



RETIREMENT COMPENSATION FUNDING

**To:** Hon. Mr. Jim Flaherty  
Minister of Finance

**Sent by:** E-mail  
Fax  
Letter

**From:** Roy W. Craik

**Date:** January 23, 2009

**Subject:** Corporate Pension Reform

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Dear Mr. Flaherty,

I note from the January 10, 2008 Globe and Mail that you are inviting discussion on corporate pension reform. Having been involved in "Supplemental Pensions"/Income Plans for over 40 years, I offer one simple solution that could have long-lasting positive effects on pension benefits, be immensely popular with taxpayers and, at no cash loss to Government:-

**Lower the withholding tax transfers to the Refundable Tax Account (RTA) for Retirement Compensation Arrangements (RCAs) defined under Section 248(1) of the Income Tax Act.**

Let me explain:-

- 1) The RCA provisions in the Act were introduced in 1986 but only became of interest to private corporations in 1998 when CRA indicated that,

"a normal level of benefits would be the same benefit provided under a registered pension plan without regard to the Revenue Canada maximum. This would be 2% x years of service x final five-year average earnings or about 70% of pre-retirement income for an employee with 35 years of service." (commonly referred to as the Generally Accepted Guidelines)

and, that contributions to an RCA within these guidelines could be made without invoking the Salary Deferral Arrangement (SDA) provisions that can deem an RCA a SDA.

- 2) Although much negative press is focused on lower asset values in Defined Benefit Pension Plans (DBPP), where the real problem lies is in Money Purchase Pension Plans (MPPPs) and RRSPs. This is because current legislation allows for the top-up of DBPPs to offset investment losses and Plan Members continue to be entitled to the Defined Benefits promised.
- 3) This is not the case for MPPPs and RRSPs. Current contribution caps do not provide the ability to mitigate investment losses as DBPPs do. The solution is for corporations to establish for their employees what we refer to as a MPPP/RRSP Wrap, in which an RCA is "wrapped" around the MPPP/RRSP (or even a DBPP for higher wage earners to offset the DBPP benefit cap to provide a pension up to the Generally Accepted Guidelines).

*Supplemental & Pension Shortfall Funding*

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### **The Refundable Tax Account (RTA)**

- 1) In 1986 both Corporate and Personal Tax rates were approximately 50%. As such, the 50% withholding tax to the RTA did not deter those requiring supplemental pensions. The RCA was effectively tax neutral.
- 2) Although salaried employees are not affected by the lowering of corporate taxation rates, for owners of CCPCs the changes are important relative to Supplemental Pension Arrangements and, the use of RCAs to provide an adequate pension in retirement.
- 3) RCAs for owners of CCPCs have been traditionally funded from earnings over the small business limit ("SBL") where the difference between the combined Provincial and Federal Corporate rate and the 50% to the RTA were within a few percentage points. This is no longer the case. Low taxed earnings below the SBL have generally been reinvested back in the company and not used to make RCA contributions.
- 4) Public corporations with pension shortfalls for executives earning over the CRA maximum pension amounts will not utilize an RCA to prefund these benefits when the RTA rate is significantly greater than their corporate tax rate. Mercers and Towers Perrin have estimated that such unfunded corporate executive pension amounts are greater than the total amounts of funded pensions.

### **The Problem and the Danger**

- 1) With corporate tax rates for earnings over the SBL declining so that by 2012 they will range between 26.5% to 32.5% (dependent on Province), many will view the spread between the corporate tax rate and the 50% currently required to be remitted to the RTA negatively and, turn away from the use of RCAs.
- 2) The danger will be the rise in the use of what the insurance industry markets as Insured Retirement Plans (IRPs – both Personal and Corporate) which are far from being safe as the word "Insured" might imply and, which masquerade as key man insurance to avoid being deemed an RCA under Section 207.6(2). The reason is that they are dependant on leverage given the double taxation that arises under the Adjusted Cost Base rules for "exempt" insurance policies. In order to get retirement funds they must borrow against the policy from a bank or take money from the policy which is subject to the adjusted cost base rules. A difference in spread of more than 2% would destroy the benefits to the individual/corporation. Leveraging has caused many of the problems the world faces today and, in my opinion, should not be a requirement in retirement planning.

### **Positive Effects**

- 1) Raising contribution rates for Money Purchase Pension Plans like MPPPs/RRSPs to offset substantial investment losses is problematic for Government. Some RRSP/MPPPs have loses, others do not and the lost tax revenue would be significant. The advantages of the RCA are that, ultimate total pension benefits integrated with other registered pensions based on the "generally accepted guidelines", real investment earnings over time, and there would not be lost tax revenue as long as the RTA rate was equal to the corporate tax rate.
- 2) For private business owners and/or employees, the opportunity of fully funded pensions through base and supplemental plans (as enjoyed by many executives in the public and government sectors) is also politically positive.



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- 3) Many private business owners will see earnings drop below the SBL thus endangering continuing contributions to existing RCAs.

### **Compliance**

- 1) There already exists in the Income Tax Act provisions that allow an RCA to be deemed as a SDA. These along with enforcement of the current requirement for integration of MPPP/RRSPs and a restricted ability to return funds to the corporation (by front end leveraging which CRA has indicated is not allowed) will insure funding compliance.
- 2) A change in regulation allowing only non-arms length Trustees and enforcement by CRA of existing rules or tightened provisions against certain types of leverage by the RCA as well as split-ownership of insurance policies in RCAs, should eliminate abuses.

### **Summary**

- 1) Funds that are held in the Refundable Tax Account are in effect prepaid tax that is not shared with the Provinces until benefits commence in retirement. If RTA rates are lowered to reflect corporate earnings (above or below SBC) the Federal Government still has access to combined Federal and Provincial taxes that would have been paid on the RCA contribution for which deductions were allowed. Distributions out of the RCA based on assets in the RCA Investment Account and refunds from the RTA are all taxed as personal income. For public corporations, as long as the RTA is equal or greater than the Federal corporate tax rate, there would be no tax revenue loss from a reduced RTA, but a reduced RTA would produce a significant increase in the use of RCAs by public corporations.
- 2) In one simple step the problem for investment losses in MPPP/RRSPs and the opportunity to eliminate the "Pension Gap/Shortfall" for those earning over what the pension can provide with current contribution or defined benefit caps are dealt with, at no effective cash loss to the government. Any political opposition would be at the opposing party's peril.

Our website and library contain many articles on this subject and is visited from time to time by CRA. We endeavour to closely follow the rules established for RCAs by CRA. With the collapse of equity and housing markets, the focus on pensions has never been more acute. The change that I am recommending will be as popular (if not more so) than the Tax Free Savings Account, more meaningful to taxpayers with taxable income in excess of pension limits and, tax neutral to the government.

Sincerely,

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