Federal Budget 2014
Implications for Canadian Employers

On February 11, 2014, Finance Minister Jim Flaherty tabled The Road to Balance: Creating Jobs and Opportunities ("Budget 2014"), to lay the groundwork for a balanced budget next year and surplus thereafter. From an employer perspective, the budget continues previous job growth strategies through new or enhanced training and internship programs. While the budget touches on a broad range of employer issues, it appears to merely set the stage for a 2015 pre-election budget, which will likely go much further in establishing weighty policy and reform measures. This bulletin focuses on the key announcements that have a clear and immediate effect on pension and benefit plan sponsors in Canada.

Employment Insurance – Enhancing Access to EI Sickness Benefits

Budget 2014 proposes to enhance access to EI sickness benefits for claimants who receive Parents of Critically Ill Children and Compassionate Care benefits. The proposed enhancements will allow claimants receiving these benefits to temporarily suspend their claims in order to access EI sickness benefits, should they themselves fall sick or become injured.

Currently, plan sponsors are eligible for the EI Premium Rate Reduction Program only if they provide short term disability benefits that are equal to or greater than EI sickness benefits. It is unknown at this time whether employers will be required to provide disability benefits during these types of leaves of absence to maintain their premium reduction status.

Expansion of Medical Expense Tax Credit

The Medical Expense Tax Credit ("METC") provides tax relief for individuals who have sustained significant medical expenses for themselves or certain of their dependents. Subsection 118.2(2) of the Income Tax Act ("ITA") describes the types of medical expenses that are eligible for the METC. Note that, to remain tax-effective, a Private Health Services Plan can only reimburse for services and supplies that qualify as expenses under the METC. Periodically, Canada Revenue Agency updates the list of eligible services under the METC. Budget 2014 expands the list of allowable covered services under the ITA as follows:

- costs associated with service animals specially trained to assist individuals with severe diabetes;
- amounts paid for the design of a prescribed individualized therapy plan for individuals with severe and prolonged disabilities and who qualify for the Disability Tax Credit; and
- removal of the $10,000 limit on eligible expenses that caregivers can claim under the METC in respect of a dependent relative.

Typically, Health Care Spending Accounts ("HCSAs") allow for reimbursement of services and supplies that meet the definition of a METC under the ITA. Such HCSAs will automatically expand to include the scope of coverage allowed for under this Budget. However, HCSAs that have a defined list of allowable services and supplies may not automatically expand to include these additional items. Plan sponsors should be aware of the change and contact their consultant to obtain an updated list of allowable medical expenses in order to determine whether these expenses will/will not be eligible under their plan.

Captive Insurance

Captive insurance arrangements are rarely used by Canadian benefit plan sponsors, but in recent years they have been given greater consideration as plan sponsors look at more innovative ways to manage risk.

By way of background, the ITA contains rules that protect the tax base by preventing taxpayers from shifting certain Canadian-source income to no- or low-tax jurisdictions. Under these rules, such income earned by a controlled foreign affiliate of a taxpayer resident in Canada is considered foreign accrual property income ("FAPI") and is taxable in the hands of the Canadian taxpayer on an accrual basis. A specific anti-avoidance rule in the FAPI regime is intended to prevent Canadian taxpayers, e.g., financial institutions, from shifting income from the insurance of Canadian risks (i.e., risks in respect of persons resident in Canada, property situated in Canada or businesses carried on in Canada) offshore.

Budget 2014 proposes to amend the existing anti-avoidance rule in the FAPI regime relating to the insurance of Canadian risks. Where the anti-avoidance rule applies, the affiliate's income from the insurance of the foreign risks and any income from a connected agreement or arrangement will be included in computing its FAPI.

For those companies that have captives or are considering captives, it may be appropriate to review those decisions in light of these changes.

