BUCK

CAN

FYI®
For Your Information®

2019 Canadian Federal Budget: Highlights and Discussion

Volume 01
Issue 01
March 19, 2019

Authors
Karen DeBortoli
Lizann Reitmeier
Tom Mudrinic

The 2019 Federal Budget, Investing in the Middle Class (Budget 2019), was tabled by Minister of Finance William Morneau on March 19, 2019. In addition to the widely-expected announcement of more details on the proposed national pharmacare program, Budget 2019 contained many other measures impacting pension and benefit plan sponsors, members, and other stakeholders, including:

- Enhanced protection for pension members and retirees, particularly in employer insolvencies
- Changes to the tax rules applicable to individual pension plans (IPPs)
- Two new annuity vehicles for certain retirement savings plans
- Improving access to government retirement benefits

This FYI provides an overview of these and other measures, and discusses what Budget 2019 means for employers, plan sponsors, and individuals.

National Pharmacare on the horizon

Guided by the consultations and interim report of the Advisory Council on the Implementation of National Pharmacare (Advisory Council), Budget 2019 provides more details on how the federal government plans to move forward with the development of a national pharmacare program. Three interrelated projects were announced:

1. **Creation of the Canada Drug Agency (CDA):**
   This new national agency will assess the effectiveness of new drugs, serve as a single negotiator for drug prices, and identify, in connection with provincial and territorial partners and other stakeholders, drugs for inclusion in the pharmacare formulary.

2. **Development of a National Drug Formulary (Formulary):**
   The CDA's work will include the creation of a comprehensive, evidence-based list of prescribed drugs and provide the basis for a consistent approach to formulary listing and patient access nationwide.
3. **Creation of a National Strategy for High-Cost Drugs and Rare Diseases (Strategy):**
   Developed in cooperation with provincial and territorial governments and other stakeholders, the Strategy will gather and evaluate evidence on high-cost drugs for rare diseases, improve the consistency of decision-making and access, and negotiate prices with drug manufacturers.

Thoughts and questions
Canada is currently home to a patchwork of federal and provincial pharmacare programs. The replacement of the current patchwork of prescription drug benefit programs, which provide what Budget 2019 acknowledges as "inadequate and inconsistent coverage" will be welcomed by most Canadians. In order for the CDA to operate effectively, all provinces and territories must participate. A single negotiating entity will have greater bargaining power, and a single formulary will be of greatest benefit to all Canadians.

While Budget 2019 provides valuable insights regarding the government's direction on pharmacare, many details are still outstanding. The Advisory Council's upcoming final report will hopefully provide information on a number of issues, including:

- Any coverage restrictions (deductibles, annual/lifetime maximums, income cut-offs, etc.);
- The interaction of the national program with existing employer/private programs; and
- The scope of the Formulary (basic or comprehensive).

The success and efficacy of the program will depend in large part on the last issue: The nature and content of the Formulary. In addition to being evidence-based, we hope that the Formulary will:

- Include certain high-cost but high-benefit drugs where it is established that the long-term benefits of covering such drugs, in terms of quality of life and reduced health care costs, can support the expense. In this regard, the CDA can look to Prince Edward Island's Hepatitis C Program. The province is currently providing treatment for all residents with Hepatitis C, despite the high cost, and is on track to eliminate the disease by 2025.
- Include a process for covering the high-cost "orphan" drugs identified under the Strategy to ensure that affected Canadians do not fall through the cracks, and that employer plans are protected against unaffordable burdens.

We also hope that the program will not feature high deductibles, and income/coverage cut-offs, as these may reduce utilization, thereby undermining the program's efficacy.

©2019 Buck Global, LLC. All rights reserved.

Protecting pensions in employer insolvency

In the aftermath of a number of high-profile insolvencies, including Sears Canada and Wabush Mines, Budget 2019 contains some significant announcements designed to protect employees and pensioners in the event of their employer's insolvency. Some apply to all employees, while others only apply to employees of federally incorporated businesses.

