

Pension Adjustments and Past Service Pension Adjustments

The purpose of this article is to:

- Differentiate between pension adjustments (PA) and past service pension adjustments (PSPA).
- Identify the impact of a PA and a PSPA to RSP contribution room.
- Determine how to cover the cost of the pension buyback.

Pension Adjustment

A pension adjustment is the value of the pension benefits earned in a calendar year. Anyone participating in a registered pension plan or deferred profit sharing plan will receive a PA. Your employer usually has to report a PA for you on your T4 or T4A slip.

An individual's PA for one year reduces the RSP deduction limit for the following year. Similar to participation in a Canadian pension plan, contributions to a foreign pension plan will also impact future RSP contribution limits. (This PA must be reported by the foreign employer. However, if the Canadian government is restricted from imposing reporting requirements, it is the employee's responsibility to calculate and report the PA.)

Canada Revenue Agency (CRA) issues an annual *Notice of Assessment* that details an individual's RSP contribution room. This calculation considers any PA from the prior tax year.

The following example of a CRA *Notice of Assessment* illustrates the impact of a pension adjustment on RSP contribution room:

John's 2011 RSP Deduction Limit Statement details are:

| | | |
|---|-----------------|-----|
| RSP deduction limit for 2010: | \$ 6,000 | |
| Minus: Allowable RSP contributions deducted in '10 | \$ 6,000 | |
| Unused RSP deduction limit at end of 2010 | \$ 0 | |
| Plus: 18% of 2010 earned income of \$60,000: | \$10,800 | |
| Minus: 2010 pension adjustment: \$ 6,500 | <u>\$ 6,500</u> | |
| | \$ 4,300 | |
| Minus: 2011 net past service pension adjustment | \$ 0 | |
| Plus: 2011 pension adjustment reversal | <u>\$ 0</u> | |
| Your RSP deduction limit for 2011 | \$ 4,300 | (A) |
| Your unused RSP contributions available to carry forward to 2011 | \$ 0 | (B) |



Pension Adjustments and Past Service Pension Adjustments

As can be seen, 18% of John's earned income was reduced by the Pension Adjustment of \$6,500, thereby providing him with \$4,300 of RSP contribution room in 2011.

Past Service Pension Adjustments

A PSPA is the value of additional pension credits that an employee receives as a result of:

- upgraded pension benefits; or
- pension buyback.

The improved pension benefits must relate to a period of service that occurs after 1989.

Impact of Past Service Benefits on RSP Contribution Room

| Exempt PSPA | Certified PSPA | | | | | | | | | | | | | | |
|---|---|--|----------|---------------------------------|-----------------|-------------------------------------|--------|--|--|--------------------------------------|----------|--|---------------|-----------------------|----------|
| An Exempt PSPA (created by a pension plan enhancement that generally impacts all or a specific group of employees) can create negative RSP contribution room. | A Certified PSPA (created from a buyback of past service or employment transfer) reduces RSP contribution room in the year the pension buyback occurs. | | | | | | | | | | | | | | |
| The negative amount carries forward to reduce future RSP contribution room limits until the negative RSP contribution room is depleted. | If the PSPA creates 'negative RSP room' whereby the PSPA exceeds the RSP contribution limits plus any unused RSP carry forward room, CRA will suggest the employee either: <ul style="list-style-type: none"> ■ Withdraw amounts from an RSP (subject to tax); or ■ Fund the buyback in part by transferring funds from an RSP. | | | | | | | | | | | | | | |
| For the year 2000 and prior years, the exempt PSPA reduced RSP contribution room in the year the pension was upgraded. For 2001 and going forward, the exempt PSPA impacts the RSP contribution room for the year following the pension upgrade. This was changed so the tax deductibility of an RSP contribution made just prior to the pension upgrade is not impacted. (The individual is not immediately in 'over contribution'.) | If a PSPA was certified in January 2011 and an RSP contribution was made in February 2011 for 2010 income tax deduction, the certification may be nullified as the individual may now be in 'over contribution'. Example: <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;">Mark's available RSP contribution room</td> <td style="text-align: right;">\$10,000</td> </tr> <tr> <td>Less: Jan 2011 PSPA for Buyback</td> <td style="text-align: right;"><u>\$ 9,500</u></td> </tr> <tr> <td>RSP contribution room after buyback</td> <td style="text-align: right;">\$ 500</td> </tr> <tr> <td colspan="2"> </td> </tr> <tr> <td>Feb 2011 RSP contribution (for 2010)</td> <td style="text-align: right;">\$10,000</td> </tr> <tr> <td>Less: remaining RSP cont. room after buyback</td> <td style="text-align: right;"><u>\$ 500</u></td> </tr> <tr> <td>RSP over-contribution</td> <td style="text-align: right;">\$ 9,500</td> </tr> </table> Making the \$10,000 RSP contribution for the 2010 tax year will put Mark in RSP over-contribution by \$9,500. As a result the PSPA certification may be invalid and he cannot proceed with the pension buyback. | Mark's available RSP contribution room | \$10,000 | Less: Jan 2011 PSPA for Buyback | <u>\$ 9,500</u> | RSP contribution room after buyback | \$ 500 | | | Feb 2011 RSP contribution (for 2010) | \$10,000 | Less: remaining RSP cont. room after buyback | <u>\$ 500</u> | RSP over-contribution | \$ 9,500 |
| Mark's available RSP contribution room | \$10,000 | | | | | | | | | | | | | | |
| Less: Jan 2011 PSPA for Buyback | <u>\$ 9,500</u> | | | | | | | | | | | | | | |
| RSP contribution room after buyback | \$ 500 | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | |
| Feb 2011 RSP contribution (for 2010) | \$10,000 | | | | | | | | | | | | | | |
| Less: remaining RSP cont. room after buyback | <u>\$ 500</u> | | | | | | | | | | | | | | |
| RSP over-contribution | \$ 9,500 | | | | | | | | | | | | | | |