GST/HST Exemptions

Budget 2014 proposes to expand the list of health-related goods and services that are exempt from the Goods and Services Tax/Harmonized Sales Tax (GST/HST) to include:

- designing training for individuals with a disorder or disability,
- acupuncturists' and naturopathic doctors' services, and
- eyewear specially designed to electronically enhance the vision of individuals with vision impairment.

This change, if adopted, may result in savings for plan sponsors and/or employees.
Employer Source Deductions – Remittance Thresholds

Employers are required to remit source deductions in respect of employees’ income tax, Canada Pension Plan contributions and Employment Insurance premiums. In an effort to reduce the tax compliance burden, Budget 2014 proposes the following measures related to the frequency of employers’ remittance of source deductions:

- increase the threshold level of average monthly withholdings at which employers are required to remit up to two times per month from $15,000 to $25,000; and
- increase the threshold level of average monthly withholdings at which employers are required to remit up to four times per month from $50,000 to $100,000.

These measures would apply in respect of amounts to be withheld after 2014.

Underfunded Plans – Pension Transfer Limit Relief

Budget 2014 proposes to extend the tax sheltering relief introduced in 2011 for individuals transferring benefit entitlements from underfunded defined benefit pension plans. Since 2011, the relief has only been available if the plan was being wound up due to an employer’s insolvency. It is now proposed that this relief be extended to other situations, specifically where commuted value transfer amounts are reduced pursuant to applicable pension legislation as a result of plan underfunding.

When an individual ceases to participate in a defined benefit pension plan they may be able to transfer the commuted value of their entitlement to a money purchase plan (such as a registered retirement savings plan, registered retirement income fund or defined contribution pension plan).

Regulation 8517 of the *Income Tax Regulations* limits the amount of such payments that can be transferred tax free to a money purchase plan.

When a defined benefit pension plan is underfunded, benefits may be reduced. If an individual ceases to participate in an underfunded plan and chooses to transfer the commuted value of his or her reduced benefit to a money purchase plan, the transfer limit is generally prorated based on the reduced amount received. The effect of the prorated transfer limit is that the individual may lose some of the tax-sheltering ability that would otherwise have been available if the plan was fully funded.

In 2011, Regulation 8517(3) was amended to provide relief to individuals who cease to participate in an underfunded defined benefit pension plan, where the employer is subject to proceedings under the *Bankruptcy and Insolvency Act* or the *Companies’ Creditors Arrangement Act*. This Budget proposes to extend relief to transfers from underfunded plans in additional circumstances:

- the benefits promised under the registered pension plan have been reduced due to plan underfunding;
- where the plan is a registered pension plan other than an individual pension plan, a permanent benefit reduction is approved pursuant to the applicable pension benefits standards legislation;
where the plan is an individual pension plan, the transfer of the commuted value of the member’s benefit entitlements is the last payment made from the individual pension plan; and

the use of this special rule for a particular pension plan is approved by the Minister of National Revenue.

These changes would mean that:

- if the commuted value of the individual’s reduced annual pension is less than or equal to the transfer limit that would have applied to the unreduced pension amount, the individual will be entitled to a tax-free transfer of that commuted value; and

- if the commuted value of the reduced annual pension exceeds the transfer limit that would have applied to the unreduced pension, only the excess portion of the commuted value above that limit will be required to be paid to the individual and included in his or her income.

These measures will apply in respect of transfer payments made after 2012.

On November 25, 2013, the Canada Revenue Agency also indicated that relief will be provided to individuals in the circumstances above where a reduced commuted value was transferred from a registered pension plan in 2013 and an amount in excess of the pro-rated prescribed amount was paid in cash. Such individuals will be permitted to make an additional RRSP contribution through a prescribed process.

It is not clear from Budget 2014 if this might also apply with respect to benefit reductions under a negotiated contribution multi-employer pension plan or a target benefit plan.

Should you wish additional information on this topic, please contact your local Aon Hewitt Consultant, or send an email to info@aonhewitt.com.

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