All employees will benefit from proposed changes to the *Companies' Creditors Arrangement Act* (CCAA) and the *Bankruptcy and Insolvency Act* (BIA) designed to "better protect workplace pensions in the event of corporate insolvency." The upcoming new measures will include allowing courts to investigate payments made to corporate executives leading up to insolvency, and introducing a requirement that participants in insolvency proceedings "act in good faith." They are intended to make insolvency proceedings "fairer, more transparent, and more accessible" for active and retired plan members.

Current and former employees of federally incorporated businesses may also benefit from proposed changes to the *Canada Business Corporations Act* (CBCA) and the *Pension Benefits Standards Act* (PBSA) that will:

- Clarify that corporate decision-making can include a consideration of diverse interests, including those of employees and pensioners;
- Require that publicly traded corporations disclose policies on workers, pensioners, and executive compensation, or explain the absence of such policies, and hold and disclose non-binding shareholder votes on executive compensation;
- Require that a wound up pension plan "must still provide the same pension benefits as when it was ongoing;" and
- Allow defined benefit (DB) plans to annuitize retiree pensions, to protect them from the risk of employer insolvency.

Thoughts and questions

While provincial pension legislation contains deemed trust provisions that apply in the event of plan termination, these provisions are subject to the CCAA and/or BIA in the event of the insolvency of the sponsoring employer. As was shown by the Supreme Court of Canada's 2013 decision in the Indalex case, this paramountcy of federal over provincial legislation can effectively invalidate the protections afforded by a statutory deemed trust. The proposed amendments to the CCAA and BIA seem designed to address this, although the intent of the measures announced in Budget 2019 will only become clear once the related legislation is tabled.

The vagueness of the announcements on pensioner protection raises a number of questions, including:

- How and how much the CCAA and BIA changes will protect member and retiree pensions;
- What is meant by acting "in good faith" and how this will be mandated and policed;

©2019 Buck Global, LLC. All rights reserved.

- Why the courts will only be able to examine payments to executives in the lead up to a corporate insolvency, and not also payments to shareholders/investors;
- What the forthcoming PBSA requirement that benefits from a wound-up plan be the same as the benefits paid while the plan was ongoing actually means, and how it will be enforced; and
- What rules will apply to the purchase of annuities for retirees, and whether they will vary depending on whether the plan is ongoing or being wound up.

The changes to the CBCA should also be interesting, with the focus on employee interests, the required disclosure of policies established by publicly traded corporations and non-binding votes on executive compensation are likely to generate some controversy. While these changes will only apply to federally incorporated businesses, they could end up being a template for broader legislation.

Changes to tax rules applicable to IPPs

In its discussion of "Closing Tax Loopholes," Budget 2019 announces changes designed to stop the use of IPPs to avoid the prescribed transfer limits. The *Income Tax Act* (ITA) rules currently provide that, when an individual terminates membership in a DB pension plan, they can make a tax-deferred transfer of all or a portion of the commuted value of their benefits to either another DB plan or subject to the prescribed transfer limit, to a RRSP or similar registered plan. Budget 2019 states that, to circumvent these transfer limits, IPPs are being established that are sponsored by a newly incorporated private corporation controlled by an individual who has terminated employment with their former employer. The individual then transfers the commuted value of their pension entitlement from the former employer's DB plan to the new IPP, thereby obtaining a 100% transfer instead of a restricted transfer.

To address this, Budget 2019 proposes that IPPs be prevented from providing retirement benefits in respect of past years of employment that were pensionable service under the DB plan of an employer other than the IPP's participating employer (or its predecessor employer). Any assets transferred to an IPP in violation of this rule will be considered a non-qualifying transfer, and included in the member's income for tax purposes. This measure applies to pensionable service credited under an IPP on or after March 19, 2019.

