subsection 8(8) ensures that undeducted past service AVCs are not carried forward for deduction in future years.

Provision has been made for undeducted past service AVCs, made prior to October 9, 1986, to be withdrawn on a "tax-free" basis. The withdrawals are subject to the normal withholding tax, but this tax is offset by a special deduction in respect of qualifying amounts under new section 60.2 of the Act. As well as applying to withdrawals from RPPs, the measure also applies where the undeducted AVCs have been transferred to an RRSP or a registered retirement income fund (RRIF). To qualify, the undeducted past service AVCs must be withdrawn after October 8, 1986 and before 1990. (The previously announced deadline of 1989 has been deferred for a year to ensure that taxpayers have adequate opportunity to make the withdrawals.)

New subsection 60.2 also provides for a deduction of up to $3,500 per year against retirement income in respect of undeducted past service AVCs. It applies where the AVCs were used before October 9, 1986 to provide an annuity under an RPP or RRSP or were transferred to a RRIF.

2. Contributions to DPSPs

Under subsection 147(8) of the Act, employer contributions to deferred profit sharing plans (DPSPs) continue to be deductible up to the limit of $3,500 per beneficiary in 1988. (Employee contributions to DPSPs are not deductible under the existing rules and are prohibited under the amended registration rules which take effect on January 1, 1989.)

3. Timing of Employer RPP and DPSP Contributions for PA Purposes

Under a new rule (in subsection 7701(6) of the Income Tax Regulations), employer contributions made in the first two months of a calendar year that can reasonably be considered to be in respect of services rendered by employees in the preceding year will be treated for the purpose of PA reporting as if they had been made in the preceding year. This rule will take effect after 1987 except that, for

1988, the rule will apply to contributions made in the first *four* months of the year. As a result, contributions made before the end of April 1988 in respect of 1987 service will be deemed to be made at the end of 1987. This rule is relevant to the calculation of PAs for members of RPPs and DPSPs in respect of employer contributions made on a money purchase basis to such plans. Its purpose is to make it easier for employers to make annual contributions based on a percentage of earnings.

4. Anti-Avoidance Rule

With the transition to the new system of contribution limits, earnings in 1988 serve as the base for the RRSP contribution limit in both 1988 (under the old rules) and 1989 (under the new system). In the absence of a special rule, additional contribution room could be arranged by changing a pension plan or DPSP to provide for the termination, suspension or delay of membership, contributions or accruals in respect of 1988. A special anti-avoidance rule in subsection 146(5.21) addresses this problem by denying the additional RRSP deduction that would otherwise be allowed by such a change where it is reasonable to consider that the purpose of the change was to create the extra contribution room.

5. Preparation for PA Reporting

The nature of pension adjustments (PAs), pension adjustment reversals (PARs) and past service pension adjustments (PSPAs) and the requirements for the reporting of these amounts are discussed in Chapter III, section 2 below.

The first PAs will have to be reported by the end of February 1989 on the basis of the pensionable earnings and benefit accruals of employees in 1988. Thus it is important that employers and plan administrators prepare for this reporting during 1988.

Where a PAR is reportable as a consequence of the termination of a plan member in 1988, this report is also required by February 28, 1989. The rules for calculating PAs, PARs and PSPAs are set out in sections 7700 to 7708 of the Income Tax Regulations. A detailed commentary on these rules, together with examples of their application, is provided in the explanatory notes covering these Regulations.

6. Contributions to RRSPs

(a) Contribution Limits

The existing RRSP contribution limits, found in subsection 146(5) (and, for contributions to spousal plans, in subsection 146(5.1)), will remain unchanged for

1988. For an employee who accrued benefits in the year under an RPP or DPSP, the limit is 20 per cent of earned income to a maximum of $3,500, less any employee pension contributions deductible under paragraph 8(1)(m). For other taxpayers, the limit is 20 per cent of earned income to a maximum of $7,500.

(b) Definition of Earned Income

In its application to the 1988 and 1989 taxation years, the existing definition of earned income in paragraph 146(1)(c) is modified by adding unemployment insurance premiums and net research grants and by requiring the deduction of any alimony and maintenance payments made by the taxpayer. The definition of earned income continues to include superannuation or pension benefits for the 1988 and 1989 taxation years.

(c) Definition of a Spouse of an Annuitant

Effective January 1, 1988, "spouse" will be defined to include a common-law spouse for the purpose of certain RRSP provisions. The new definition is provided in new subsection 147.1(1). Under this definition, the spouse of an individual means a person of the opposite sex who

- is married to the individual, or
- has been living with the individual in a conjugal relationship for at least one year.

This change will permit the provision of survivor benefits to a common-law spouse under an RRSP annuity or a RRIF. It will also permit the tax-free transfer of RRSP funds to the RRSP or RRIF of a common-law spouse where the taxpayer dies before his or her RRSP has been matured. This expanded definition of spouse also applies in respect of benefits under RPPs. However, the definition does not apply for the purposes of the deduction under subsection 146(5.1) in respect of contributions to a spousal RRSP – that is, one under which the taxpayer's spouse is the annuitant.

(d) Tax on Excess Contributions

Under section 204.1, a tax of one per cent per month is payable on any "excess amount" contributed to an RRSP. An excess amount arises if RRSP contributions for a year exceed the greater of either $5,500 or the amount the taxpayer is entitled to deduct. This penalty tax continues to apply in respect of excess contributions in 1988.

7. Transfer of Retiring Allowances to an RRSP

Subparagraph 60(j.1)(ii) of the Act currently provides for the tax-free transfer of a retiring allowance into an RRSP up to a limit of $2,000 for each year of service in which the employee acquired benefits under an RPP or DPSP plus an additional $1,500 for each year of service with no such benefits. In recognition of the higher RRSP limits now available to those not accruing benefits under an RPP or DPSP, the existing limits are replaced, for service in 1988 and subsequent years, by a single limit of $2,000 per year of service. For service before 1988, the current limits continue to apply.

8. Transfer of Payments out of Pension Surpluses

Where a payment is made to a taxpayer out of the actuarially determined surplus under a defined benefit provision of an RPP, its tax-free transfer to an RRSP or another RPP can result in the provision of unintended tax deferral advantages. In order to apply the tax-assistance limits in a fairer and more effective manner, the transfer of payments out of pension surpluses to other registered plans under paragraph 60(j) is being eliminated. This change takes effect for the 1988 taxation, but a new provision in paragraph 60(j.01) will permit the transfer of pension surpluses paid to taxpayers before March 28, 1988. Where a plan with less than the maximum allowable benefits is being wound up, benefits under the plan may be increased before completion of the wind-up so as to reduce the amount of any surplus.

III. Measures Effective in 1989

1. Introduction of the New Contribution Limits System

In 1989, the new system of contribution limits takes effect, with the RRSP limit depending on the individual's earned income and what are referred to as pension adjustments (PAs) reported for 1988. Several changes to the DPSP registration rules, and most of the newly codified RPP registration rules, also take effect in 1989. (Restrictions on benefit accruals under defined benefit provisions of existing RPPs apply only with respect to service beginning in 1991.) The main provisions of the new registration rules for DPSPs and RPPs are outlined in chapters V and VI below.

2. Reporting of PAs, PARs and PSPAs

(a) PA Reporting

The reporting of pension adjustments (PAs) is first required in 1989 based on earnings and pension or DPSP accruals for 1988. The PA represents the reduction in the maximum amount that an individual may contribute to an RRSP as a consequence of his or her participation in an employer-sponsored RPP or DPSP. The PA of a taxpayer in respect of an employer is calculated by reference to the benefits accruing to the taxpayer under all RPPs or DPSPs in which the employer participates on his or her behalf.

A PA is reportable whether benefits are provided absolutely or contingently. For example, a PA is reportable in respect of benefits that are only vested in the employee after a further period of service with the employer. The regulations will also permit PA reporting during a waiting period before an employee formally joins a plan as long as the employer and employee agree that benefits will be provided should the employee remain in service with the employer for a certain period of time. The reporting of PAs during employee waiting periods provides a means of avoiding the need to report a PSPA in a subsequent year.

In addition to PA reporting by employers who sponsor RPPs or DPSPs, the reporting of a special PA of 18 per cent of earnings is proposed to deal with two particular circumstances. In one case, pension benefits are provided under unregistered plans that are treated as RPPs for the purpose of the deductibility of employee contributions. In the second, benefits are accrued by Canadian residents under foreign pension arrangements. Chapter VIII provides further details on the proposed treatment of foreign plans.

The requirements for reporting PA amounts are set out in section 147.4 of the Act. Except in special circumstances, the employer is responsible for PA reporting. The plan administrator is required to report a PA only for multi-employer plans and only where:

- employee contributions, made to obtain additional benefits under the plan, are not remitted to the plan by a participating employer; or
- a plan member for whom a PA is reportable under the plan is not employed by any employer in the year – for example, in the case of a permanently disabled plan member.

Employers and pension plan administrators will be required to report the PA for each plan member by the last day of February as part of the T-4 reporting process.

(b) PAR Reporting

Where an individual ceases membership in a plan and does not retain rights to pension benefits under plans of the employer, a pension adjustment reversal (PAR) may be reportable. A PAR restores RRSP contribution room where an individual receives a termination benefit (in respect of service after 1987) under one or more RPPs or DPSPs of an employer that is less than the total amount of the PAs and PSPAs previously reported for the individual by the employer. PAR reporting is required within 60 days of the time the amount becomes reportable except that no PAR is reportable before February 28, 1989. Where a PAR is reported in respect of an individual in 1988, the corresponding PA is reportable in the regular manner in February 1989.

(c) PSPA Reporting

A past service pension adjustment (PSPA) represents the reduction in an individual's RRSP contribution limit associated with benefits provided to him or her under a defined benefit provision of an RPP in respect of service before the current calendar year. Benefits in respect of past service may be provided without PSPA reporting where:

- the benefits are in respect of years before 1988;
- because the benefits reflect an upgrade in previously accrued benefits within limits set by increases in the average wage or in prices, the PSPA determined in accordance with the regulations would be zero; or
- the benefits are in respect of a waiting period prior to formal plan membership, and an appropriate PA was reported for each year of that waiting period.

Where PSPA reporting is required, an application for certification must be made before any contributions may be made in respect of the past service benefits, and

the PSPA must be certified by the Minister of National Revenue before benefits may be paid to a plan member. Before a certification has been made in respect of past service benefits, the PSPA is subject to change or cancellation and is therefore provisional. The reporting of a provisional PSPA is a necessary step in the process of providing past service pension benefits. A previously proposed requirement that employee approval be obtained by the employer before a provisional PSPA is reported has been dropped. However, once a provisional PSPA has been certified, the applicant must report the PSPA to the plan member within 60 days after the notice of certification is received. Since 1989 is the first year in which a past service credit can be provided in respect of service after 1987, no PSPA will be reported before 1989.

Section 147.4 includes provisions requiring the administrator of a plan and the employer or employers who participate in the plan to exchange whatever information is necessary to permit PAs, PARs and PSPAs to be reported as required.

As noted above, the rules for calculating PAs, PARs and PSPAs are set out in sections 7700 to 7708 of the Regulations. A description of the rules, together with examples of their application, is provided in the explanatory notes on those provisions.

(d) Condition for PSPA Certification

Subsection 7706(2) of the Regulations provides that the Minister of National Revenue will make a certification in respect of past service benefits only where the provisional PSPA associated with the benefits does not exceed the sum of

- $8,000,
- the taxpayer's unused RRSP deduction room at the end of the immediately preceding taxation year,
- any PARs reported in the year up to the time of the certification,
- certain "qualifying transfers" from RRSPs, DPSPs or money purchase provisions of RPPs made to fund the past service benefits,
- certain "qualifying withdrawals" from RRSPs made for the purpose of the certification,

less the total of any certified PSPAs to date in the year.

The amount with which the provisional PSPA is compared includes an $8,000 allowance in recognition of the fact that the taxpayer's RRSP deduction limit for the year of certification is not fully taken into account.

Once a certification has been made, the provisional PSPA becomes a certified PSPA. As noted in section 5(a) below, the taxpayer's RRSP deduction room is only reduced by the amount by which the certified PSPA exceeds the sum of any

"qualifying transfers" and "qualifying withdrawals" made for the purpose of the certification.

