Intelligence MEMOS

From: Nick Pantaleo

To: The Hon. Bill Morneau, Minister of Finance

Date: March 19, 2019

Re: It's Time to End Over-Taxation of Lump Sum Pension Payouts

A central theme of the government is to strengthen Canada's middle class, in part through targeted tax relief aiming to make the tax system fairer for middle-class Canadians. The government stated its focus is to help middle-class Canadians to save and invest for their retirement and to grow the Canadian economy. I would like to bring to your attention an area within the tax system that is failing many middle-class Canadians by taxing prematurely, often at the highest marginal rates, their pension savings – for many, their lifeblood to ensure they are able to sustain themselves and their loved ones financially in their senior years.

Meet Rob: He is a close friend whom I have known almost all my life – 62 years. Following graduation from college, Rob took a job with a large Canadian company as a skilled mechanic responsible for his employer's heating and air conditioning systems. Rob was a full-time employee for almost 40 years earning a middle-class salary. In 2017, Rob was forced to take early retirement because his role was being outsourced. This occurred at a time when his company was struggling financially and it would soon cease operations in Canada.

Rob was a member of his employer's defined-benefit pension plan. On his retirement, he was given several options for the pension benefit he had accumulated. However, his employer's dire financial situation forced him to take a "haircut" on his pension benefits. Rob ended up taking the commuted value of his pension benefit as a lump sum payment – about $500,000. This would be Rob's biggest asset and the primary source of his retirement income. Under current Income Tax Act rules, Rob was only able to transfer about 55 percent of the commuted value to an RRSP on a tax-deferred basis. The rest was subject to immediate income tax at rates much higher than any Rob had paid in the past or will pay in the future.

This is unfair and inappropriate.

I cannot discern any reasonable tax policy rationale for why Rob, and others in a similar situation, should not be permitted to transfer the entire commuted value on a tax-deferred basis to an RRSP or an equivalent pension saving plan.

I understand the income tax rules covering pension plans are complex. I also appreciate that these rules are in urgent need of an update, as outlined in a C.D. Howe Institute Commentary by William B.P. Robson. In particular, Robson explains that the so-called "Factor of Nine," which is the measure of the equivalency of saving between the different pension vehicles, is flawed. The rules governing transfers of accrued retirement wealth from a defined-benefit pension plan to a registered capital (de)accumulation plan provide a stark illustration of the Factor of Nine's uneven treatment of different tax-deferred arrangements.

I appreciate there is a legitimate policy debate over the amount taxpayers should be able to defer from taxation when saving for retirement. But this is not the issue in Rob's case. Rob met the requirements to enable him to earn a promised tax-deferred pension for almost 40 years until he needed the funds to sustain him and his family in his retirement years. The tax rules should not restrict his ability to transfer his pension benefits to another registered plan, let alone apply a flawed equivalency factor when the result is to reduce the retirement wealth on which he was counting.

I respectfully request you acknowledge that middle-class Canadians like Rob are being treated unfairly by the tax system in these circumstances and direct your officials to prepare legislative amendments to permit the tax-free transfer of the entire commuted value to another retirement plan. A prospective tax change does not help Rob and the many who have already been unfairly treated by the current rules. Since the government has unfairly profited from middle-class Canadians like Rob, I also urge you to consider amendments that will retroactively achieve a fair result. I am sure there are creative ways in which middle-class Canadians like Rob could regain the pension wealth he needs to sustain his retirement.

Nick Pantaleo is a retired executive of Rogers Communications and a retired tax partner of PwC LLP. He is currently the Executive in Residence at the University of Waterloo's School of Accounting and Finance.

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