Thoughts and questions

These proposals appear designed to address situations where new business owners establish their businesses primarily for the purpose of avoiding taxation on their pensions. While there are instances where individuals deliberately establish new corporations and IPPs to frustrate transfer rules applicable to pension commuted values, there are many more individuals who are legitimately embarking on a second career and are legitimately starting a new business. The IPP proposals mean that such individuals will be forced into leaving their commuted values in their former employer's plan or transferring the funds to a LIF or LIRA, and in many cases receiving part of the CV in taxable cash. However, individuals who move to employment with a non-connected employer will presumably still have the opportunity to transfer the full commuted value to another vehicle.

©2019 Buck Global, LLC. All rights reserved.

New annuity options for registered plans

Budget 2019 announces that two new annuity options, Advanced Life Deferred Annuities (ALDAs) and Variable Payment Life Annuities (VPLAs), will be added to the tax rules to provide members of certain registered plans with greater flexibility in managing their retirement savings. Information about these two new annuities is provided below.

ALDAs

- **Qualifying plans:** These annuities will be qualifying annuity purchases under a defined contribution (DC) pension plan, DPSP, PRPP, RRIF, and RRSP.
- **Overview:** A life annuity, commencement of which may be deferred until the end of the year in which the annuitant reaches 85 years of age. The value of the ALDA will not be included when calculating the minimum amount required to be withdrawn from the qualifying plan after the year in which the annuity is purchased. An ALDA can be single or joint-life.
- **Limits:** An individual will be subject to a lifetime ALDA limit of 25% of the sum of the value of all property (other than most annuities, including ALDAs) held in the qualifying plan as at the end of the previous year, and any amounts from the qualifying plan used to purchase ALDAs in previous years. An individual will also be subject to a comprehensive lifetime ALDA limit of $150,000 from all qualifying plans, indexed to inflation for taxation years after 2020. A tax of 1% per month will apply to any ALDAs purchased in excess of these limits, except to the extent the excess is due to reasonable error.

VPLAs

- **Qualifying plans:** These annuities will be paid to members directly from a DC pension plan and a PRPP.
- **Overview:** Administrators of qualifying plans can establish a separate annuity fund under the plan to receive transfers of amounts from members' accounts to provide VPLAs. At least 10 retired member participants are required to establish a VPLA, and it must be reasonable to expect that there will be at least 10 participants on an ongoing basis. A VPLA can be single or joint-life. Payments must begin by the end of the year in which the annuitant reaches 71 years of age.
- **Limits:** Direct employer and employee contributions are not permitted.

Thoughts and questions

The introduction of the ALDA is an interesting one, and addresses concerns about protecting retirement income streams as life expectancies increase. Full details on the nature and operation of ALDAs will be found in upcoming legislation, which will be released for public consultation. Employers offering qualifying plans should investigate this new annuity product, and determine whether they wish to offer it to their plan participants. The ability to defer payment commencement until age 85 should prove quite attractive to individuals.

The government will conduct consultations on amending the PBSA to accommodate VPLAs. Any provinces wishing to permit VPLAs for a provincially regulated DC plan must amend their legislation. However, while a number of provinces have amended their

©2019 Buck Global, LLC. All rights reserved.

pension legislation to permit DC plans to pay variable benefits (LIF-like payments) directly from the plan, interest in this option from DC plan sponsors has been low. While the VPLA is more in the nature of a group-based annuity, it is unclear how widely it will be embraced.

Other notable measures

Budget 2019 also included the following announcements, which will be of interest to employers and plan sponsors:

- **Changes to contribution rules for SMEPs:** SMEPs are a specific type of union-sponsored DB plan. These plans are not subject to the ITA rules on DB pension plan contributions, which ensure that no contributions can be made in respect of a member that can no longer accrue benefits. Specifically, due to the collectively bargained nature of SMEP contributions, the ITA rules deem such contributions to be eligible contributions, even when they are made in respect of members over the age of 71, or of members who are receiving pension benefits (other than phased retirement benefits). Budget 2019 proposes changing the current rules to prohibit SMEP contributions in respect of a member after the end of the year the member attains 71 years of age, and to a DB provision of a SMEP if the member is receiving a pension (other than a phased retirement pension) from the plan. The new rules will apply in respect of SMEP contributions made pursuant to collective bargaining agreements entered into after 2019, and made after the date the agreement is entered into.