3. Contributions to RPPs

(a) Employer Contributions

The existing rules relating to the deductibility of employer contributions to an RPP as set out in paragraphs 20(1)(q) and (s) and subsections 20(22) and (23) will no longer apply after 1988 (except in respect of contributions made before 1989 and deductible for an employer's 1989 taxation year). For contributions after 1988, the deduction is provided by new subsection 147.5(1). Under that subsection, employer contributions under money purchase provisions are deductible to the extent that they are made in accordance with the terms of the plan as registered. Employer contributions under defined benefit provisions are deductible if they are "eligible contributions" as that expression is defined in subsection 147.5(2). Under both these provisions, the limits on contribution deductibility are ultimately determined by the conditions of plan registration.

The conditions of plan registration which are most important in limiting deductible employer contributions are found in new paragraphs 147.1(17)(a) and (b). Under paragraph (a), the PA of a plan member for a year in respect of an employer must not exceed the lesser of

(i) the money purchase limit for the year ($10,500 for 1989), and

(ii) 18 per cent of the member's remuneration from the employer for the year.

Paragraph (b) provides a special rule for members of more than one plan within a group of related employers. It requires that the aggregate of the taxpayer's PAs in respect of the group of employers not exceed the money purchase limit for the year.

By so limiting the PA for each plan member, the provisions limit both the money purchase contributions that can be made by the employer on the member's behalf and the retirement benefits that the member can accrue on a defined benefit basis.

For an employer contribution under a defined benefit provision of an RPP to qualify as an *eligible* contribution, subsection 147.5(2) requires that the contribution be made pursuant to the recommendation of an actuary who certifies that the contribution is required to ensure that the assets of the plan are sufficient to fund the benefits promised under the provision. It also requires that the actuary's recommendation be approved by the Minister of National Revenue.

The actuary's recommendation must be made in the year in which the contribution is made or in one of the three preceding years, and the report containing the recommendation must be filed with the Minister. However,

approvals given before 1989 pursuant to paragraph 20(1)(s) will continue to be valid for the purpose of determining whether contributions qualify as eligible contributions. Where Ministerial approval is necessary in respect of contributions to be made in 1989, an existing actuarial report prepared in 1986 or later may be filed with the application for approval.

Where a plan is a surplus position, employer contributions may be restricted or prohibited. More specifically, if the assets of the plan (relating to the defined benefit provision) exceed the actuarial liabilities under the provision by more than the lesser of (i) 20 per cent of those liabilities and (ii) twice the estimated cost of benefits accruing in the year, the excess actuarial surplus is required to be applied to fund accruing benefits before any further employer contributions may be made. The allowance for an actuarial surplus equal to twice the annual cost of benefits should accommodate most plans. However, consideration will be given to the possibility of including special transition rules if there is a need to give plans that are currently in a surplus position more time to adapt to these limits on employer contributions.

(b) Employee Contributions for Current Service and Post-1987 Past Service

The changes to the deduction provisions for employee pension contributions parallel those for employer contributions. The existing rules are set out in paragraph 8(1)(m). For 1989 and subsequent years, the rules relating to the deduction of employee contributions to an RPP are found in new paragraph 147.5(4)(a). Under this paragraph, a deduction for contributions by an employee in a taxation year under an RPP in respect of services (current or past) rendered after 1987 is allowed to the extent that the contributions are made in accordance with the plan as registered. For contributions under money purchase provisions of an RPP, paragraphs 147.1(17)(a) and (b) of the pension plan registration rules effectively limit employee as well as employer contributions, since both are included in the PA which must not exceed the annual limit equal to the lesser of $10,500 (for 1989) and 18 per cent of remuneration.

> **Example:** In a money purchase plan with a fixed employer contribution rate of 8 per cent of employee pay, the plan terms could provide for employee contributions in 1989 of up to the lesser of:
>
> - 10 per cent of pay, and
> - $10,500 less the employer's contribution.
>
> These could be required or voluntary contributions or a mixture of both. Any contributions made in accordance with these terms would be deductible.
>
> If the plan contained a defined benefit provision with a PA of 8 per cent of an employee's pay, the terms of the plan could again provide for supplemental money purchase contributions in 1989 of up to 10 per cent of pay or, if less, $10,500 minus the PA of the defined benefit provision. Again, any such contributions would be deductible.

In the case of employee contributions under a defined benefit provision of an RPP, the maximum PA rule has no direct application since the employee's PA in respect of the provision depends on the promised retirement benefits rather than contributions made in the year. Any employee contribution to a defined benefit provision of a plan that is required under the terms of the plan is deductible in the year it is made regardless of the amount. This applies equally to contributions made in respect of current service or post-1987 past service.

(c) Employee Contributions for Pre-1988 Service

The new deduction rules for employee contributions do not apply to contributions made in connection with the purchase of past service benefits (under a defined benefit provision of an RPP) for service prior to 1988. The deduction limits for such contributions, which are currently provided in subparagraphs 8(1)(m)(ii) and (iii) and subsection 8(8), are replaced, for 1989 and subsequent years, by parallel provisions in new paragraphs 147.5(4)(b) and (c). Up to $3,500 per year may be deducted in respect of contributions made in respect of years of past service while the taxpayer was not a contributor to a pension plan. This deduction is in addition to any deduction for contributions in respect of post-1987 service. For contributions in respect of years while the taxpayer was a contributor, the maximum deduction is $3,500 less any other deductions for pension contributions made by the taxpayer in the year. The new rules clarify that a taxpayer is to be considered to have been a contributor in a past year if he or she contributed to *any* RPP for the year. (However, this clarification will not restrict deductibility where the past service contributions are made before March 28, 1988 or are made pursuant to an agreement in writing entered into before March 28, 1988.) In addition, the special rule that treats teachers as not having been RPP contributors in prior years is being repealed after 1994.

4. Employer Contributions to DPSPs

The existing rule relating to the deduction for employer contributions to DPSPs in subsection 147(8) is being replaced by a rule providing that contributions may be deducted in computing income to the extent that they are paid in accordance with terms of the plan that comply with the registration requirements for DPSPs.

The limits are set out in the DPSP registration rules which, in new paragraph 147(2)(a.2) and new subsection 147(5.1), restrict employer contributions to a DPSP in respect of an employee to the lesser of

(i) one-half of the money purchase limit for the year (one-half of $10,500, or $5,250, for 1989), and

(ii) 18 per cent of the employee's remuneration for the year in respect of the employer.

These limits apply to the aggregate of all contributions for the benefit of the employee: under all DPSPs of the employer, in respect of all employers who participate in a plan, and in respect of contributions to plans by other related employers. Paragraph 147(5.1)(c) provides that the aggregate of an employee's PAs in respect of all RPPs and DPSPs of any group of non-arm's-length employers must not exceed the lesser of the money purchase limit for the year and 18 per cent of remuneration.

5. Contributions to RRSPs

(a) Deduction Limits

For 1989, the RRSP deduction limits in subsection 146(5) are replaced by a deduction of amounts up to the "RRSP deduction limit" as defined in new paragraph 146(1)(g.1).

For most taxpayers, the 1989 RRSP deduction limit is

> 18 per cent of 1988 earned income (maximum $8,500)
> less: PA in respect of 1988.

However, employee terminations from employer-sponsored plans that occur in 1988 and 1989 will produce pension adjustment reversals (PARs) that will increase the RRSP limit for 1989. Also, the provision of additional pension benefits in 1989 in respect of 1988 service will produce past service pension adjustments (PSPAs) that will reduce the 1989 RRSP limit. The full RRSP deduction limit of a taxpayer for a taxation year is the amount, if positive, that is determined by the formula

$$A + B + C - D$$

where

A is the taxpayer's unused RRSP contribution room at the end of the immediately preceding taxation year (for 1989 this amount is the aggregate of any PARs for 1988),

B is the amount, if positive, by which

(i) the lesser of the RRSP dollar limit for the year ($8,500 for 1989) and 18 per cent of the taxpayer's earned income for the preceding taxation year

exceeds

(ii) the aggregate of the taxpayer's PAs for the preceding year in respect of his or her employers,

C is the aggregate of the taxpayer's pension adjustment reversals (PARs) for the year,

D is the taxpayer's net PSPA for the year; the net PSPA is the aggregate of PSPAs certified in the year less certain inter-plan transfers and RRSP withdrawals which can be applied to obtain certification of a PSPA.

Towards the end of 1989, Revenue Canada will issue individual statements to taxpayers informing them of their RRSP deduction limits for the 1989 taxation year.

(b) Contributions to a Spousal RRSP

The deduction which can be claimed under subsection 146(5.1) in respect of contributions to a spousal RRSP continues to be the difference between the taxpayer's RRSP deduction limit and the amount the taxpayer deducts in respect of contributions to his or her own RRSP. The limit is unaffected by any transfers of retirement income to a spousal RRSP under the special rules provided in paragraph 60(j.2) and described in Chapter III, section 7 below.

(c) Tax on Excess Contributions

The tax of one per cent per month under section 204.1 on any "excess amount" contributed to RRSPs before 1989 is maintained in 1989 and subsequent years. For application of a parallel one-per-cent tax in respect of contributions made after 1988, a "cumulative excess amount" is defined.

The "cumulative excess amount" of a taxpayer in respect of RRSPs at any time in a year, is defined in subsections 204.2(1.1) to (1.4) as the amount, if any, by which

(a) the amount of the taxpayer's undeducted RRSP premiums at the time

exceeds

(b) $8,000 + A + B + C − D.

The taxpayer's undeducted RRSP premiums are determined as the balance of such undeducted premiums at the start of the year (net of amounts deducted in computing the preceding year's income) plus premiums paid up to the time in the year (net of some amounts such as amounts transferred between plans) less RRSP withdrawals up to the time in the year. The amounts A, B, C and D are defined as in section 5(a) above except that the D is the net PSPA determined as of the time in the year rather than as of the end of the year.

The exclusion of $8,000 of undeducted RRSP premiums from the "cumulative excess amount" avoids conflict with the rule for PSPA certification under which a PSPA can be certified even where it exceeds the taxpayer's available RRSP deduction room by up to $8,000. This exclusion also greatly reduces the likelihood of the tax being imposed where the undeducted RRSP premiums result from RRSP contributions being made on the basis of a fixed percentage of current year earnings.

In conjunction with these changes to the excess contributions tax, the RRSP deduction provision in subsection 146(5) is being changed to permit the deduction of contributions made in a prior year. This will make it possible for contributions that are not deducted in the year they are made – because of an over-contribution situation or because of an unexpectedly low level of taxable income – to be carried over for deduction in a subsequent year.

6. Transfer of Funds Between Registered Plans

The tax provisions relating to the transfer of funds between registered plans also change in 1989. Under the current rules a transfer usually involves the inclusion of the transferred amount in income (under subparagraph 56(1)(a)(i) in the case of an RPP or subsection 147(10) in the case of a DPSP) and the deduction of the transferred amount as a contribution under paragraph 60(j) or 60(k). Beginning in 1989, and subject to the exception noted below, a transfer of funds from one registered plan to another can be made on a tax-free basis only if the funds are transferred directly between the plans. Such transfers are provided for in existing subsection 146(16) for transfers from RRSPs, new subsection 147(19) for DPSPs and new section 147.2 for RPPs. These provisions only permit the transfer of lump sum amounts; they do not accommodate the transfer of periodic payments of retirement income to another registered plan. Further details concerning these inter-plan transfers are provided in Chapter VII below. The existing deduction provisions, in paragraphs 60(j) and 60(k), are maintained in 1989 to accommodate the transfer of pension income under RPPs, DPSPs, Old Age Security, and the Canada and Quebec Pension Plans.

7. Transfer of up to $6,000 of Pension Income to a Spousal RRSP

New paragraph 60(j.2) permits a taxpayer to transfer into a spousal RRSP up to $6,000 of income received, on a periodic basis, from an RPP or DPSP. The transfer is additional to any contribution to a spousal RRSP under the taxpayer's RRSP contribution limit. This measure applies in respect of taxation years after 1988 and before 1995. Its purpose is to provide those who are now retired or are nearing retirement with transitional relief from the restrictions imposed on pension income transfers on a tax-deferred, "roll-over" basis after 1989. While the measure is particularly addressed to those whose pension plans do not provide survivor benefits, it applies to all recipients of periodic payments from RPPs or DPSPs who wish to contribute to spousal RRSPs.

IV. Measures for 1990 and Future Years

In 1990 and subsequent years, the structure of the contribution limits is the same as in 1989 with four modifications:

- the dollar limits on contributions and PAs are increased over the phase-in period and are then indexed to reflect changes in the average wage,
- in 1990, the carry-forward of unused RRSP deduction room first becomes available,
- in 1996, the seven-year limit on the carry-forward of unused RRSP deduction room begins to apply, and
- in 1990 and 1995, restrictions on the transfer of pension and annuity income to an RRSP begin to apply.

