

FTR Now

Expanded CPP: The Next Generation

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Farewell ORPP, Hello Expanded CPP: Legislative reforms have now been tabled to implement the much-anticipated expanded Canada Pension Plan (CPP) for Canadians. Find out what may be coming next – and what your organization should be doing now to prepare for it.

Will Canadians have enough saved for retirement? Concerns that the answer would be “no” for a sizable proportion of the population combined with the previous federal government’s reluctance to discuss CPP enhancement prompted Ontario to take action. Accordingly, in 2014, the provincial government forged ahead and established an Ontario Retirement Pension Plan (ORPP) framework. However, the election of a new federal government in the Fall of 2015 changed the dynamics, and an [agreement in principle to enhance the CPP was reached with nine of the provincial Ministers of Finance](#) – including Ontario – in June of 2016. With the agreement’s subsequent ratification, the federal government introduced legislation on October 6, 2016 that, once adopted, will support CPP enhancement – and change the retirement landscape in Canada.

In this *FTR Now*, we outline what an expanded CPP might mean for your organization, and what steps you should be considering going forward.

Bill C-26

As we previously reported, [the federal government introduced Bill C-26, An Act to amend the Canada Pension Plan, the Canada Pension Plan Investment Board Act and the Income Tax Act](#) (Bill C-26) on October 6, 2016. If adopted in their present form, the Bill C-26 amendments will implement the enhancements to the CPP highlighted in our discussion below.

How is CPP’s Design Changing?

The enhancement has three key components:

- The CPP benefit formula will be improved by increasing the target income replacement from 25% to one-third of pensionable earnings
- The maximum amount of earnings subject to CPP will increase by 14%
- Employers and employees will both contribute more to fund the higher benefit formula and higher earnings limit.

The improved benefit will apply to future service only, meaning that existing workers will only partially benefit from the enhancement.

The enhancements will be phased-in starting on January 1, 2019. First, the higher benefit rate and increased contribution rate on earnings up to the Year’s Maximum Pensionable Earnings (YMPE) will be phased-in over five years (2019 to 2023). Then, the increase to the maximum earnings limit and the contributions on those additional earnings will be phased-in over two years (2024 and 2025).

Based on the government's estimates, employers and employees will each contribute an additional 1% on pensionable earnings up to the YMPE by 2023, for a total of 5.95% each.^[1]

	Employee Rate Increase	Employer Rate Increase	Combined Increase
2019	0.15	0.15	0.3
2020	0.3	0.3	
			0.6
2021	0.5	0.5	
			1.0
2022	0.75	0.75	
			1.5
2023	1.0	1.0	
			2.0

Starting in 2024, employers and employees will also each contribute 4% on earnings above the YMPE up to the new Year's Additional Maximum Pensionable Earnings (YAMPE), which is projected to be \$82,700 in 2025. The YAMPE will be phased-in with half of the increase effective in 2024 and the full YAMPE effective in 2025.

Year	Projected YMPE	Contribution Rate Phase-In		Employer Contribution Rate	Employee Contribution Rate
		Projected YAMPE	YAMPE as Share of YMPE		
2024	\$70,100	\$74,900	107%	4%	4%
2025	\$72,500	\$82,700	114%	4%	4%

The contribution increases and earnings limits are currently estimates and must be confirmed by the Chief Actuary.

The government has stated that, as required by the CPP legislation, the enhancement must be fully funded in order to ensure that the CPP remains financially sustainable, which will also serve to preserve intergenerational equity. Accordingly, contributions in respect of current and enhanced CPP benefits will be tracked separately, under different accounts, and the funded status of these accounts will be managed independently. Similar to current CPP rules, it is contemplated that the enhanced CPP contribution rates and/or enhanced CPP benefits could be adjusted up or down, based on the funding status of the account maintained for enhanced CPP benefits. Any such changes are to be governed by rules set by regulation, requiring the support of at least two-thirds of the provinces, having in total not less than two-thirds of the population within the provinces.

As part of the announced package, there are two tax measures being implemented in relation to the additional contributions:

- An enhancement to the federal Working Income Tax Benefit (WITB) to offset the impact of increased contributions on low-income workers

- Making employee contributions associated with the enhanced portion of CPP tax deductible instead of eligible for a tax credit.

The proposed changes to the WITB under the *Income Tax Act* would increase the amount of the tax credit for which eligible individuals can qualify based on a given level of income.

