THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

August 17, 2020

Via email: RPD.LPRA2@cra-arc.gc.ca

Jeff Boxer
Registered Plans Directorate
Canada Revenue Agency
Ottawa ON K1A 0L5

Dear Mr. Boxer,

Re: Draft Actuarial Bulletin No.4 – Reasonable Methods to Apportion Assets and Actuarial Liabilities

The Canadian Bar Association Pensions and Benefits Law Section (CBA Section) is pleased to comment on the *Draft Actuarial Bulletin No.4 – Reasonable Methods to Apportion Assets and Actuarial Liabilities* (Draft Bulletin) published by the Canada Revenue Agency in March 2020. The Draft Bulletin gives guidelines and examples of reasonable methods to apportion assets and actuarial liabilities for funding a defined benefit (DB) provision of a registered pension plan with more than one participating employer.

The CBA is a national association of over 36,000 members, including lawyers, notaries, academics and students across Canada, with a mandate to seek improvements in the law and the administration of justice. The CBA Section contributes to national policy, reviews developing pensions and benefits legislation and promotes harmonization. Our members are involved in all aspects of pensions and benefits law, including counsel who advise plan administrators, employers, unions, employees and employee groups, trust and insurance companies, pension and benefit consultants, and investment managers and advisors.

Clarify Scope and Application

Pursuant to section 147.2(2)(a)(vi) of the *Income Tax Act* (*ITA*), when determining eligible contributions, an actuary must apportion assets and liabilities between participating employers in a "reasonable manner." Typically, the term "reasonable" indicates flexibility to make a rational judgment based on an assessment of all circumstances, provided the outcome reflects the legislative intent. In that sense, guidelines are instructive to communicate underlying principles and give specific examples of potential reasonable outcomes in certain circumstances.

However, we are troubled by statements in the Draft Bulletin appearing to require separate balance sheets for each participating employer in a plan with more than one employer and appearing to declare two recommended apportionment methods reasonable and differing results presumptively unreasonable, apparently without regard to the circumstances.

A reasonable apportionment method may vary based on the type of DB plan under review. The Draft Bulletin seems to apply broadly: to multi-employer plans (MEPs), specified multi-employer plans (SMEPs) and plans with more than one employer that are neither MEPs nor SMEPs. The differences between a MEP and a SMEP are explicitly recognized in the *ITA*, and these differences inform the reasonableness of a particular apportionment method. Further, the third category – plans with more than one employer that are neither MEPs or SMEPs (with related or affiliated participating employers) – also warrant different considerations.

A reasonable apportionment method must consider other relevant circumstances of the plan (e.g. recent business purchase and sale, regulator's decision, insolvency proceeding, joint sponsorship agreement).

We also suspect that the actuarial valuation reporting requirements in the final section of the Draft Bulletin are currently not widely followed. Imposing these reporting requirements on every plan with more than one participating employer would depart from current industry practices and from the 1989 Technical Note for section 147.2(2) which stated: "It is not intended that the allocation require a separate accounting in respect of each employer, as if each employer had established its own plan."

We recommend the Draft Bulletin further particularize (a) the *type of plan* and the *other circumstances* when the Registered Plan Directorate's preferred methods of apportionment and other guidelines are meant to apply, and (b) the scope of the Draft Bulletin in general.

Administratively Impractical

Generally, we have no concerns with the two apportionment methods in the Draft Bulletin since allocating assets in proportion to liabilities and separate accounting are common methods to apportion assets and liabilities. We do believe the CRA should be open to allowing other methods if they can be shown to be reasonable.

We do, however, have concerns with the proposed requirement to track and record separately the benefit accrued by a member who works for more than one participating employer over the course of participating in a pension plan and to prorate benefit accrual between these employers, particularly where a plan is maintained for a related group of companies (i.e., not a MEP or a SMEP). This requirement would increase administrative costs to track and maintain data for each distinct period of employment. It would also add costs to prepare the actuarial valuation report due to the need to allocate portions of a member's liabilities to each participating employer that employed the member during his or her participation in the plan.

We propose a slightly different method that is commonly used for transferred employees, is simpler and less costly. Under this method, instead of determining liabilities for each period of past service with a participating employer, all a member's liabilities are allocated to the most current employer. This means that when a member transfers from one participating employer to another, all the member's entitlements are treated as the liability of the current employer. For example:

- Member works for Employer A and accrues benefits for the period of service with Employer A. During this period, the liabilities for that member are allocated to Employer A who pays the normal cost associated with the member as well as any special payments for accrued liabilities.

- Member transfers to Employer B. The member accrues future benefits for service with Employer B and all past liabilities for the service accrued while working for Employer A are now allocated to Employer B. During this period Employer B pays the normal cost for the member and any special payments that arise from the member's liabilities for all past service.
- Member continues to work for Employer B until retirement or termination from the plan. The member's liabilities remain allocated to Employer B following retirement or termination.

For most plans, any tax advantage gained by transferring employees between participating employers will be immaterial relative to the size of the plan because, as a matter of practice, only a small percentage of members transfer between participating employers. This impact will be further minimized because transfers are often reciprocal, with a transfer of an employee from Company A to Company B offset at some point by the transfer of another employee from Company B to Company A. Over time these transfers tend to equalize the funding impact between employers.

For plans other than individual or small pension plans, we believe this suggested apportionment method will not cause any material difference in the funding between different participating employers. It will, however, be less costly. We believe, therefore, that it meets the reasonableness requirements of section 147.2(2)(a)(vi) of the *ITA* and the CRA's requirement that the apportionment method not create a bias towards a particular participating employer.