1. Increases in the Dollar Limits on Contributions and PAs

The *money purchase limit*, defined in subsection 147.1(1), is the dollar limit on contributions to a stand-alone money purchase pension plan. It also limits the PA of a taxpayer under all RPPs and DPSPs of an employer. (These amounts are also subject to a limit of 18 per cent of the taxpayer's remuneration.) The money purchase limit rises from $10,500 in 1989 to $15,500 in 1994.

Beginning in 1995, this limit will be adjusted annually in accordance with the increase in the average wage. The average wage, defined in subsection 147.1(1), is the measure used in the indexing of the year's maximum pensionable earnings (the YMPE) under the Canada and Quebec Pension Plans.

The dollar limit on employer contributions to a DPSP is one-half of the money purchase limit. Thus it rises in proportion to the increases in the money purchase limit and is indexed to growth in the average wage beginning in 1995.

The dollar limit on contributions to an RRSP (referred to as the *RRSP dollar limit*) is defined in paragraph 146(1)(g.2), for 1990 and subsequent years, as the money purchase limit for the immediately preceding year. Thus, it rises from $10,500 in 1990 to $15,500 in 1995 and will be adjusted in accordance with the increase in the average wage beginning in 1996.

These three sets of dollar limits are set out below for the years 1989 to 1995.

Dollar Limits on Contributions and PAs

Year	Money purchase limit	DPSP limit	RRSP limit
		(in dollars)	
1989	10,500	5,250	8,500
1990	11,500	5,750	10,500
1991	12,500	6,250	11,500
1992	13,500	6,750	12,500
1993	14,500	7,250	13,500
1994	15,500	7,750	14,500
1995	15,500[1]	7,750[1]	15,500

[1] Indexed to growth in the average wage.

2. Carry-Forward of Unused RRSP Deduction Room

For the 1990 and subsequent years, new paragraph 146(1)(k) defines a taxpayer's unused RRSP deduction room at the end of a taxation year as the amount, whether positive or negative, determined by the formula

$$A + B + C - D - E$$

where A, B, C and D are defined as in Chapter III, section 5(a) of this guide and E is the amount of RRSP contributions deducted by the taxpayer in computing his or her income for the year.

This balance is the unused room that is carried forward (as A) in determining the following year's RRSP deduction limit.

A taxpayer's unused RRSP deduction room can be negative where Revenue Canada certifies a PSPA that exceeds the deduction room available to the taxpayer. Such PSPA certifications will be permitted to create a negative balance of up to $8,000. The effect of a negative amount of unused RRSP deduction room is to reduce the taxpayer's RRSP limit in the following year.

As in 1989, Revenue Canada will issue statements to taxpayers towards the end of each year informing them of their RRSP contribution limits for the year.

3. Seven-Year Carry-Forward Limit

For 1996 and subsequent years, a taxpayer's unused RRSP deduction room will be limited by the seven-year carry-forward limit. The cap on unused room at the end

of a year is determined as the aggregate for each of the seven preceding years of 18 per cent of the taxpayer's earned income in the year up to the year's RRSP dollar limit.

4. Transfer of Pension Income to an RRSP

Paragraph 60(j) currently permits the tax-free transfer to an RRSP of pension income, including Old Age Security (OAS) benefits, benefits under the Canada and Quebec Pension Plans (CPP/QPP) and income from a DPSP. A similar transfer to an RRSP of annuity income from another RRSP is permitted under subsection 146(16). Commencing in 1989, new paragraph 60(j.2) also permits the transfer to a spousal RRSP of up to $6,000 per year of income from an RPP or DPSP. In addition, the inclusion of superannuation or pension benefits, retiring allowances and death benefits in the definition of "earned income" for RRSP purposes provides another avenue by which retirement income can be re-contributed to an RRSP.

These provisions will be changed in 1990 and 1995. After 1989, paragraph 60(j) will no longer permit the deduction of amounts received from an RPP or DPSP (or from OAS or CPP/QPP) and contributed to another RPP or an RRSP. As described in Chapter III, section 6 above, inter-plan transfers made on a tax-free basis will be provided for under subsections 146(16) and 147(19) and new section 147.2. However, these provisions will permit only the transfer of lump-sum amounts and will not accommodate the transfer of periodic payments of retirement income from one registered plan to another. Also, the definition of "earned income" in paragraph 146(1)(c) is being amended, effective after 1989, to exclude superannuation or pension benefits, retiring allowances, death benefits and other payments out of RPPs and DPSPs. Finally, after 1994, the special provision in paragraph 60(j.2) for a transfer to a spousal RRSP of up to $6,000 of pension income will no longer apply.

By eliminating opportunities for some taxpayers to obtain further tax deferrals on payments of pension income, these changes are intended to focus tax assistance for retirement saving more closely on the objective of assisting Canadians to provide income replacement for earnings that cease upon retirement. The transition period to January 1, 1995 before the changes relating to pension income transfers take full effect is designed to assist those now at or near retirement.

V. Rules Applicable to DPSPs

Several amendments are made to the DPSP registration rules as set out in section 147. They are generally effective in 1989 and subsequent years. Changes to these registration requirements and related rules that have been described above include:

- the timing rule for employer contributions (in II-3),
- limits on employer contributions (in III-4), and
- transfers between plans (in III-6).

Other significant changes are summarized below. Consequential changes, such as modification of the plan revocation rules to conform to the new registration requirements, are not noted here. The measures proposed on October 9, 1986 included a rule to restrict the amount of DPSP monies invested in the shares of an employer. This proposed rule has been dropped.

1. Prohibition of Employee Contributions and Excess Employer Contributions

Subsection 147(2) of the Act sets out the DPSP registration rules. New paragraph 147(2)(a.1) requires every DPSP to include terms restricting contributions that may be made to the plan to employer contributions made in accordance with the terms of the plan. As a consequence of this rule, DPSPs will not be able to accept employee contributions. In the past, such contributions, although not deductible, have provided unintended tax deferral advantages. As a further consequence, employer contributions to DPSPs will be limited to amounts specifically called for by the terms of the plan. Such contributions are subject to the limits described in Chapter III, section 4 above.

2. Two-Year Vesting

The existing requirement, in paragraph 147(2)(i), regarding the vesting of benefits in the employee is replaced by a requirement that amounts allocated to a plan beneficiary after 1988 vest irrevocably in the beneficiary not later than the time of allocation except that, for employees with less than two continuous years as beneficiaries under the plan, vesting will occur at the end of two such continuous years. The existing rules apply with respect to amounts allocated or reallocated before 1989 – such amounts may vest at any time up to five years after the end of the year in which they were allocated or reallocated.

3. Return of Forfeited Amounts

New paragraph 147(2)(i.1) requires a DPSP to provide, after 1988, that where an employee ceases to be a beneficiary under a plan in a calendar year, any amount allocated or reallocated to the beneficiary that is not vested in the beneficiary must be repaid to the contributing employer within 120 days after the end of the year. This provision ensures that forfeited amounts will not be used to provide benefits to other plan members that are not taken into account in applying the comprehensive limit on tax-assisted retirement saving.

VI. Rules Applicable to RPPs

New section 147.1 of the Act provides a set of registration requirements for RPPs which replaces most of the provisions of Revenue Canada's Information Circular 72-13R7. The main rules are briefly described in this Guide; further details are provided in the explanatory notes to the legislation. Under the new comprehensive limits system, the provision of benefits under RPPs will also be affected by regulations relating to the determination and application of PAs, PARs and PSPAs. In this summary of the rules that are proposed to apply to RPPs, these effects are noted as well.

1. Introduction

This introduction deals with the structure of the new registration rules and the scope and timing of their application.

(a) Structure of the Rules

While some of the registration requirements apply to all pension plans, many apply to a particular provision of a plan, and requirements often differ as between money purchase and defined benefit provisions. In section 147.1, subsections (3) to (8) contain rules relating to defined benefit provisions while subsections (9) and (10) contain rules relating to money purchase provisions. Subsection 147.1(2) contains many of the rules that apply to all plans.

For the purpose of the rules, a "money purchase provision" is defined as those terms of an RPP under which benefits in respect of a plan member are only those that can be provided by the contributions made under those terms by or on behalf of the member together with the earnings on the contributions.

A "defined benefit provision" is defined as those terms of an RPP under which benefits provided in respect of a plan member are determined in any way other than under a money purchase provision. The registration rules contemplate the possibility of benefits being provided in respect of a member under two or more benefit provisions. Each provision is treated, in effect, as if it were a separate pension plan.

(b) Application of the Rules

The registration rules apply differently to new and existing plans. For this purpose, an existing plan is one for which an application for registration has been submitted to the Minister of National Revenue before March 28, 1988. Where the new registration requirements do not restrict the benefits that may be provided under an RPP, they generally take effect as of January 1, 1989 for both new and existing plans. Rules of this type include restrictions on investments and borrowing and the limits on employer contributions under defined benefit provisions. Benefit-related requirements applicable to money purchase provisions also take effect from January 1, 1989. Benefit-related requirements applicable to defined benefit provisions, such as the maximum pension limit or restrictions on ancillary benefits, are generally applicable to all service for new plans and to benefits in respect of service after 1990 for existing plans. Existing plans do not need to be amended until the end of 1990 to comply with such requirements.

For new plans, the new registration rules generally apply to benefits accruing in respect of periods before 1988 as well as to benefits which will accrue in respect of future periods. For existing plans, benefits accrued under defined benefit provisions prior to 1991 are generally not subject to the new rules. In place of these rules, new subsection 147.8(2) of the Act requires that the defined benefit provisions of an existing plan be acceptable to the Minister. It is intended that already-approved provisions will continue to be acceptable but that amendments to such provisions will be considered on a case-by-case basis.

Existing plans will have to be amended effective January 1, 1989 to comply with the rules that take effect on that date. In particular, certain of the new rules require that a plan include a requirement as a stipulation of the plan itself. The stipulations which a plan must include as of January 1, 1989 are as follows:

Plans affected	Paragraph	Subject of stipulation
All plans	147.1(2)(a)	permissible contributions
	(b)	assignment of rights
	(f)	investments
	(g)	borrowing
	(h)	determination of amounts
Plans with defined benefit provisions	147.1(3)(d)	certification of past service benefits
	(f)	reduction in benefits to avoid revocation
Plans with money purchase provisions	147.1(9)(b)	return of contributions to avoid revocation
	(c)	refund of forfeited amounts to employer

2. General Conditions of Registration

Requirements that apply to all RPPs are set out in subsection 147.1(2) and subsections 147.1(11) to (27). This section describes the more important of these and lists others.

(a) Establishment of and Membership in an RPP

No restriction is placed on who can set up an RPP. However, to qualify for registration, a plan must require contributions by an employer.

An indirect result of the registration rules is that an RPP can provide benefits only to employees (or office holders), and to their beneficiaries after death. Persons connected with employers – for example, persons holding more than 10 per cent of the shares of the employer – are permitted to participate in RPPs. However, as outlined in Chapter VI, section 9(b) below, any benefits provided to these plan members are subject to a special limit, and special rules apply with respect to the crediting of additional past service benefits in respect of service before 1988.

(b) Pensionable Service

Paragraph 147.1(2)(e) sets limits on the periods of service in respect of which retirement benefits may be provided under a benefit provision of an RPP. Periods of employment with a participating employer are included unless they are prescribed periods. It is intended that this prescription will deny eligibility for foreign service except where certain conditions are met, as is now the case under the rules set out in Revenue Canada's Information Circular.

Pensionable service may also include a period of temporary absence or a period of disability subject to certain conditions which are outlined below in section 3 (for disability) and section 9 (for temporary absence).

Pensionable service under a plan may include a period of pensionable service with a former employer under another RPP provided that no benefits are retained under the other plan. A reciprocal agreement is not necessary for benefits to be provided in respect of such service.

(c) Pension Adjustment Limits

Subsection 147.1(17) requires that a PA of a plan member for a year in respect of a participating employer not exceed the lesser of the money purchase limit for the year ($10,500 in 1989, for example) and 18 per cent of the member's remuneration for the year from the employer. If a member's PA for any year exceeds the limit, the registration of the plan can be revoked.

