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COMMUNIQUÉ

FEDERAL BUDGET 2014

On February 11, 2014, the Honourable Jim Flaherty, Minister of Finance, tabled the federal budget. There are a few measures that are of interest to employers who sponsor pension and benefit plans.

Public Sector Compensation

The government intends to implement a disability and sick leave management system in the public sector. This would include the introduction of a formal short-term disability plan and case management to support early return. The government notes that the current system of sick day accumulation is often inadequate to cover the period before an employee becomes eligible for long-term disability benefits.

The government also intends to phase in equal cost sharing for the Public Service Health Care Plan (PSHCP), which supplements provincial and territorial health insurance plans for retirees. The years of service required to be eligible for the PSHCP will increase from two to six. Current low income pensioners will not be adversely affected by the change in contributions, and there will be no change to the health care contributions of employees.

The government notes that it continues to engage with bargaining agents and key stakeholders toward timely resolution on its proposals and is prepared to consider reasonable plan improvements if they are fair to taxpayers.

Crown Corporation Pension Plans

As originally announced in 2012, the government will work with Crown corporations to align their pension plans with the plans of other federal employees. The intention is to move to 50-50 cost-sharing and to raise the normal retirement age to 65 for new hires. The reforms are expected to be implemented by Crown corporations subject to the *Pension Benefits Standards Act, 1985* by 2017.

Transfers from Underfunded Pension Plans

An existing rule allows certain members of registered pension plans, whose benefits are reduced because of pension underfunding, to enjoy a tax deferred transfer limit based on their full benefit. That rule generally applies in cases of terminating plans sponsored by insolvent employers. It will be extended, for transfers made after 2012, to apply when the reduction in the pension benefits is approved under pension standards legislation, with no requirement to wind up the plan except in the case of an individual pension plan.

Amateur Athlete Trusts

The definition of earned income for RRSP contribution purposes will be expanded for certain high-performance amateur athletes. Such athletes may shelter otherwise taxable income by contributing to an amateur athlete trust, which pays no tax on its investment earnings. Income that is so contributed will qualify as earned income of the athlete. The measure will apply after 2013 but an election will be permitted to have income that was contributed in 2011, 2012 and 2013 also qualify as earned income, with a cumulative addition being made in such case to the RRSP contribution room for 2014.

FATCA

The budget highlights recent development concerning the *Foreign Account Tax Compliance Act* (FATCA), a law designed to provide the Internal Revenue Service of the US federal government (the IRS) with information about the investments of US taxpayers. A principal enforcement mechanism of FATCA is a 30% withholding tax applied to US-based income of various non-US entities if they do not comply with the FATCA reporting requirements. On February 5, 2014, Canada and the US entered into the Intergovernmental Agreement for the Enhanced Exchange of Tax Information under the Canada–US Tax Convention (the IGA). In general, compliance with the IGA, which includes reporting obligations under the *Income Tax Act*, will preclude the application of the 30% withholding tax under FATCA. The government notes that the IGA provides for the exchange of enhanced tax information between the countries commencing in 2015.

Non-Resident (Immigration) Trusts

The *Income Tax Act* contains rules to prevent the use of non-resident trusts by taxpayers to avoid Canadian tax. If a person resident in Canada contributes property to a non-resident trust, the deemed residence rules may apply to treat the non-resident trust as resident in Canada. An exemption (the 60-month exemption) applies if the contributors to the trust are individuals each of whom is resident in Canada for a total period of not more than 60 months (i.e., newly resident Canadians). Where the 60-month exemption applies the trust is not subject to Canadian taxation on its foreign-source income.

The 60-month exemption for the “immigration trust” will be eliminated for all trust taxation years that end after February 10, 2014, except that, if an immigration trust already exists and no contributions are made to it after February 10, 2014 and before 2015, the exemption will be eliminated for trust taxation years that end after 2014.

The elimination of the immigration trust exemption will complicate tax planning for many management level employees who accept transfers to Canada.

Captive Insurers and Canadian Risks

Canadian risks insured by a controlled foreign affiliate of a Canadian resident taxpayer are taxable in the hands of the taxpayer on an accrual basis, where the Canadian risks insured represent a specified percentage of the total book of business of the affiliate. Some taxpayers have entered into derivative transactions in order to avoid this accrual taxation in Canada. The government will be including rules to combat this avoidance, effective for taxation years commencing after February 10, 2014. Employers seeking to use captive insurers in connection with their employee benefit plans will face greater tax risks.

Investments

The government's medium term debt management strategy continues to call for issuance of long-term debt, including real return bonds, 10 and 30 year nominal bonds, as well as potential issuance of bonds with maturity of 50 years. As a result, the average term to maturity of the domestic market debt is projected to increase from the current level of around 7.6 years to approximately 8.7 years over the next decade. These measures would increase the availability of long term bonds and might allow pension plans to better manage their interest rate risk.

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