Since many plans have not tracked employee transfers in the manner suggested in the Draft Bulletin, administrators will often not have this information and it will be difficult or impossible to generate now.

Remote Risk of Mischief

We also consider three different types of pension plans with more than one participating employer and explain why the employers are unlikely to engage in behavior intended to create a bias in contributions towards a particular participating employer:

Plan where the participating employers are all related

Generally, related participating employers in a pension plan do not engage in employee transfers for the purpose of manipulating contributions that a participating employer makes to the pension plan. Employee transfers are arranged for specific business purposes, such as moving employees with a specific skill to the business requiring that skill or for broadening an employee's experience by cycling the employee through different areas. There may be exceptions, but they are likely only in individual pension plans and very small plans with only a handful of members.

Multi-employer plan as defined in section 8510(1) of the ITR

A multi-employer plan that is not a SMEP will contain employers that are not related to each other. There is no commercial incentive for unrelated employers to transfer employees for the purpose of manipulating their contributions to the pension plan. Employee transfers among related employers are normally motivated by factors other than skewing permitted contributions to the pension plan.

Jointly sponsored pension plans (JSPPs) in Ontario's *Pension Benefits Act* are illustrative. Most JSPPs are designed so that employees and employers share costs on a 50/50 basis, with a portion of both employee and employer contributions allocated to fund any plan deficit. JSPPs can have dozens, and in a few cases hundreds, of participating employers and the only practical way to calculate and apply employer contributions is based on the payroll for active employees. This method of sharing funding costs in JSPPs is designed for equity and simplicity and is not designed to circumvent the reasonableness requirement in section 147.2(2)(a)(vi) of the *ITA.*

A specified multi-employer plan as defined in section 8510(2) of the ITR

Employer contributions to a SMEP are, by definition, determined under a formula arising from collective bargaining so there is no opportunity for participating employers to manipulate contributions.

Removing a Participating Employer from a Plan

The Draft Bulletin's proposed treatment of employers withdrawing from a pension plan will have punitive results for many plans and members. In some large multiple employer pension plans (many of which will also be "multi-employer plans" as defined in the *ITA*), additions of new employers and withdrawals of existing employers are frequent. The Draft Bulletin proposes to freeze the funded ratio attributable to a participating employer at the time of its withdrawal and set that point-in-time ratio as a go-forward maximum funded ratio in respect of employees and former employees of that employer.

This interpretation could lead to unfairness. Example: a multiple employer plan where assets attributable to one employer are in an excess surplus position while assets attributable to another inactive employer are well below liabilities, requiring the administrator to reduce accrued benefits for one group but not others (where permissible under pension standards legislation). Where the terms of the plan clearly contemplate such differential treatment, this may well be equitable, but where they do not the Draft Bulletin would force a plan to this result.

We do not agree that section 147.2(2)(a)(vi) should be interpreted so narrowly such that "a participating employer in a DB pension plan cannot fund the benefits provided from another participating employer". If it were so, there would be no authority in the *ITA* for the CRA to provide the limited relief "on an administrative basis" proposed in the Draft Bulletin, since any cross-subsidization should then be precluded.

In our view, section 147.2(2)(a)(vi) should be interpreted with more flexibility. It requires only that "assets and actuarial liabilities are apportioned in a reasonable matter among participating employers". In many plans, it may be reasonable for assets attributable to an employer to be pooled, collectivized and ultimately used in part to fund benefits for employees and former employees of another inactive employer. Where employers act at arm's length, and are in many cases commercial competitors, it should be expected that cross-subsidization would not form part of a concerted scheme to abuse the *ITA* eligible contribution rules.

We appreciate that employers who do not deal at arm's length could theoretically leverage an unreasonable allocation of assets and liabilities to maximize the deductibility of eligible contributions by one member of an employer group. In our experience this is more a theoretical risk than a practical issue. Further, the *ITA* already contains a solution to this mischief by permitting the Minister to argue that the allocation is unreasonable. There is no need to further impose, on a blanket basis, a requirement that funded ratios for withdrawing employers must be perpetually frozen.

In corporate transactions, many purchasers are unwilling to take on past service DB liabilities for employees in the purchased business. In cases where the business being sold is part a group of related companies, it is common for an affiliate of the seller (e.g., a parent company) to assume responsibility for plan deficits for transferred employees. Where the purchaser and seller are arm's length entitles, this structure is not a cross-subsidization part of a concerted scheme to abuse the *ITA*'s eligible contribution rules. The structure is in place solely because the purchaser is unwilling to assume DB liabilities and the seller and its affiliate (e.g. a parent company) want to ensure the pension promise made to transferred employees is fulfilled. If this is not permitted it will have significant implications for corporate transactions, including numerous prior transactions.

Similarly, in cases where there is a *bona fide* insolvency of a participating employer when the plan is in a deficit position, if remaining participating employers are willing to make up the deficit to ensure the pension promise made to transferred employees is fulfilled, there are sound policy reasons to accept this as meeting the reasonableness requirement in section 147.2(2)(a)(vi) of the *ITA*.

The CBA Section appreciates the opportunity to comment on the Draft Bulletin. We trust our comments are helpful and would be pleased to offer further clarification.

Yours truly,

(original letter signed by Marc-Andre O'Rourke for Jeff Sommers)

Jeff Sommers
Chair, CBA Pensions and Benefits Law Section