- **Enhancements to the Guaranteed Income Supplement (GIS):** Starting with the 2020-2021 benefit year, forthcoming legislation will extend the earnings exemption eligibility to self-employment income, and implement the following changes to the exemption:
    - Increase the maximum full exemption from $3,500 to $5,000 for recipients and their spouses, and
    - Introduce a new 50% exemption on earnings up to of $10,000 (above the full exemption limit) for recipients and their spouses.

- **Changes to Canada Pension Plan (CPP) enrollment:** To assist the eligible contributors that either fail to apply, or apply late, to start receiving their CPP pensions, forthcoming legislation will proactively enroll contributors who are age 70 or older in 2020 but have not applied to receive their pensions.

- **Supports for ongoing training:** The New Canada Training Benefit will be introduced in 2020 for workers between the ages of 25 and 64 with earnings (including maternity or parental benefits) of between $10,000 and $150,000. Eligible workers receive an automatic credit of $250 per year, up to a lifetime limit of $5,000, which can be applied against training fees at colleges, universities, and other eligible institutions starting in 2020. The related EI Training Support Benefit, expected to be introduced in late 2020, will provide up to four weeks' of leave, paid at 55% of average earnings, to workers with at least 600 insurable hours in their qualifying

©2019 Buck Global, LLC. All rights reserved.

period. The government will consult with the provincial and territorial governments to provide job protection for this new leave under employment standards legislation.

- **Changes to the tax treatment of employee stock options:** The government intends limit the application of the current tax rules for employee stock options (which provide preferential personal income tax treatment in the form of a stock option deduction) to employees of start-ups and rapidly growing Canadian businesses. The rules applicable to stock options granted to employees of "large, long-established, mature firms" will be aligned with those of the United States, by applying a $200,000 annual cap on employee stock option grants (based on the fair market value of the underlying shares) eligible for preferential tax treatment. Details on this measure will be provided in a consultation expected in the summer of 2019.

- **Updates on Health and Welfare Trust (HWT) conversion:** The government still intends to proceed with tax measures designed to facilitate the conversion of HWTs to Employee Life and Health Trusts.

- **Enhancements to Registered Disability Savings Plans (RDSPs):** The government proposes eliminating the requirement to close an RDSP when a beneficiary no longer qualifies for the Disability Tax Credit, allowing grants and bonds that would otherwise be repayable to remain in the plan (subject to some restrictions on access). It also proposes exempting RDSP funds from seizure by creditors, except for contributions made in the 12-month period before a bankruptcy filing. This measure will provide peace of mind to disabled Canadians and their caregivers.

- **Details and funding for population health measures:** Budget 2019 commits funds to the National Dementia Strategy, a pan-Canadian system for organ donation and transplantation, enhanced home care, mental health services, and healthy eating, all of which will improve population health.

- **Details on specific health-related tax relief:** Supplies of human ova and *in vitro* embryos, multidisciplinary health care services, and foot care devices supplied on the orders of a podiatrist or chiropodist will be GST/HST exempt after March 19, 2019. While the impact of these measures on employer plans will be small, they will help members extend their plan dollars.

In closing

While Budget 2019 provides many details regarding a range of measures (some expected, some not), much is still unknown. Reports, consultations, and draft legislation released in the coming weeks and months will hopefully answer most of the questions raised by today’s announcements. For more details on Budget 2019, and information on how to answer the questions it raises for you, talk to your Buck consultant or contact the Knowledge Resource Centre at talktous@buck.com or +1 866 355 6647.

©2019 Buck Global, LLC. All rights reserved.