Hewitt Research Advisory

Canadian Research Group

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Hewitt

The Hewitt Research Advisory is a regular Hewitt newsletter designed to provide a detailed overview of specific legislative and regulatory developments in Canada relating to human resources.

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Few Major Pension & Benefits Changes in 2006 Federal Budget

The 2006 Federal Budget was announced on May 2, 2006. It contains several measures of interest in the pension and benefits areas.

DB Pension Plan Funding Changes

Many Defined Benefit (DB) pension plans have been struggling with increasing deficits, and higher funding requirements and accounting charges, as a result of low interest rates and the impact of investment returns. Budget 2006 offers temporary funding relief to DB plans that are federally-regulated under the *Pension Benefits Standards Act, 1985* and its Regulations. In general, pension plans are federally regulated if they provide benefits to employees in federally regulated industries (for example, banks, telecommunications and inter-provincial transportation companies).

Federally regulated DB plans will have a choice of temporary funding measures. The relief measures would only be available to plan sponsors whose funding payments are up-to-date, and only available for the first funding valuation report filed with the federal regulator OSFI (the Office of Superintendent of Financial Institutions) before 2008. Federally regulated DB plans will be able to choose to:

- Increase the funding of solvency deficits to a 10-year term rather than the current five-year term, if no more than one-third of plan members or retirees object to the change. Plan sponsors will have to prove that plan members are fully informed about the proposal.

- Even if two-thirds of plan members do not approve extending the funding period to 10 years, plan sponsors will be permitted to do so *if* they secure the difference between the five-year and 10-year payment levels with a letter of credit. This will protect pension benefits while still reducing the plan's payment level.

- Consolidate solvency payment schedules and amortize the entire existing solvency deficits over a new, five-year period. In effect, this allows plans to smooth their outstanding solvency payment obligations through five equal payments over the next five years.

- Agent federal Crown corporations will have the further option to extend their solvency funding payment period to 10 years, subject to terms and conditions "that will ensure a level playing field."

All these options are to be explained in further detail by draft regulations that will be published "shortly".

Hewitt Comment: *Sponsors of federally regulated pension plans will want to assess the timing of their valuations to take advantage of this opportunity. This continues the trend in some provincial jurisdictions, including Québec and New Brunswick, to address the additional financial burdens created by solvency valuations in a low-interest environment. The Budget 2006 proposals are an attempt to balance plan sponsors' interests with the need to ensure the security of pension benefits.*

Tax Relief for Pensioners
Budget 2006 proposes to increase the pension income credit for eligible pension income. For many years, a credit was given for the first $1,000 of eligible pension income. This will increase to $2,000 effective for the 2006 and subsequent taxation years. The $1,000 amount had been unchanged since 1975.

GST Changes
Budget 2006 proposes to reduce the Goods and Services Tax (GST) rate by one percentage point, from seven to six per cent, effective July 1, 2006. The Goods and Services Tax/Harmonized Sales Tax (GST/HST) is a consumption tax that applies to the majority of goods and services consumed in Canada. Currently, GST/HST is imposed at the rate of seven per cent, and in the harmonized provinces (Nova Scotia, New Brunswick and Newfoundland and Labrador), as the seven per cent federal component of the combined 15 per cent federal-provincial HST.

The federal budget proposes changes to the GST *rate*, but not the expenses on which the GST is paid. This means that employers who now pay GST on their benefits or pension expenses will pay less in tax. The situations in which employers must pay GST are unchanged, and are summarized below for information purposes.

The GST and Health Benefit Plans
Premiums paid to an insurance company for benefit plans under an insured arrangement do not attract GST. Administrative fees and premium taxes for self-insured plans under an Administrative Services Only (ASO) arrangement are subject to GST, except when there is an element of insurance (i.e. a pooling provision) within the plan.

The GST and Pension Expenses
GST is payable on certain pension plan expenses, either by the employer-plan sponsor or by the pension plan trust. For expenses which are paid by the employer directly, the employer may claim an Input Tax Credit - essentially a refund of GST paid on a purchase - for the GST they pay, in most situations. If a pension trust pays an expense directly, the GST Input Tax Credit can only be used in limited situations.

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