Current employee contributions will continue to qualify for a tax credit, whereas additional contributions up to the YMPE and contributions payable on income between the YMPE and YAMPE will qualify for a tax deduction. Similarly, self-employed individuals will be eligible to receive a tax deduction on all additional contributions up to the YMPE and YAMPE, as applicable. Base CPP contributions on self-employed earnings will continue to qualify for a tax deduction for one-half and a tax credit for the other half.

Bill C-26 contains no amendments related to the deductibility of employer contributions, which already qualify for a tax deduction. The existing language will be relied on to provide a deduction for both base contributions and additional contributions that are part of the enhanced CPP.

Unlike the ORPP, there is no comparable workplace pension plan exemption available to avoid the application of the enhancements.

And what of the ORPP? The Ontario government announced its plans to repeal the [Ontario Retirement Pension Plan Administration Corporation Act, 2015](#) this Fall.

Will Employees Immediately Benefit From the Enhancement?

The enhancement does not apply to past service. Anyone currently in the workforce and contributing to CPP when the enhancement is phased-in will see a partial benefit for the additional contributions they make, but its full effect will not be seen for 40 years. In this sense, the enhancement will be of most benefit to the next generation of workers. As noted below, the immediate effect of higher contributions compared to the delayed benefit improvement makes responding to the new CPP design more complicated for employers.

What About Employees in Quebec?

Quebec, which operates the Quebec Pension Plan (QPP) for Quebec workers, is examining its options. The Quebec government has signaled that it may take a different, more targeted approach to modifications to the QPP (which already has higher contributions than the CPP). If it proceeds, the QPP and CPP may no longer offer identical benefits.

How Will the Enhancements Affect Employers?

Aside from higher contributions starting in January 2019, the overall impact is less definable and may vary from employer to employer.

Many defined benefit pension plans have contribution and/or benefit formulas that are integrated with the YMPE. As currently proposed, it is not clear that the cost of or benefits payable under these plans would automatically be affected by the enhancement and the introduction of the YAMPE. In defined contribution (DC) pension plans or for group RRSPs that have

voluntary employee contributions, some members may contribute less since they will be contributing more to CPP. This could, in a matched DC plan, offset or partially offset the higher contributions employers will be making to the CPP. Employers and plan sponsors will need to individually assess the expected overall cost impact to them in their circumstances.

Cost implications aside, the alterations to the CPP's design present an opportunity for employers/plan sponsors to step back and consider their own retirement plan designs. What kind of retirement incomes are expected to be produced for employees from such plans? Do these plans pay too much when combined with CPP? How could these designs affect member behaviour? Will employees retire too soon, or too late?

For some employers/plan sponsors, the enhancement may prompt an assessment of their plan design that is overdue or may never have been undertaken when the design was first finalized. Employers/plan sponsors who are considering adjustments to their retirement plan designs face a challenging dilemma of balancing the relatively immediate additional costs associated with the enhancement with the reality that the full impact of the improvement to the CPP benefit will not take effect for many years and will not fully benefit many of the generations currently in the workforce. For plans with members in Quebec, this assessment may be further complicated to the extent that the QPP's design diverges from the design of the CPP.

Before conducting this analysis, employers/plan sponsors may find it helpful to educate key internal decision-makers about the changes. It might also be desirable to be proactive and educate the broader employee population about the changes: i.e. what they are and when they begin.

After considering the cost and design issues, some employers/plan sponsors may determine that it is desirable to amend their retirement plans. Before making retirement plan changes or changes to other aspects of employee compensation packages, employers (or, as applicable, plan sponsors) must consider any filing and notice requirements under pension law, constructive dismissal implications for non-union employees and the collective bargaining implications in a unionized workplace. Other employers/plan sponsors may determine that changes are not necessary and the additional payroll costs will simply be absorbed.

Are the Changes Final?

As discussed, the federal government introduced Bill C-26 on October 6, 2016. Bill C-26 contains amendments to the *Income Tax Act*, the CPP and other legislation that are needed to implement the enhancement. It is expected that Bill C-26 will pass.

In light of the many complexities outlined above, planning now rather than later can better position employers in preparing for the changes, including responding to and addressing employee concerns that may arise as we move forward.

Should you have any questions or require further information, please contact [any member of our Pension, Benefits and Executive Compensation group](#) or your regular [Hicks Morley lawyer](#).

[1] Currently, employers and employees contribute to the CPP at a rate of 4.95% of each covered employee's income between \$3,500 and the YMPE, which is \$54,900 for 2016.



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