May 14, 2010

Mr. James Rajotte, M.P.
Chair, House of Commons Standing Committee on Finance
Room 406, Justice Building
House of Commons
Ottawa ON K1A 0A6

Re: Estimated Cost of Bill C-290, *An Act to Amend the Income Tax Act (Tax Credit for Loss of Retirement Income)*

Dear Mr. Rajotte:

Further to the House of Commons Standing Committee on Finance's request of April 20, 2010, I am pleased to provide you with a preliminary assessment of the cost estimates prepared by the Government and Bloc Québécois regarding Bill C-290, *An Act to Amend the Income Tax Act (Tax Credit for Loss of Retirement Income)*[1],[2].

As I noted in my consultations with specific members of the Committee and highlighted in my correspondence to the Clerk[3], it is evident that the **differences between the cost estimates arise from varying interpretations of the legislation**. In effect, the cost estimates shared by the Government ($10 billion per annum) and the Bloc Québécois ($3 million to $5 million per annum) relate to **distinct legislative proposals**.

As highlighted in Table 1, the two estimates appear to be based on similar categories of eligible recipients, but different qualifying conditions and benefit calculations.

The Government estimate assumes that all recipients of income from registered pension plans (RPPs) that file a federal tax return are eligible for a 22% refundable tax credit on eligible pension income. In contrast, the legislative interpretation of the Bloc Québécois is more restrictive, assuming that only retirees whose pension income has been reduced as a result of financial distress of the sponsoring firm are eligible for a 22% refundable tax credit on lost income.

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1. http://www2.parl.gc.ca/HousePublications/Publication.aspx?DocId=4448137&Language=E&Mode=1&Parl=40&Ses=3. . Accessed May 2010.

2. Bill C-290 is presented at: http://www2.parl.gc.ca/HousePublications/Publication.aspx?DocId=4330037&Language=e&Mode=1. Accessed May 2010.

3. Consultations with Government and Bloc Québécois members were undertaken during the week of April 26, 2010, and correspondence was delivered electronically on May 5, 2010.

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Table 1. Competing Legislative Interpretations of Bill C-290

	Government	Bloc Québécois
ELIGIBLE GROUP	All retirees receiving funding from a registered pension plan.	All retirees receiving funding from a registered pension plan.
QUALIFYING CONDITIONS	File federal tax return.	Pension income has been reduced due to financial distress of sponsoring firm.
BENEFIT	22% refundable tax credit on all income from registered pension plans, not including retirement compensation arrangements.	22% refundable tax credit on the amount of pension income loss.

Reasonableness of the Assumptions

It is impossible to come to a single cost estimate until this legislative ambiguity is resolved. As such, my **assessment is focused on the reasonableness of the assumptions that underpin each estimate**[4].

The Government Estimate

As noted in Table 1, the **Government includes a broader range of eligible individuals** (*i.e.* all recipients of income from RPPs, less income from retirement compensation arrangements [RCAs]) and a richer benefit (*i.e.* tax credit based on all pension income, rather than lost pension income).

The Government approach to estimating the cost relies on a "top-down" method, using aggregate federal tax data from 2003 (for RCAs) and 2006 (for RPPs), extrapolating their growth to 2009, and applying the given 22% tax credit on the difference between the two. As such, the only potential assumptions that could affect the cost estimate are the assumed growth rates for RPP and RCA income.

Using the most recent public data available from the Canada Revenue Agency and Statistics Canada[5], my staff have estimated forgone federal tax revenues using a range of growth rates based on short- and longer-term averages. Overall, regardless of the growth rate applied, **the Government estimates appear to be reliable.**

4. Supporting calculations are presented in Annex A.
5. Canada Revenue Agency Tax Statistics for 2008 were used to obtain income "from other pensions and superannuation" and are presented at: http://www.cra-arc.gc.ca/gncy/stts/gb08/pst/ntrm/menu-eng.html Accessed May 2010. Statistics Canada data regarding RCAs was obtained from its publication entitled *Canada's Retirement Income Programs*. Catalogue 74-507XCB.

The Bloc Québécois Estimate

The Bloc Québécois estimate is prepared using "bottom-up" analysis, which identifies **specific Quebec-based case studies where the proposed tax credit would apply** (*i.e.* bankrupt firms that reduced their pension payouts), counting the number of eligible individuals and calculating the average reduction in pension income. The Quebec-specific estimate is then "grossed-up" by a range of 2X to 3X to estimate the Canadian total.

Given that the underlying data reflect actual experience, (*e.g.* Atlas Steel, Jeffrey Mine); the relevant assumptions assessed by my staff include the frequency of registered pension plan terminations owing to bankruptcy or financial distress and the amount by which retiree benefits are reduced in this scenario.