Subsection 147.1(13) requires that a plan contain terms sufficient to ensure that the PAs of the members of the plan will comply with the limits in subsection

147.1(17). In the case of a money purchase plan, this means that the terms must be such that under no circumstances will the combined employer and employee contributions in a year exceed the lesser of 18 per cent of the employee's remuneration and the money purchase limit for the year. In the case of a defined benefit plan, the terms of the plan must limit benefits so that the PA of a plan member complies with the same limit.

If a plan permits voluntary current service pension contributions to be made, the terms required by subsection 147.1(13) must restrict such contributions to ensure that the PA limits are respected. Such contributions will be permissible only where the total PA associated with defined benefits or required money purchase contributions is less than 18 per cent of earnings and the money purchase limit for the year.

(d) Permissible Contributions

Paragraph 147.1(2)(a) prohibits any contribution or gift to a plan other than employer or employee contributions made under the terms of the plan as registered, permissible transfers of retiring allowances, transfers from other registered plans in accordance with the applicable provisions of the Act, and prescribed amounts. It is intended to prescribe transfers from foreign pension plans where certain conditions are met.

Employer contributions under a defined benefit provision of a plan must qualify as *eligible* contributions. As described in Chapter III, section 3 above, this means that they must be based on the recommendation of an actuary who has certified that they are necessary to ensure that the plan has sufficient funds to pay the promised benefits. The actuary's recommendation must be accepted by the Minister of National Revenue.

The effect of this paragraph is to prevent RPPs from accepting contributions (apart from certain transfers) which do not meet the conditions for deductibility set out in section 147.5 of the Act.

(e) Permissible Distributions

Paragraph 147.1(2)(c) limits the payments or distributions that may be made from an RPP. Permissible distributions include:

- "lifetime retirement benefits";
- lump sum payments;
- transfers of lump sum amounts to another RPP or RRSP in accordance with section 147.2 of the Act;
- payments in connection with the division of property on marriage breakdown; and

- distributions of actuarial surplus to an employer or a plan member.

It is not intended that this rule restrict payments made to defray reasonable administrative expenses or to pay for investments. Such payments are not considered to be "distributions".

"Lifetime retirement benefits" are periodic payments to a plan member that will continue to be paid until the member's death. Thus they do not include bridging benefits (periodic payments which cease when the plan member begins to receive benefits under the Old Age Security program or the Canada or Quebec Pension Plan). Paragraph 147.1(2)(c) provides only for the payment of the lifetime retirement benefits in equal annual or more frequent amounts. Exceptions to this rule to accommodate inflation adjustments and other benefit variations are permitted by subsections 147.1(8) and (10).

Lump sum payments can be made to a plan member at any time before retirement benefits commence to be paid to him or her from a plan. Where a lump sum payment is made, paragraph 147.1(3)(g) requires that the promised retirement benefits be reduced in present value by an amount at least equal to the payment.

Subsection 147.1(12) authorizes distributions which would not otherwise meet the registration requirements if the distribution (for example, under a "50-per-cent minimum employer contribution rule") is required to comply with the Pension Benefits Standards Act, 1985 (PBSA) or similar provisions of a provincial act, or would be so required if the PBSA or a provincial act were applicable to the plan members.

(f) Other Conditions

Subsection 147.1(2) also requires that a registered pension plan:

- provide that rights under the plan cannot be surrendered or assigned except as a consequence of the breakdown of a marriage or other conjugal relationship;
- provide for retirement benefits to commence no later than the month following the member's 71st birthday;
- provide that the plan may only hold investments that are
  - permitted under provincial pension benefits legislation or, where no such legislation applies, the PBSA; and
  - investments in arm's-length entities that are not prescribed under new Regulation 7800; this regulation makes exceptions for NHA-insured mortgages and shares listed on a prescribed stock exchange; and
- provide that money may not be borrowed in connection with the plan except on a short-term basis in certain limited circumstances or in connection with the purchase of income-producing real property.

3. Conditions Applicable to Defined Benefit Provisions

Any RPP that contains a defined benefit provision must comply with the conditions set out in subsection 147.1(3) and (4) and is also subject to subsections 147.1(5), (6) and (8). For the most part, these rules limit the level and form of benefits that can be provided under defined benefit provisions of RPPs.

(a) Contributions

The limits on employer contributions are set out in paragraph 147.1(2)(a) and subsection 147.5(2) and are outlined above in Chapter III, section 3(a).

Paragraph 147.1(3)(a) of the Act requires that employee contributions in respect of current service must reasonably be expected not to exceed the lesser of: (i) 9 per cent of remuneration and (ii) $600 plus 70 per cent of the employee's pension credit for the year under the provision. (The pension credit is the employee's PA in respect of the provision.) Contributions made in respect of certain special periods (periods of disability or temporary absence, for example) and contributions required in connection with the provision of benefits for past service must reasonably be expected not to exceed the amounts necessary to fund the benefits accruing in respect of such periods. The purpose of these restrictions is to ensure that employee contributions are not out of proportion to promised benefits.

(b) Determination of Retirement Benefits

Paragraph 147.1(3)(b) requires that retirement benefits under a defined benefit provision be determined in such a manner that the member's PA for a year is determinable at the end of the year. This precludes the use of a benefit formula that depends on the exercise of discretion before benefits can be calculated. This parallels an existing requirement (in paragraph 9(a) of the Information Circular) that benefits must be in accordance with a definite formula set forth in the plan.

(c) Restrictions on Benefit Accruals

By virtue of paragraph 147.1(3)(c), no benefits may be provided to a member in respect of a period of service after the member has commenced to receive retirement benefits under the provision. As outlined below, an exception is made to this rule in the case of certain periods of disability.

By virtue of paragraph 147.1(3)(d), benefits in respect of past service after 1987 may be provided to a member only where:

- the PSPA associated with the benefits is zero (as will often be the case where benefits are upgraded in line with wage or price increases, for example), or

- the Minister of National Revenue makes a certification in respect of the benefits.

The requirements for PSPA certification are described in Chapter III, section 2(d) above.

Paragraph 147.1(3)(f) requires a plan with a defined benefit provision to provide that benefits can be reduced if necessary in order to comply, for example, with the PA limit in subsection 147.1(17) or the maximum pension limit in subsection 147.1(4) and thus avoid the registration of the plan being revoked.

(d) Maximum Pension

Subsection 147.1(4) sets out the maximum lifetime retirement benefits that can be provided under a defined benefit provision of an RPP. Limits are defined first for the year in which the pension commences and then for subsequent years.

In paragraph 147.1(4)(a), the limit for the year the pension commences is defined as the lesser of

(a) 2 per cent of average best earnings times the number of years of pensionable service, and

(b) $1,722.22 (indexed after 1994) times the number of years of pensionable service.

For this purpose, the expression "average best earnings" means the greater of either one-third of the member's remuneration for the period of 36 consecutive months of highest remuneration or one-fifth of the member's remuneration for the five 12-month periods (non-overlapping) of highest remuneration. The periods of remuneration need not be periods of pensionable service but the remuneration must be with one or more employers with whom the member has pensionable service under the provision.

This limit corresponds to the existing pension limit set out in paragraph 9(g) of the Information Circular. However, it differs from the existing limit in the following ways:

- As provided in paragraph 147.1(5)(a), in applying the maximum pension limit, the amount of remuneration in a year may be updated to the year of commencement of the pension in accordance with the increase in the average wage.

- The existing dollar limit of $1,715 per year of service is modified to $1,722.22 which is equal to one-ninth of the 1994 money purchase limit. For years after 1994, the dollar limit will be defined as one-ninth of the money purchase limit for the year. By this means, the maximum pension limit, applicable in the year pension payments begin, will be indexed in accordance with increases in the average wage.

- The existing requirement, for funding purposes, that the actuarial value of a pension with survivor benefits may not exceed the value of the maximum pension paid as a single life annuity guaranteed for 10 years is being eliminated.
- The existing restriction of 35 years on the length of pensionable service is being removed. Maintaining this limit would have served little purpose since individuals no longer accruing pension benefits can obtain roughly comparable tax assistance by making maximum RRSP contributions of 18 per cent of earnings.
- The maximum pension rule applies to each defined benefit provision separately. It does not require the aggregation of benefits under a defined benefit provision with benefits derived from a money purchase provision or any other defined benefit provision. Control over aggregate benefits is provided by means of the PA limits found in subsection 147.1(17).
- The existing exemption from the maximum pension limit for pensions of $300 or less per year of pensionable service is being eliminated.

As described in section 9(b) below, a modified form of this maximum pension limit applies to benefits in respect of any periods of service where a member is a "person connected with an employer" who participates in the plan.

After a pension commences, the maximum pension limit is the limit in the year of commencement adjusted in accordance with increases in the consumer price index.

(e) Early and Late Retirement

Paragraph 147.1(3)(e) requires that benefits coming into pay before a member reaches a certain age must be reduced to take account of the longer period of pay associated with early retirement. No reduction is required if benefits commence after the earliest of the days on which:

(i) the member attains age 60;

(ii) the member has 30 years of pensionable service under the plan;

(iii) the aggregate of the member's age plus years of pensionable service under the plan is equal to 80; and

(iv) the member ceases employment because of a permanent disability.

For plan members in prescribed occupations that require early retirement for reasons of public safety, the age in (i) is replaced by age 55, and the aggregate in (iii) is replaced by 75. The prescribed public safety occupations are: firefighter, police officer, corrections officer, air traffic controller, and commercial airline pilot. An exemption from the rule is also provided for the plan established by the Canadian Forces Superannuation Act.

Where a pension commences prior to the earliest day set out above, the level of the member's lifetime retirement benefits must be reduced by at least 1/4 of one per cent for each month (or 3 per cent for each year) between the time it commences and the earliest day at which an unreduced benefit could have been paid.

Where a pension commences after the member attains age 65, benefits may be actuarially increased. Under subsection 147.1(6), such an increase is permitted even where it results in retirement benefits in excess of the maximum pension limit. A provision of the PA regulations ensures that an actuarial increase in benefits to reflect their deferral after age 65 will not result in a positive PSPA. These provisions help to ensure that defined benefit plans can provide benefits comparable to those available under money purchase plans in cases where pension commencement is deferred beyond age 65.

(f) Bridging Benefits

"Bridging benefits" of up to the total of benefits under the Old Age Security program and the Canada and Quebec Pension Plans may be paid under a defined benefit provision to a plan member who commences to receive retirement benefits before age 65. Under paragraph 147.1(8)(a), the maximum level of bridging benefits may be provided only where, at the time the benefits commence, the individual has attained age 60 and has at least 10 years of pensionable service under the provision. Where these conditions are not met, the allowable level of bridging benefits is reduced:

- by 1/4 of one per cent for each month (or 3 per cent per year) between the time they commence and the time the member attains age 60, and
- by 10 per cent of their maximum level for each year by which the member's pensionable service falls short of 10.

These rules are intended to ensure that plans do not provide bridging benefits that are out of proportion to the lifetime retirement benefits they provide.

(g) Inflation Adjustments

The new registration rules accommodate inflation adjustments to defined benefits both before and after the time of pension commencement.

Before a pension commences, the level of benefits may be adjusted to reflect, in whole or in part, increases in the average wage. These adjustments are accommodated, first, by a provision of subsection 147.1(5) which permits remuneration to be updated to the year of pension commencement for the purpose of determining the maximum pension limit and, second, by a provision of the PA regulations which ensures that such adjustments will not result in a positive PSPA. Together, these provisions will permit pension accruals in flat benefit and career average plans to be adjusted in line with wage increases. In addition, they will allow wage increases to be taken into account in determining the initial benefit

level under a deferred annuity or the value of a lump sum termination benefit based on such a deferred annuity.

After retirement benefits have commenced to be paid, paragraph 147.1(8)(b) provides that they may be adjusted to reflect, in whole or in part, increases in the consumer price index. Again, this accommodation is made both in the maximum pension provisions and in the rule for determining a PSPA. Also, this paragraph permits retirement benefits to be adjusted for inflation notwithstanding the requirement of paragraph 147.1(2)(c) that benefits be paid in equal periodic amounts. Indexing after pension commencement as well as before can be taken into account in determining the present value of a deferred annuity.

The registration provisions and PA regulations that accommodate the adjustment of retirement benefits for inflation apply equally where a plan provides for automatic indexing and where inflation adjustments are made from time to time on an ad hoc basis.

