Knowledge & Insights

MORNEAU SHEPELL

Special Communiqué

Finance Ministers agree to Canada Pension Plan expansion

June 2016

On June 20, 2016, the Federal and Provincial Finance Ministers agreed to expand the Canada Pension Plan (CPP). The agreement includes the federal government and all provinces except Manitoba and Quebec. Quebec intends to propose its own approach, which may exempt low income from the increases, for consultation. The new Manitoba government will study the agreement before determining its position.

Summary of changes

The objectives of the Finance Ministers are twofold: 1) to increase the replacement rate on pensionable income from 25 per cent to 33 per cent for 65 year olds with a full working career, and 2) to increase the earnings ceiling for contribution and benefits purposes (the Year's Maximum Pension Earnings, or YMPE) by 14 per cent. It is important to note that the official announcement refers to a target for the YMPE of $82,700 in 2025. This maximum threshold is in 2025 dollars. Applying the announced 14 per cent increase would increase the 2016 YMPE from $54,900 to approximately $62,600.

To achieve these objectives, the contribution rate for both employees and employers will increase. Although not specified in the formal announcement, it appears the increase will be approximately 1 per cent of pensionable earnings on the part of both employers and employees. The current CPP contribution rate is 4.95 per cent of pensionable earnings for both employers and employees.

Phase-in

A seven-year phase-in of the contribution increase is scheduled. Specifically, the contribution rate increase will be phased in over five years commencing January 1, 2019. After the five-year phase-in (i.e., starting on January 1, 2024), the maximum earnings limit will be increased over two years.

While not explicitly mentioned in the announcement, the benefit increase will apply only to future service. In other words, the benefit increase will not be applied retroactively and so will not affect retirees. Accordingly, the full benefit increase will take approximately 40 years before it will apply to an entire working career.

Tax deductibility

Currently, employee CPP contributions receive a tax credit based on the lowest income tax rate. According to the agreement, the enhanced portion of employee CPP contributions will be tax deductible. This tax treatment will be much more favourable to higher income individuals than a tax credit.

Employer CPP contributions will remain fully deductible.

Working income tax benefit

To offset the impact of higher CPP contributions on lower-income Canadians, an increase to the Working Income Tax Benefit is promised.

Impact on Ontario Retirement Pension Plan

As a result of the agreement on CPP expansion, the Ontario Finance Minister, Charles Sousa, has stated that the Ontario Retirement Pension Plan (ORPP) will not go forward, provided that the announced deal is confirmed by July 15, 2016. It should be noted that the cost of CPP expansion will be lower for those employers and employees who would have participated in the ORPP, given that: 1) the contribution rate increase is lower than the 1.9 per cent increase that would have applied in the ORPP; and 2) the maximum earnings threshold of $90,000 in 2017 dollars was significantly higher than the increase to the YMPE now proposed under the CPP. The benefits for those employees who would have participated in the ORPP will also be lower as the CPP expansion provides an additional 8 per cent replacement rate (based on the YMPE) while the ORPP was targeting a replacement rate of 15 per cent (based on a maximum earnings threshold of $90,000 in 2017 dollars). CPP expansion will also be phased in more slowly than the ORPP. Under the CPP, however, there are no exemptions for employers who sponsor "comparable workplace pension plans".

Next steps

With the agreement of all the provinces except Manitoba and Quebec, the required threshold of two-thirds of provinces representing two-thirds of the population will be met.

Commentary

Overall, the proposed expansion should be considered good news for Canadians in general and the middle class in particular. We note that many stakeholders were unhappy with the original CPP when it was introduced in 1966 and yet, over time, the plan has woven itself into the fabric of Canadian society. We expect the same result with respect to this enhancement.

While many businesses will not be happy with the increase in payroll costs, the increase is modest compared to the other serious proposals for CPP expansion that have been considered in recent years.

As a result of the increased cost to businesses, many workplace pension plans are expected to be examined and updated to integrate the CPP enhancement.

Accomplishing such changes will require negotiations with unions in collectively bargained settings. The good news is that the lengthy phase-in period will provide sufficient time for such changes to be carefully considered and implemented.

In Quebec, the public consultation expected in the coming months will determine whether the QPP plan design will deviate further from the CPP.

Quebec Pension Plan

The Quebec Finance Minister, Carlos Leitao, has stated that the proposed expansion is not sufficiently targeted. The Quebec Government will propose a modified version of CPP expansion to the QPP for public consultation. Specifically, it has been suggested that the increase in contribution and benefit rates will only apply to income greater than half of the YMPE (i.e., approximately $27,500 in 2016).

The Quebec Pension Plan (QPP) contribution rate is currently 5.25 per cent of pensionable earnings for both employers and employees.

MORNEAU SHEPELL

Morneau Shepell is the only human resources consulting and technology company that takes an integrative approach to employee assistance, health, benefits and retirement needs. The Company is the leading provider of employee and family assistance programs, as well as the largest administrator of retirement and benefits plans and the largest provider of integrated absence management solutions in Canada. Through health and productivity, administrative, and retirement solutions, Morneau Shepell helps clients reduce costs, increase employee productivity and improve their competitive position. Established in 1966, Morneau Shepell serves approximately 20,000 clients, ranging from small businesses to some of the largest corporations and associations in North America. With almost 4,000 employees in offices across North America, Morneau Shepell provides services to organizations across Canada, in the United States, and around the globe. Morneau Shepell is a publicly-traded company on the Toronto Stock Exchange (TSX: MSI)

morneaushepell.com

@Morneau_Shepell

Morneau Shepell

MENTAL HEALTH PARTNER