Cost of Past Service Benefits

The PSPA measures the value of the past service benefits rather than the actual cost you have to pay to purchase the benefits, so the amounts will not likely be the same.

The cost of past service benefits can be paid for by:

- Making a lump-sum contribution;
- Making instalments contributions; or
- Directly transferring amounts from other registered plans.

Generally, a qualifying transfer is a direct transfer of a lump-sum amount from an unmatured RSP, a money purchase provision of an RPP or a DPSP. A qualifying transfer can pay for all or a part of the cost of the pension buyback. A qualifying transfer will reduce the PSPA amount the plan administrator has to report.

For example:

If Joanne's pension buyback generates a \$27,000 provisional PSPA, and she transfers \$19,500 from her RSP to purchase the buyback, a \$7,500 PSPA is issued to CRA for certification (i.e. \$27,000 - \$19,500 = \$7,500). Joanne's RSP contribution room will only be reduced by \$7,500.

| | |
|------------------------------------|----------|
| Provisional PSPA | \$27,000 |
| Less: RSP transfer to fund buyback | \$19,500 |
| PSPA reduced to | \$ 7,500 |
| RSP contribution room reduced by | \$ 7,500 |

When a PSPA cannot be certified

When the PSPA causes the RSP contribution room to be negative by more than \$8,000, CRA will notify the individual in writing that the PSPA cannot be certified unless the employee makes a qualifying RSP withdrawal.

A qualifying withdrawal is an amount that is withdrawn from an RSP and included in income the year it is withdrawn. CRA form *T1006, Designating an RSP Withdrawal as a Qualifying Withdrawal* is used. An employee may consider making the qualifying withdrawal, if the pension income generated by the buyback exceeds the potential income generated from the withdrawn RSP amount at retirement, taking into account the tax payable on withdrawal.

Pension Adjustments and Past Service Pension Adjustments

For example:

| | |
|------------------------------------|----------|
| Provisional PSPA | \$30,000 |
| Less: RSP transfer to fund buyback | \$15,000 |
| PSPA reduced to | \$15,000 |
| Less: Allowable negative RSP Room | \$ 8,000 |
| RSP withdrawal required | \$ 7,000 |

To fund the buyback Harry will transfer \$15,000 from his RSP, plus he must **withdraw** an additional \$7,000 from his RSP to create eligible RSP contribution room. Harry will have the after-tax value of the \$7,000 withdrawal (\$5,000 assuming a 28% tax-rate) to reinvest in a non-registered investment.

The PSPA calculation can be extremely complex. The employer or the pension plan administrator should be the first source of information. A tax specialist may need to be consulted.

CRA also provides details on the certification process in the Guide *T4040 RSPs and Other Registered Plans for Retirement*.



The information contained herein has been provided by TD Wealth and is for information purposes only. The information has been drawn from sources believed to be reliable. Where such statements are based in whole or in part on information provided by third parties, they are not guaranteed to be accurate or complete. Graphs and charts are used for illustrative purposes only and do not reflect future values or future performance of any investment. The information does not provide financial, legal, tax or investment advice. Particular investment, trading or tax strategies should be evaluated relative to each individual's objectives and risk tolerance. TD Wealth, The Toronto-Dominion Bank and its affiliates and related entities are not liable for any errors or omissions in the information or for any loss or damage suffered.

TD Wealth represents the products and services offered by TD Waterhouse Canada Inc. (Member – Canadian Investor Protection Fund), TD Waterhouse Private Investment Counsel Inc., TD Wealth Private Banking (offered by The Toronto-Dominion Bank) and TD Wealth Private Trust (offered by The Canada Trust Company).

® The TD logo and other trade-marks are the property of The Toronto-Dominion Bank.

Revised 30/01/2012