(h) Guarantee Period

Paragraph 147.1(8)(c) permits a defined benefit provision of an RPP to contain a benefit guarantee under which retirement benefits may be paid to one or more beneficiaries of a deceased plan member for up to 15 years after the date on which the member commenced to receive retirement benefits. The total of the retirement benefits paid in a period under a benefit guarantee must not exceed the retirement benefits that would have been paid to the member in the period had he or she lived. However, retirement benefits under a guarantee may be commuted rather than paid on a periodic basis.

(i) Post-Retirement Survivor Benefits

Where a member dies after commencing to receive retirement benefits under a defined benefit provision of an RPP, paragraph 147.1(8)(d) permits the plan to pay survivor benefits to a spouse or a dependant of the member. The provision of survivor benefits does not require any reduction in the level of retirement benefits payable to the plan member upon retirement.

For this purpose, a dependant is a parent, grandparent, brother, sister or child of the member who was dependent on the member for support immediately before the member died. The payment of survivor benefits to a spouse can continue until the death of the spouse. The payment to a dependant can continue until the end of the year in which the dependant attains age 18, or, if later, the time at which he or she ceases to be in full-time attendance at an educational institution, except that if the person is dependent by reason of infirmity, payment can continue until the person ceases to be infirm.

The level of survivor benefits payable to any one person in a period may not exceed 75 per cent of the retirement benefits (including bridging benefits and

inflation adjustments) that the member would have received in the period. In addition, the total amount of survivor benefits payable to all eligible recipients for a period, together with any amounts payable (or that would have been payable but for their commutation) under a guarantee period provision, may not exceed the retirement benefits that the member would have received.

(j) Pre-Retirement Survivor Benefits

Paragraph 147.1(8)(f) allows a plan, under a defined benefit provision, to pay survivor benefits to a spouse or dependant of a member who dies before commencing to receive retirement benefits. These benefits can continue for the same periods as for post-retirement survivor benefits.

In the general case, the registration requirements allow a survivor benefit of up to 75 per cent of the pension the member would have received had he or she retired immediately before the date of death. In determining this amount, no actuarial reduction is required on account of early retirement. Where payments are made to two or more beneficiaries, the total pension must not exceed the member's accrued pension.

These provisions permit survivor benefits that are consistent with those available for a member who dies after commencing to receive retirement benefits. However, they may permit only very limited benefits in the case of plan members with short periods of pensionable service. Accordingly, a proposed regulation will permit the survivor benefit defined above to be increased to a level not exceeding the lesser of:

- 75 per cent of the projected pension of the member had he or she continued to accrue benefits until age 65,
- the YMPE in the year of the member's death.

Survivor benefits may be adjusted for inflation in the same manner as a member's retirement benefits. The terms of a pre-retirement spousal survivor benefit may include a guarantee period of up to 15 years.

(k) Disability Benefits

Paragraph 147.1(2)(e) permits the continued accrual of pension benefits during a period of disability. For this purpose, disability is defined in subsection 147.1(1) to mean a physical or mental impairment that prevents the plan member from engaging in employment (temporarily or permanently) and has been so certified by a medical doctor.

Pension benefits may continue to accrue during any period of disability *prior* to pension commencement that satisfies the above definition. Where a plan member is permanently disabled, paragraph 147.1(3)(e) permits the payment of a pension without reduction by reason of early retirement. Furthermore, a proposed regulation will provide for the pension payable to a permanently disabled plan member to be increased to an amount not exceeding the lesser of:

- the projected pension of the member had he or she continued to accrue benefits until age 65, and
- the YMPE in the year of pension commencement.

These benefits will be subject to the same provisions regarding inflation adjustments, guarantee period and survivor benefits as are other retirement benefits.

As in the case of pre-retirement survivor benefits, these rules permit pension plans to be used to provide a substantial level of earnings-replacement benefits while controlling tax-assistance costs by requiring that additional benefits be provided through other vehicles such as long-term disability plans.

(l) Lump Sum Payments after Death

In place of the payment of pre-retirement survivor benefits on a periodic basis under a defined benefit provision, paragraph 147.1(8)(h) permits a plan to provide for the payment of lump sum benefits to one or more beneficiaries after the death of a plan member. The total of such lump sums must not exceed the present value of the member's accrued retirement benefits at the date of the member's death, plus interest to the date of payment. Such amounts must be paid by the end of the year following the year of the member's death.

Where no other amounts are payable after the death of a member, the plan may provide for the payment to one or more beneficiaries of amounts that in aggregate do not exceed the cumulative balance of the member's contributions plus associated interest less any amounts already paid or transferred out of the plan under the provision on behalf of the member.

(m) Optional Form of Benefits

A plan may permit a member to select an optional form of retirement benefits under a defined benefit provision as long as the initial level of lifetime retirement benefits is not increased and there is no increase in the present value of benefits calculated as of the time benefits commence. Under these conditions, paragraph 147.1(8)(j) provides for plan members to elect a variety of benefit forms including guarantee periods, survivor benefits, bridging benefits and inflation adjustments. In each case, the ancillary benefits must obey limits similar to those set out in other paragraphs of this section or section 147.1(10) relating to money purchase provisions. In the case of survivor benefits, an election can be made to provide such benefits only to a spouse, and the level of survivor benefits may not exceed the level of the member's pension. In the case of inflation adjustments, permissible forms include:

- a fixed increase of up to 4 per cent per year;
- adjustments which reflect, in whole or in part, increases in the consumer price index; or

- adjustments linked to the return on, or value of, a pool of investment assets.

Paragraph 147.1(8)(k) permits an optional form of benefits to be elected by a surviving spouse of a plan member who dies before commencing to receive retirement benefits. However, this election may not include a second generation of survivor benefits.

Election by a plan member of a lower level of lifetime retirement benefits with more generous ancillary benefits does not affect the PAs reported for the member.

4. Conditions Applicable to Money Purchase Provisions

An RPP that contains a money purchase provision must satisfy the conditions of subsection 147.1(9) and is subject to the provisions of subsection 147.1(10).

(a) Contributions

By virtue of paragraph 147.1(2)(a), employer and employee contributions may be made under a money purchase provision of an RPP only if they are made in accordance with the terms of the plan as registered. Subsection 147.1(17) limits the PA for a plan member in respect of a participating employer, and subsection 147.1(13) requires an RPP to include terms to ensure that these limits will be respected. As a result of these restrictions, a stand-alone money purchase plan may provide for a combination of employer and employee money purchase contributions, made on a scheduled or discretionary basis, of up to 18 per cent of the employee's remuneration for a year, but not exceeding the money purchase limit for the year. Where defined benefits are also provided under the same plan or a different plan, benefits provided under the defined benefit provision and contributions under the money purchase provision must be co-ordinated to ensure that the PA limits are respected.

Paragraph 147.1(9)(e) adds a further requirement that employer contributions under a money purchase provision must be acceptable to the Minister of National Revenue. This provision will permit the Minister to set guidelines for minimum employer contributions. It is anticipated that such guidelines will distinguish between stand-alone money purchase plans and money purchase provisions which are supplementary to defined benefit provisions.

Paragraph 147.1(9)(b) requires an RPP containing a money purchase provision to provide that employer or employee contributions can be returned to the contributor to avoid the revocation of the plan's registration. This situation might arise, for example, where the PA limits of subsection 147.1(17) had been violated.

(b) Separate Accounts

Paragraph 147.1(9)(a) requires an RPP to provide that a separate account be maintained for each member under a money purchase provision. All contributions

and transfers to the plan in respect of the member, and all the earnings attributable to them, must be allocated at least annually to the member's account.

(c) Refund of Forfeited Amounts

Paragraph 147.1(9)(c) requires an RPP containing a money purchase provision to provide that where a member ceases to have any rights with respect to an employer contribution, the contribution, and all earnings attributable to it, will be paid to the employer within 120 days after the end of the year. This provision prevents forfeited amounts being reallocated to other plan members.

(d) Annuities

Paragraph 147.1(9)(d) requires an RPP containing a money purchase provision to provide that retirement benefits payable in respect of a member under the provision will be provided either:

- by means of an annuity purchased with the balance of the member's account from a licensed issuer of annuities; or
- under a prescribed arrangement.

The prescribed arrangement, which is described in the explanatory notes, is intended to permit a money purchase plan to provide self-insured annuities under certain conditions.

(e) Form of Benefits

Subsection 147.1(10) permits an RPP to provide certain benefits under a money purchase provision of the plan that do not satisfy the requirement for equal annual payments contained in paragraph 147.1(2)(c). The permissible benefits differ in some respects from the benefits which are permitted by subsection 147.1(8) in the case of defined benefit provisions. The difference is a reflection of the fact that the benefits that can be provided under a money purchase provision are limited by the contributions and earnings available to fund them. Ancillary benefits such as inflation adjustments can be provided only if retirement benefits are correspondingly reduced. The same trade-off of benefits does not exist in the case of a defined benefit provision.

The main provisions of subsection 147.1(10) are summarized in the following points:

- retirement benefits may be reduced when the member begins to receive OAS or CPP/QPP benefits or upon the death of the member's spouse;
- inflation adjustments may be provided in one of three forms:

  - a fixed annual increase of up to 4 per cent per year,
  - adjustments linked to changes in the consumer price index, or
  - adjustments linked to the return on, or value of, a pool of investment assets;
- retirement benefits may be guaranteed for a period of up to 15 years;
- where a member dies after commencing to receive retirement benefits, survivor benefits (not exceeding the retirement benefits that the member would have received) may be paid to a spouse of the member until the spouse's death;
- where a member dies before commencing to receive retirement benefits, the balance in the member's account may be used to provide survivor benefits to a spouse for the duration of the spouse's life; these survivor benefits may be subject to inflation adjustments and a guarantee period of up to 15 years;
- where a member dies before commencing to receive retirement benefits, one or more lump sums may be paid to one or more beneficiaries out of the member's account; such amounts must be paid by the end of the year following the year of the member's death; where such an amount is paid to a dependant of the member who is under 18 years of age, it is proposed that the amount be eligible to be used to purchase an annuity that will have a term ending no later than the end of the year in which the dependant attains age 18;
- the payment of retirement benefits according to one of the forms set out above may either be specified by the plan or provided for at the option of the plan member; the plan may also provide a similar election to a surviving spouse except that the plan cannot provide for the election of a second generation of survivor benefits.

It should also be noted that under paragraph 147.1(2)(c), a plan may permit a member's benefits to be paid in a lump sum rather than taken in the form of retirement benefits.

5. Combinations of Plans and Provisions

The above discussion of the registration requirements has generally assumed that an individual is accruing benefits in the year under one single-employer plan with a single defined benefit or money purchase provision. However, to provide effective limits on tax assistance, several of the rules must be elaborated to recognize that benefits may accrue to an individual:

- under two or more provisions of a plan;
- under two or more plans of the employer;

- under plans of non-arm's-length employers;
- in respect of service with, or remuneration in respect of, two or more employers who participate in the same plan.

The key provision which is elaborated in this manner is the maximum PA limit in subsection 147.1(17). The PA of a taxpayer in respect of an employer is defined in terms of all plans and provisions of the employer under which the taxpayer accrues benefits in the year.

Subsection 147.1(17) also extends this by applying the money purchase limit for the year to the aggregate of a plan member's PAs in respect of a participating employer in a plan and all employers who do not deal at arm's length with the participating employer. This requires that the terms of a benefit provision of a plan not be considered in isolation from the individual's benefit accruals under other provisions of the plan and other plans of the employer or non-arm's-length employers.

A similar test applies in the case of bridging benefits, under subsection 147.1(18), and is proposed to apply in situations such as temporary absence, disability and death prior to retirement where benefits may be credited on the basis of deemed service or earnings.

6. Multi-Employer Plans

Special rules that apply in the case of multi-employer plans are set out in subsections 147.1(11), (17) and (18). A "multi-employer plan" is defined, in subsection 147.1(1), as a pension plan with more than one participating employer where at the beginning of the year the following conditions may reasonably be expected to be satisfied throughout the year:

- participation is pursuant to a collective bargaining or similar agreement, a by-law or a statute;
- employer contributions are made in accordance with a negotiated or fixed schedule of rates; and
- no more than 50 per cent of the active plan members are employed by a single employer or group of related employers.

It is proposed that the PA limits in subsection 147.1(17) will not apply to multi-employer plans in the same manner as to other RPPs. Where an employee belongs, for example, to a multi-employer RPP (that is not a specified multi-employer plan) as well as to another RPP or DPSP of his or her employer, only the single-employer plan will be subject to the limits in subsection 147.1(17) on the PA in respect of the employer. The multi-employer plan will only be required to comply with a PA limit applied at the plan level. Similarly, the cross-plan limit on bridging benefits in subsection 147.1(18) will not apply to multi-employer plans.

Further special rules apply in the case of "specified multi-employer plans". These are plans that are treated essentially as money purchase plans for the purpose of PA reporting. The plan must contain no defined benefit provision other than a flat benefit provision. In addition, for a plan to be treated as a specified multi-employer plan, the administrator must file an election with the Minister of National Revenue.

A specified multi-employer plan will be exempt from the cross-plan PA limits as will other multi-employer plans. Moreover, a specified multi-employer plan will not be subject to any PA limit applied at the plan level provided that no contributions are made to the plan on a money purchase basis.

A specified multi-employer plan will also be generally exempt from the requirement of paragraph 147.1(3)(d) that no benefits be provided under a defined benefit provision in respect of past service except according to the PSPA certification provisions of subsection 7706 of the Regulations. All employer contributions made in a year will be included in the PAs of the plan members on whose behalf they are made without regard to whether some portion of the contributions may go to fund past service benefits. However, where a contribution is made under the provision by a plan member, such part of the contribution that is used to increase prior year benefits will generally be subject to PSPA reporting and certification rather than PA reporting. (An exception is that employee contributions made in January in respect of service in the previous year will be included in PA in the year they are made.)

7. Administration of an RPP

(a) Responsibilities of the Administrator

Paragraph 147.1(2)(i) requires that every RPP have a designated administrator. The administrator's responsibilities include:

- making application for registration of the plan;
- making application for acceptance of an amendment to the plan;
- ensuring that the plan is administered in accordance with its terms as registered;
- apportioning pensionable service between participating employers where required;
- filing actuarial reports with the Minister of National Revenue where required;
- filing an annual information return with the Minister of National Revenue (see (d) below); and
- providing information to a participating employer as required to enable the employer to report PAs, PARs and PSPAs.

(b) Registration and Amendment of a Plan

After 1988, a plan will be treated as having been registered on the date specified in the plan but no earlier than the first day of the year in which the plan is submitted to the Minister of National Revenue for registration.

For a plan amendment to be accepted by the Minister of National Revenue, subsection 147.1(19) provides that the plan as amended must qualify for registration. Subsection 147.1(27) provides that a "plan as registered" means the terms of the plan as accepted for registration and as amended by (a) all amendments that have been accepted by the Minister and (b) amendments submitted to the Minister that can reasonably be expected to be accepted.

(c) Additional Conditions

In order to ensure that the objectives of the Act with respect to RPPs are not frustrated or avoided, subsection 147.1(20) authorizes the Minister of National Revenue to impose such conditions as are considered reasonable with respect to any pension plan. Some scope for Ministerial discretion in ensuring the objects of the Act are met is considered to be necessary because it would not be practical or desirable for the regulations to cover all possible circumstances involving the provision of pension benefits to taxpayers.

(d) Reporting Requirements

The requirements for the reporting of PAs, PARs and PSPAs are set out in section 147.4 of the Act and summarized in Chapter III, section 2 above.

Two additional reports are required to be filed with the Minister of National Revenue: an annual information return and, for plans with defined benefit provisions, actuarial reports. Under subsection 147.4(10), the plan administrator is required to file an information return by the end of April each year beginning in 1990. This return will include information such as any changes in the method used to determine PAs and whether or not the plan membership includes persons connected with an employer.

As noted in Chapter III, section 3(a) above, an employer contribution to a defined benefit provision of an RPP in a year must be based on an actuary's recommendation in the year or in one of the three immediately preceding years. Under subsection 147.5(3), the actuarial reports upon which these employer contributions are based must be filed with the Minister in order to obtain his approval of the actuary's recommendation. Even where employer contributions are not being made to a plan with a defined benefit provision, section 147.3 requires that an actuarial report in respect of the provision be filed by the end of the third calendar year after the previous report was filed. The filing of the first such report is required on or before December 31, 1991 or, if later, the end of the third year after the plan's acceptance for registration.

8. Revocation of Registration

Where an RPP does not qualify for registration or where it is not administered in accordance with its terms and with the registration requirements, the registration of the plan may be revoked. (A plan administrator may also apply for revocation of a plan.)

As set out in section 147.6, the process of revocation would begin with a "notice of intent" sent to the plan administrator by the Minister of National Revenue. The notice of intent would specify an effective date of revocation which could be on, before or after the date on which notice is given. Should the compliance problem not be corrected to the Minister's satisfaction, a "notice of revocation" would then be given to the plan administrator at any time after 30 days after the mailing of the notice of intent. Revocation of the plan would be effective as of the date specified in the notice of revocation unless, following an appeal under subsection 172(3), the Federal Court of Appeal orders otherwise.

In the event of the revocation of an RPP, it would become a retirement compensation arrangement (RCA). Employer contributions would continue to be deductible and, under new paragraph 8(1)(m.1), employee contributions would also be deductible. However, these contributions would be subject to the special 50-per-cent refundable tax under Part XI.3 of the Act. Investment earnings in the plan would also become subject to the 50-per-cent tax. These taxes would be payable by the custodian of the arrangement and would be refundable as benefits are paid to beneficiaries. As a result of this treatment, there would be no immediate tax consequences for employees or employers. The effect of the refundable tax, though, would be to deny any further tax assistance on the funds in and contributions to the plan.

9. Special Situations

Provisions relating to periods of reduced pay or temporary absence and to the provision of benefits to related beneficiaries are outlined below.

(a) Periods of Reduced Pay or Temporary Absence

Special provisions in the Income Tax Regulations will permit additional money purchase contributions to be made or defined benefit pension credits to be granted in respect of periods where a plan member either worked at a reduced pay level or was temporarily absent from employment. In both cases, a deemed amount of remuneration may be included in the definition of remuneration upon which the 18-per-cent PA limit is based. In the case of temporary absence, an additional period of service may also be counted, in accordance with paragraph 147.1(2)(e), in determining the pension that can be provided on a defined benefit basis.

The "reduced pay" provision permits service to be credited, or money purchase contributions made, on the basis of full pay levels in situations where pay levels

are reduced: for example, job sharing, phased retirement, or austerity program pay cuts. While the provision may have little application in "best average" pension plans where low-earning years do not affect pension levels, it provides an avenue for pension benefits to be maintained despite low-pay years in money purchase, career average and final average plans. To qualify as a period of reduced pay, the period must be a period of pensionable service during which the plan member's remuneration does not exceed 75 per cent of his remuneration with the employer in a previous period of at least three years of service with the employer.

A period of temporary absence of a member of an RPP in respect of an employer is a period of

(i) loan to another employer,

(ii) sabbatical, educational or maternity leave, or

(iii) lay-off from employment.

A member may or may not receive remuneration from the employer during a period of temporary absence. (However, a period must not be counted both as a period of employment and as a period of temporary absence in determining benefits.) A qualified period of temporary absence is a period which meets several additional conditions.

For both reduced pay and prescribed temporary absence periods, the member must certify to the plan administrator that he will not accrue any benefits under an RPP or DPSP of another employer in respect of the period. The reporting of PA on the basis of deemed remuneration is required for these periods. Where possible, this reporting should occur during the period in question but in some cases reporting of a corrected PA in a subsequent year may be necessary.

Qualified periods of reduced pay and qualified periods of temporary absence are subject to a combined limit of five years which applies to the "unpaid portion" of the periods. The unpaid portion of such a period is equal to the duration of the period multiplied by the fraction by which the plan member's pay is reduced from the level it would have been were it not for the pay reduction or temporary absence. This means, for example, that a year of job sharing or temporary absence at two-thirds pay would use up only one-third of a year of the five-year limit.

The current registration rules contained in Revenue Canada's Information Circular 72-13R7 permit the crediting of additional years of service in situations where early retirement is imposed for reasons such as technological change. This rule has proven very difficult to administer. Accordingly, no equivalent provision is included in the new registration rules. However, it is anticipated that the reduced pay and temporary absence provisions will provide plan sponsors with some flexibility to create special early retirement arrangements where the need exists.

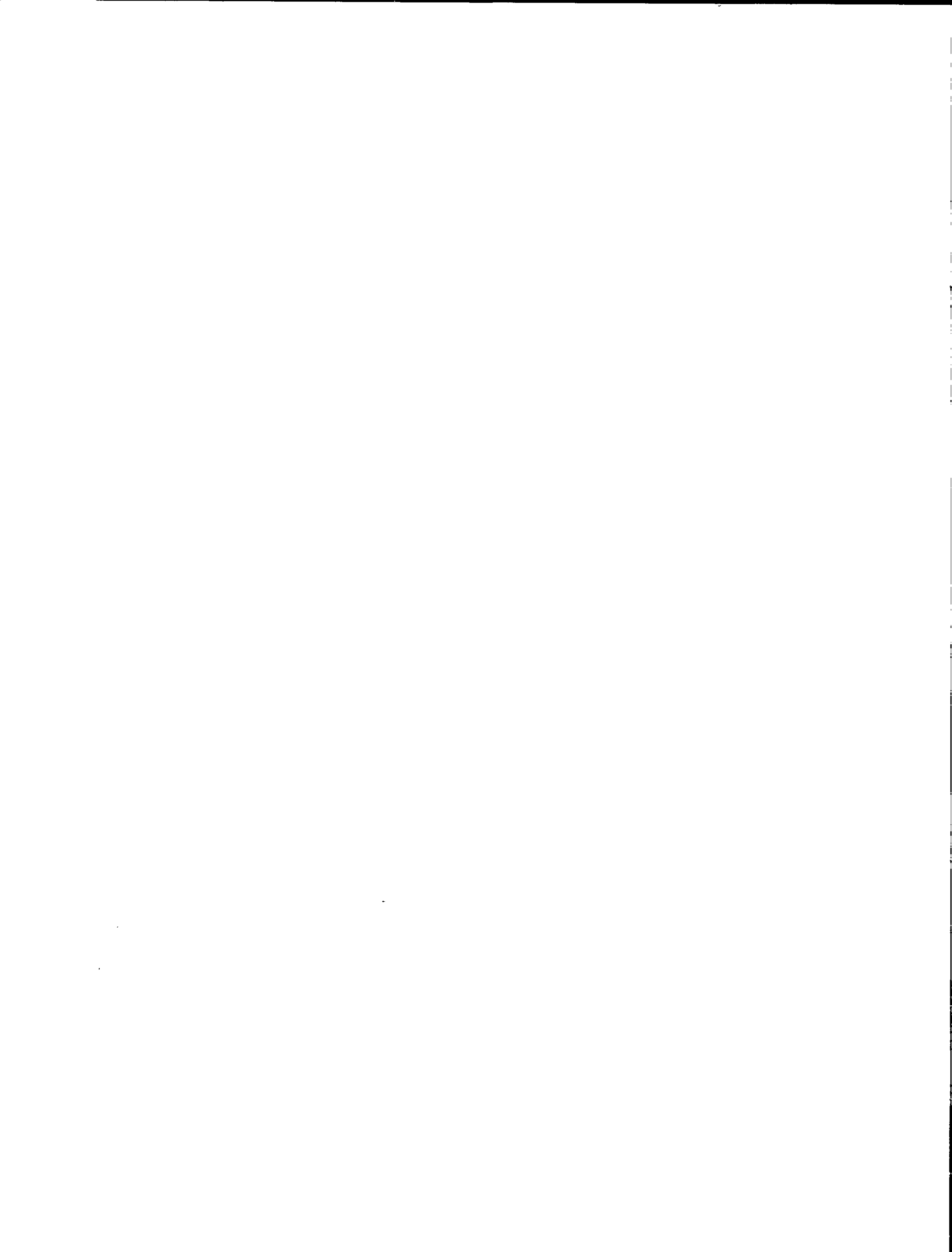
(b) Person Connected with an Employer

Special rules are applicable in the case of a member of an RPP who is connected with a participating employer of the plan. The term "person connected with an

employer" is defined, in subsection 147.1(24), similarly to but somewhat more broadly than "specified shareholder" in the Act and "significant shareholder" in Revenue Canada's Information Circular. In particular, it follows the specified shareholder definition in including a person who owns 10 per cent or more of any class of the shares of an employer whereas the test in the Information Circular is based on ownership of 10 per cent of voting rights. A person is also considered to be connected with an employer if he or she does not deal at arm's length with the employer.

Subject to certain conditions, the registration requirements permit all persons connected with employers to accrue benefits, after 1988, under defined benefit and money purchase provisions of RPPs for service after 1987. For additional benefits to be provided to such persons in respect of pre-1988 service, subsection 147.1(7) provides that the approval of the Minister of National Revenue is required. This will permit the existing rules with respect to pre-1988 benefits for significant shareholders to continue to apply.

Under subparagraph 147.1(4)(a)(i), a modified version of the maximum pension rule applies in respect of periods of service after 1988 in which a plan member was a person connected with an employer. Benefits under a defined benefit provision in respect of such a period are limited to 2 per cent of the member's updated remuneration for the period (or the dollar limit on benefits, if lower). Updated remuneration for this purpose means earnings adjusted in accordance with increases in the average wage. The rules which will permit pre-retirement death benefits and disability benefits to be calculated on a projected basis will not apply in the case of connected persons; nor will the rules that provide special treatment for periods of reduced pay or temporary absence.



VII. Inter-Plan Transfers

The new system of comprehensive limits on tax-assisted retirement saving requires new regulations to deal with the movement of funds and individuals between plans. Under the new system, the rules regarding the transfer of funds between plans are interwoven with the provisions under which an individual may be credited with additional RRSP deduction room on leaving one plan or may use up RRSP room as a condition of obtaining past service benefits on joining another. For example, certain transfers of funds are deducted in determining the PAR of a taxpayer while other transfers are included in the amount against which a provisional PSPA is compared for the purpose of a certification in respect of past service benefits. These different aspects of inter-plan transfers are outlined in this section.

1. General Structure of Transfer Provisions

As indicated in Chapter III, section 6 above, transfers of funds between registered plans under the new contribution limits system are restricted to transfers of lump sum amounts that are effected on a direct (plan-to-plan) basis rather than indirectly. The provisions for indirect transfers – an income inclusion under paragraph 56(1)(a)(i) or subsection 147(10) and a deduction under paragraph 60(j) or 60(k) – will not apply under the new system. Instead, after 1988 direct transfers are provided for under existing subsection 146(16) for RRSPs, new subsection 147(19) for DPSPs and new section 147.2 for RPPs. When an amount is transferred under these provisions, the amount is not included in the taxpayer's income and may not be deducted by the taxpayer.

As a general rule, no amounts may be transferred from an RPP to another RPP or RRSP after 1988 except under the provisions of section 147.2. However, transfers of pension income can also be made under paragraph 60(j) before 1990 and under paragraph 60(j.2) before 1995. Also, paragraph 60(j) will continue to provide a deduction in respect of lump sums transferred from unregistered pension plans attributable to services rendered while the taxpayer was not resident in Canada.

2. Specific Transfer Provisions

In subsections 147.2(1) to (4), four general types of transfer are provided for: (a) transfers between money purchase provisions, (b) transfers from money provisions to defined benefit provisions, (c) transfers between defined benefit provisions, and (d) transfers from defined benefit to money purchase provisions.

Apart from the requirement that they not take place after retirement benefits have commenced to be paid, no limitations are provided regarding when such transfers can occur.

Additional provisions are also included in section 147.2 to deal with transfers in three special circumstances: marriage breakdown, a refund of contributions, and the death of the plan member.

(a) Money Purchase to Money Purchase

Transfers between money purchase provisions of two plans may be in full or partial satisfaction of the individual's rights under the first plan. A transfer of this type is deducted in determining the taxpayer's PAR, if any, associated with his or her termination from the first plan. No limits apply to these transfers and no PSPA reporting is involved.

(b) Money Purchase to Defined Benefit

Funds paid out of a money purchase provision of an RPP, whether paid to the former plan member or transferred to any other registered plan, are deducted in determining the PAR, if any, of the former plan member.

Where funds are transferred to a plan to fund defined benefits, they will generally be associated with the provision of past service benefits. Consequently, the process will involve the reporting of a provisional PSPA and a certification by the Minister of National Revenue in respect of the benefits. The amount of any funds transferred from a money purchase provision of an RPP (or from a DPSP or RRSP) to fund the defined benefits will be included in the amount against which the provisional PSPA is compared in determining whether the condition for certification set out in subsection 7706(2) of the Regulations is met. The amount of such a transfer also serves to reduce the "net PSPA" defined in paragraph 146(1)(d.1) of the Act and thus reduces the amount of any decline in the taxpayer's RRSP deduction limit associated with the crediting of the past service benefits.

In certain instances, the application of amounts transferred from a money purchase provision to obtain defined benefits could result in an unintended level of tax-assisted benefits. An example would be where a large accumulation of money purchase benefits was used in late career to obtain many years of past service benefits under a defined benefit provision of a plan. Consideration is being given to a regulation that would restrict the scope for transfers of this nature being included in the amount against which the resulting provisional PSPA is compared.

(c) Defined Benefit to Defined Benefit

Where an individual gives up defined benefits under one plan in exchange for defined benefits in another, a certification will again be required in respect of the past service benefits provided under the new plan. This procedure will ensure that taxpayers who move between plans with different benefit rates are treated fairly.

Where an amount of funds is transferred from one defined benefit provision to fund defined benefits in another plan, this amount is not deducted in determining the PAR of the taxpayer; nor is the transfer included in the amount against which the provisional PSPA is compared in applying the condition for the certification of the past service benefits under the new plan. This different treatment than in the case of money purchase to defined benefit transfers accommodates inter-plan transfers between defined benefit plans in an equitable manner while avoiding the concern addressed by the restriction that is proposed to apply to transfers from money purchase plans.

A transfer from a defined benefit provision to any other plan or provision cannot include any amount that is part of a plan member's interest in an actuarial surplus.

(d) Defined Benefit to Money Purchase

Since no defined benefit credits are obtained as a result of a transfer of this type, no PSPA certification is involved. However, where any part of the funds transferred from a defined benefit provision goes to a money purchase provision, then the total of the funds transferred from the defined benefit provision will be limited to a prescribed amount. As outlined in the explanatory notes to subsection 147.2(4), the prescribed amount is a multiple of the taxpayer's lifetime retirement benefits accrued under the provision. The multiple depends on the taxpayer's age and is based on a standardized cost of the retirement benefits.

The purpose of this restriction on transfers of amounts from defined benefit provision of RPPs to money purchase RPP provisions or to RRSPs is to avoid the use of such transfers as a means of obtaining larger tax-assisted retirement benefits than intended. In particular, the measure restricts the extent to which early retirement benefits – including bridging benefits and the additional value of an actuarially-unreduced pension that commences at an age younger than 65 – can be converted into additional lifetime retirement benefits commencing at a later age. The restriction also ensures that unduly conservative assumptions are not used in the determination of commuted values of retirement benefits for purposes of the transfer.

This limitation on the amount transferable between plans does not restrict the payment of benefits or lump sums under the defined benefit provision.

(e) Transfers in Special Circumstances

Subsections 147.2(5), (6) and (7) provide for transfers in special circumstances. Under subsection 147.2(5), a lump sum amount received by a spouse or former spouse of a member from an RPP pursuant to a court order or separation agreement relating to a division of property on marriage breakdown can be transferred to another RPP or to an RRSP.

Under subsection 147.2(6), an amount received by a plan member as a return of employee contributions and interest thereon may be transferred to another RPP or to an RRSP where

(i) it is in respect of contributions made prior to 1988, or

(ii) it is in respect of contributions made after 1987, and the present value of the benefits to be provided in respect of the member under the plan is reduced by the amount of the contribution refund.

Under subsection 147.2(7), a single amount received by the spouse of a member from an RPP after the member's death may be transferred to another RPP or to an RRSP. Single amounts received by beneficiaries other than a spouse will no longer be eligible for transfer to another RPP or RRSP after 1988. However, where such an amount is paid to a dependant of the member who is under 18 years of age, it is proposed that the amount be eligible to be used to purchase an annuity that will have a term ending no later than the end of the year in which the dependant attains age 18.

VIII. Foreign Pension Arrangements

1. Canadian Residents

Contributions to foreign pension or retirement benefit plans on behalf of Canadian residents are generally subject to the 50-per-cent refundable tax on contributions made to retirement compensation arrangements (RCAs). However, the existing law provides an exception for contributions made on behalf of individuals resident in Canada for a limited time. As set out below, a further exemption from the RCA rules is proposed for arrangements which meet certain conditions. (The implementing legislation has not yet been prepared.)

The existing exemption from the RCA tax, provided by subsection 207.6(5), accommodates individuals who move to Canada for a temporary period at a time when they are members of foreign pension plans. Contributions made to a foreign plan in respect of services rendered by such an individual who has been resident in Canada for no more than five of the six years immediately preceding the time the services were rendered are not subject to the RCA tax.

A further exemption from the RCA tax is proposed where contributions are made to a foreign pension plan on behalf of a Canadian resident employee. The exemption will apply in respect of such an individual if the following conditions are met:

(a) the employer is a non-resident corporation or an international organization;

(b) the foreign plan is a statutory plan or a superannuation, pension or retirement plan in connection with which a certificate of exemption has been issued under subsection 212(14) of the Act;

(c) the individual does not participate in an RPP or a DPSP of his employer or of a person who does not deal at arm's length with his employer; and

(d) the employer reports a PA in respect of the individual for each year equal to the lesser of

(i) 18 per cent of the individual's total remuneration for the year from the employer, and

(ii) the money purchase limit for the year ($8,500 in 1988 and $10,500 in 1989, for example).

The first of these conditions limits the exemption to situations where a non-tax purpose for the pension arrangement may be presumed. The second restricts its application to plans which qualify for tax preferred treatment in the country in which they are based. Since Canadian registration requirements are not applied to the foreign plans, this provision is intended to ensure that the plans are subject to some control in their own country. The third and fourth conditions are included to ensure that the foreign pension benefits are a substitute for, rather than an addition to, tax-assisted savings in Canadian pension plans, DPSPs and RRSPs based on the same earnings. These conditions are intended to accommodate foreign pension arrangements in a reasonable manner without creating serious inequities in the tax assistance offered to Canadians saving for retirement.

2. Contributions by Canadian Employers in Respect of Foreign Nationals

Where a Canadian employer contributes to a foreign pension plan for the benefit of non-residents in respect of services rendered outside Canada, the plan has sometimes been registered with the Minister of National Revenue in order to ensure that the employer contribution is deductible. With the introduction of new codified registration rules, it is not proposed to register these plans. Reasonable contributions by Canadian employers to such plans will be deductible as normal outlays or expenses incurred to earn income.

A Better Pension System

RRSPs

Saving for Retirement

Canada

The government is acting to give Canadian men and women 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 federally regulated private pension plans were raised, effective 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 period to 1995.

This publication outlines important changes in the tax treatment of retirement saving of particular interest to self-employed persons and employees who are not members of an employer-sponsored registered pension plan (RPP) or deferred profit sharing plan (DPSP). These measures were announced in a policy statement in October 1986 and in the Tax Reform White Paper of June 1987.

Greater Fairness and Flexibility

Currently, those building retirement savings only through RRSPs receive less tax support than those in generous 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 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 covered by most 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 self-employed professionals, small business owners and many employees, are treated equitably.

As in 1987, the contribution ceiling for the 1988 taxation year will be 20 per cent of earned income to a dollar limit of $7,500. Thereafter, the contribution limit will be 18 per cent of earned income up to a dollar limit which will rise as follows:

1989	$ 8,500
1990	$10,500
1991	$11,500
1992	$12,500
1993	$13,500
1994	$14,500
1995	$15,500

After 1995, this dollar limit will be indexed to the growth in average wages.

After 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 at all earnings levels.

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 to taxpayers of their RRSP contribution limits towards 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, taxpayers 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 1989, based on earnings of $45,000 in 1988 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 has also implemented proposals in the February 1986 budget to give retired Canadians who have RRSPs or registered retirement income funds (RRIFs) 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.

March 1988

Department of Finance Canada · Ministère des Finances Canada

A Better Pension System

Employer-Sponsored Pension Plans

Saving for Retirement

Canada

The government is acting to give Canadian men and women 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 federally regulated private pension plans were raised, effective January 1, 1987. Provincial governments are introducing parallel measures. 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 period to 1995.

This publication outlines important changes in the tax treatment of retirement saving of particular interest to members of employer-sponsored registered pension plans (RPPs). These measures were announced in a policy statement in October 1986 and in the Tax Reform White Paper of June 1987.

Greater Fairness and Flexibility

Currently, those building retirement savings only through RRSPs receive less tax support than those in generous 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 be able to make larger contributions to registered retirement savings plans (RRSPs).
- All taxpayers will have the right to carry forward unused RRSP contribution room for seven years.

Employer-Sponsored Plans

Employer-sponsored registered 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 given dollar amount or as a percentage of pensionable earnings for each year of service under the plan. For example, for a plan member with 35 years of service, a 2-per-cent defined benefit plan would pay a pension of 70 per cent of earnings ($2\% \times 35$ years $= 70\%$).

A money purchase plan provides whatever pension income can be purchased, at retirement, from the accumulated contributions and investment earnings in the plan.

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, but there is a continuing limit on the size of the tax-assisted benefits that a defined benefit plan can provide. Thus, tax assistance for such plans is currently available to help build pensions of up to $60,000 a year – the equivalent of $15,500 a year in contributions. This limit will remain during the phasing-in of more equitable tax treatment for the retirement savings of those who lack access to the same level of pension benefits.

Beginning in 1989, combined employer-employee contributions will be limited to 18 per cent of earned income, with dollar limits phased in as follows:

1989	$10,500
1990	$11,500
1991	$12,500
1992	$13,500
1993	$14,500
1994	$15,500

Beginning in 1995, the pension limit and limits on tax-deductible contributions will be indexed to the growth in average wages.

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 apply for 1988.

Beginning in 1989, 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 1989. Those in plans with lower benefit rates will gain more RRSP contribution room – about $4,000 in 1989, for example, for a $40,000 earner who belongs to a 1.5-per-cent plan.

After 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.

For members of employer-sponsored pension plans, RRSP contribution room will be 18 per cent of previous-year earnings to a dollar maximum, minus a *pension adjustment* amount. This dollar maximum will rise as follows:

1989	$ 8,500
1990	$10,500
1991	$11,500
1992	$12,500
1993	$13,500
1994	$14,500
1995	$15,500

For *defined benefit* plans, the pension adjustment will reflect pension benefits accrued in the plan during the year. For *money purchase* plans, the adjustment will simply be the total of employee and employer contributions to the plan in the year. After the end of each year the pension adjustment amount will be reported by the employer to Revenue Canada, which will calculate the RRSP contribution room of each taxpayer and send individual notices of the amount, beginning in 1989.

March 1988

Department of Finance Canada / Ministère des Finances Canada

A Better Pension System

Executive Summary

Saving for Retirement

March 1988

Canada

Overview

This booklet is a summary of a detailed guide to the draft legislation dealing with the new system of tax assistance for retirement saving. The legislation has been prepared to implement the proposals announced by the Minister of Finance on October 9, 1986 and modified in the process of tax reform. The guide is intended primarily to assist employers, pension plan administrators and others who require a detailed working knowledge of the new rules governing tax-assisted retirement saving.

The legislation includes the codification of many of the pension plan registration rules currently found in Revenue Canada's Information Circular 72-13R7. This change has been made to adapt the registration rules to the new system of contribution limits. Codifying the registration rules requires that they be set out with more precision than is required in the Information Circular. Thus, it is important that plan sponsors, employees, union representatives and pension industry professionals have a full opportunity to examine and comment on them. For this reason, the legislation is being released in draft form before its formal introduction in Parliament.

Comprehensive Limit

The aim of the legislation is to provide fairer and more flexible limits on tax assistance for retirement saving. The basis of the new system is a uniform, comprehensive limit on tax-assisted saving of 18 per cent of an individual's earnings. The limit is comprehensive in two senses. It applies (directly or indirectly) to contributions both by taxpayers and by their employers. Also, it applies to contributions to all types of registered savings plans: registered pension plans (RPPs), deferred profit sharing plans (DPSPs) and registered retirement savings plans (RRSPs).

Providing a uniform limit on saving in different types of plans is important because individuals in different employment situations do not have equal access to the types of plans which, under the existing rules, can provide the most generous benefits. Even within a given type of plan, the access of individuals to tax-assisted saving under the existing system varies significantly according to the generosity of the plans provided by their employers. The new system takes into account variations in employer-provided retirement benefits and allows taxpayers to supplement them by making RRSP contributions up to the uniform contribution limit.

The contribution limit of 18 per cent of earnings was chosen because it is consistent with the existing limit of 2 per cent of earnings per year of service that applies to

pension benefits provided under defined benefit RPPs. That is, contributions of 18 per cent of earnings made over an individual's career should be sufficient to provide for a pension of 2 per cent of pre-retirement earnings per year of service. The 2-per-cent pension limit is considered to be an appropriate limit for tax-assisted retirement saving. Over a career of 30 to 35 years, it permits the build-up of a pension of 60 to 70 per cent of pre-retirement earnings. For most individuals, such a pension will replace sufficient earnings to avoid any significant drop in living standards upon retirement. At lower income levels, where less earnings replacement at retirement is needed from private sources because of the relatively greater role played by retirement benefits under the Old Age Security program and the Canada and Quebec Pension Plans, the limits should be more than adequate to meet this objective.

Providing a consistent treatment of savings in different types of plans also means increasing the limits on contributions made on a money purchase basis (through RRSPs, DPSPs and some RPPs) to make them consistent with the dollar limit on pensions provided on a defined benefit basis. As adjusted under tax reform, these limit increases will be phased in over a period ending in 1994 for employer-sponsored plans and 1995 for RRSPs. At the end of the phase-in period the dollar limit on contributions will be $15,500. Annual contributions at this level over a full career

should provide for a pension comparable to the maximum defined benefit pension of $1,722.22 per year of service. Beginning in 1995, both the contribution and pension limits will be adjusted each year in accordance with the increase in the average wage in the same manner as the maximum pensionable earnings under the Canada and Quebec Pension Plans are adjusted. Under the mature system, these limits are expected to provide full tax assistance on savings out of individual earnings up to 2.5 times the average wage.

Retirement Compensation Arrangements

Retirement benefits in excess of the limits can be provided, but not on a tax-assisted basis. Any arrangement for funding such benefits will be subject to the rules of the Income Tax Act regarding retirement compensation arrangements (RCAs). Contributions to, and earnings in, an RCA are subject to a special refundable tax which assures that no tax deferral advantages are gained through such arrangements.

Reporting the Pension Adjustment Amount

To implement the new comprehensive limit, employers who sponsor RPPs or DPSPs will be required to report a pension adjustment (PA) for each plan member each year. The

PA reflects the pension benefit accruing to the plan member during the year under employer-sponsored plans, and this amount is subtracted from the contribution limit to determine the maximum RRSP contribution the individual may make for the year. For money purchase plans, under which retirement benefits are based directly on the level of contributions plus associated investment earnings, the PA will simply be the total of the employer's contribution in respect of the employee plus any contribution by the employee. For defined benefit plans, under which benefits are determined according to a formula and do not depend on the contributions made in a particular year, the PA for a plan member will be determined directly from the benefit formula and, where applicable, the member's pensionable earnings in the year. A 2-per-cent defined benefit plan will use up most of the plan member's 18-per-cent contribution limit while a less generous plan will use up proportionately less, thus leaving more RRSP contribution room. For administrative reasons, employers participating in certain multi-employer defined benefit plans will be permitted to report PA based on contributions made in the year as is the case for money purchase plans.

The reporting of PAs will be the responsibility of the employer and will be part of the T-4 reporting process. (Reporting by plan administrators is provided for in two particular circumstances involving multi-employer plans.) The first PA report is due

by the end of February, 1989 based on pension or DPSP accruals in 1988. The methods of calculating PAs for different plan types were described in the proposals released on October 9, 1986, and draft regulations embodying these methods are included with the draft legislation. Revenue Canada is prepared to assist employers in determining an acceptable PA formula for particular plans and in resolving any other problems associated with the reporting requirements.

Individual Statements on RRSP Limits

As RRSP contribution limits will now depend on the PA amounts, Revenue Canada will issue statements to individual taxfilers each year informing them of their RRSP limits for the year. The first such statement will be issued towards the end of 1989 and, as under the current rules, taxpayers will have until 60 days after the end of 1989 to make RRSP contributions for that year. To enable Revenue Canada to provide this information to taxpayers, the RRSP limit for each taxation year will be based on earnings and PAs for the preceding year. Thus, the RRSP limit for 1989, for example, will be based on earnings and pension accruals in 1988.

Seven-Year Carry-Forward for RRSP Contributions

The legislative changes also include measures designed to improve the fairness and

flexibility of tax assistance in relation to prior years of service. Under the current system, the ability of individuals to make up for missed saving opportunities is generally quite restricted. At the same time, opportunities exist for some individuals to obtain past service pension credits in excess of the intended limits.

The new system will provide for a seven-year carry-forward of RRSP contribution room not used in a year. This will permit all those saving for retirement to make up for contributions they missed making in prior years. It will also provide considerable scope for individuals to adapt the pattern of their retirement saving to their other financial needs. The first opportunity for carry-forward contributions will come in 1990, based on contribution room unused in 1989.

Added Pension Benefits For Past Service

Under the new system of comprehensive limits, RRSP contributions are regarded as an alternative to pension benefit accruals as a means of saving for retirement. Consequently, additional pension benefits in respect of past service (after 1987) can be credited to an individual only to the extent that the individual has not taken full advantage in prior years of the opportunity to make deductible RRSP contributions. A procedure for the certification of additional past service benefits is being introduced to

co-ordinate the provision of such benefits with the use made of RRSPs. An employer proposing to provide such benefits must calculate an amount called a past service pension adjustment (PSPA) in respect of the benefits and submit the PSPA to Revenue Canada. If the PSPA does not exceed an individual's RRSP contribution room carried forward from prior years, Revenue Canada will provide a certification. The certification permits the past service benefits to be paid and results in a reduction of the individual's RRSP limit by the amount of the PSPA. This procedure does not apply to past service upgrades that simply involve benefit increases in line with wage or price growth. Such increases will generally give rise to a PSPA of nil and so are not subject to the certification requirement.

Termination of Plan Membership

Where a taxpayer leaves an RPP and retains no right to future benefits, the employer will often be required to report a pension adjustment reversal (PAR). In general terms, PAR is the difference between the PAs reported in respect of the taxpayer and any payments made for his or her benefit by the plan. The PAR will increase the taxpayer's RRSP limit. Both these adjustments in respect of past service — PSPA and PAR — will increase the fairness of the system by making the RRSP limit better reflect the benefits actually earned under employer-sponsored plans.

Inter-Plan Transfers

To ensure that the tax-assistance limits are maintained where a taxpayer moves from one plan to another, new provisions governing inter-plan transfers of funds and pension accruals are being introduced. An important feature of these rules is that, beginning in 1989, the transfer of lump sum amounts from one plan to another on a tax-free basis will be permitted only if the amounts are transferred directly. Transfers from defined benefit plans to money purchase RPPs or RRSPs will be subject to limits. The existing rules that permit deductions in respect of amounts transferred between registered plans, whether directly or indirectly, will no longer apply.

Pension Plan Registration

As indicated above, the legislative amendments include the codification of many of the pension plan registration rules currently found in Revenue Canada's Information Circular 72-13R7. These rules are being included in the Income Tax Act to ensure their consistency with the new system of pension and contribution limits. Apart from changes made to adapt the registration rules to the new structure of contribution limits, there has been no intention to modify in any general way the level of benefits currently permitted under the provisions set out in the Information Circular. However, in a number of cases codification means that rules must be spelled out

more precisely than they are in the Information Circular.

An unavoidable consequence of the introduction of the new limits and the other registration rule changes is that certain changes will be required to most pension plans. As a general rule, the new registration requirements come into effect for 1989 and subsequent years. Thus, most, if not all, plans will have to be amended as of January 1, 1989 and the amendments submitted to Revenue Canada. However, some of the provisions applying to benefits provided under defined benefit plans that were submitted for registration before March 28, 1988 will come into force only after 1990 and only in respect of service after 1990. This will provide existing plans with more time to make any necessary changes to those benefit provisions. For existing plans, the requirements of the Information Circular as administered by the Minister of National Revenue will generally continue to apply for service prior to the application of the new registration rules.

Additional Information

A more detailed description of the proposed amendments is provided in the guide and the explanatory notes. The amendments are concentrated in several sections of the Income Tax Act. Deduction provisions are contained in subsections 8(1) and 20(1) and section 60 as well as in sections 146

and 147 and new section 147.5. Section 146 contains provisions relating to the registration of RRSPs, and section 147 contains parallel provisions for DPSPs. The provisions relating to registered pension plans are contained in new sections 147.1 to 147.8.

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