Based on a survey of public pension plan data, there are only two regulators that identify when pension plans have been terminated as a result of bankruptcy or financial distress (Nova Scotia and Alberta)[6]. These data indicate that 1 to 5 plans per year in each province are terminated owing to some form of financial distress, which affect up to 2,000 plan members (*i.e.* active members and pensioners)[7]. Extrapolated nationally[8], this could suggest that *up to* 60 plans per year may be terminated as a result of financial distress, which is higher than the Bloc Québécois estimate (based on two terminations in Quebec over a period of 3 years)[9].

With respect to the assumption regarding benefit reductions, the average solvency rate for the most recent year of publicly available data for Canadian-regulated plans ranged between 61% and 86%[10]. My staff was unable to locate public data regarding the average solvency rate for plans terminated as a result of financial distress. However, given that terminated plans likely have below-average solvency ratios, the Bloc Québécois range of benefit reductions appears to be reasonable.

Overall, the **assumptions underpinning the Bloc Québécois estimate may underestimate the cost of the proposal given the potentially greater number of distressed RPPs.**

Next Steps

I want to thank the Committee for the opportunity to undertake this work on its behalf and extend my appreciation to the Government and Bloc Québécois for sharing their internal analysis.

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6. The annual report regarding registered pension plans regulated by the Province of Nova Scotia is located at: http://www.gov.ns.ca/lwd/pensions/docs/AnnualReport2009_000.pdf. Accessed May 2010. The annual report for pensions regulated by the Province of Alberta is located at: http://www.finance.alberta.ca/publications/pensions/pdf/info-annual-stats-2008-09.pdf. Accessed May 2010.
7. The Bloc Québécois legislative interpretation would only provide financial support to pensioners, rather than all plan members.
8. Assuming that the proportion of all Canadian regulated registered pension plans is terminated from financial distress is consistent across all provinces.
9. Nationally, the frequency assumption used by the Bloc Québécois implicitly assumes that there are 0.6 terminations per year owing to financial distress in the Province of Quebec (2 plans/3 years); and that this represents roughly ¼ of total national activity (0.6/0.25) = 2.4 or 3 plans per year in Canada.
10. Either the calendar year 2008 or 2009, or the fiscal year 2008/09.

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To date, the PBO analytical process has largely focused on the terms of reference and methodology required to fulfill the Committee's request. Should the Committee reach a common understanding regarding the legislative interpretation of Bill C-290, I would be pleased to continue with the analytical process towards a cost estimate based on such a consensus.

Yours truly,

K Page

Kevin Page
Parliamentary Budget Officer

Encl.: Summary of Calculations

c.c.: Mr. Jean-François Pagé, Clerk, House of Commons Standing Committee on Finance

Annex A: Summary of Calculations

Figure 1. Government Methodology

(i)	Registered Pension Plan (RPP) Income in 2006 ($B)	45
(ii)	Assumed Annual Growth to 2009 (%)	5
(iii) = (i)*(1+ii)^n	Forecast RPP Income in 2009 ($B)	52
(iv)	Retirement Compensation Arrangement (RCA) Payments in 2003 ($B)	1
(v)	Assumed Annual Growth to 2009 (%)	10
(vi) = (iv)*(1+iv)^n	Forecast RCA Payments in 2009 ($B)	2
(vii) = (iii) - (vi)	Income Elgible for Tax Credit ($B)	50
(viii)	Federal Tax Credit Rate (%)	22
(ix) = (vii)*(viii)	**Annual Tax Expenditure ($B)**	11

Figure 2. Summary of Sensitivity Analysis

		High	*Low*
(i)	Other Pensions and Superannuation Income in 2008 ($B)	65	65
(ii)	Share Attributed to RPP Income (%)[1]	87	87
(iii)	Assumed Annual Growth to 2009 (%)	5	14
(iv) = (i)*(ii)*(1+iii)^n	Forecast Income in 2009 ($B)	59	64
(v)	RCA Payments in 2003 ($B)	1	1
(vi)	Assumed Annual Growth to 2009 (%)	12	51
(vii) = (v)*(1+vi)^n	Forecast RCA Payments in 2009 ($B)	2	14
(viii) = (iv) - (vii)	Income Elgible for Tax Credit ($B)	57	50
(ix)	Federal Tax Credit Rate (%)	22	22
(x) = (viii)*(ix)	**Annual Tax Expenditure ($B)**	12	11

Notes:

1. Based on Finance Canada figures of $45 billion in RPP income for 2006 and reported CRA statistics of $52 billion in "other pension income" for 2006.

Figure 3. Bloc Québécois Methodology

		High	Low
(i)	Number of Eligible Plans in Quebec (2002 to 2005)[1]	2	2
(ii)	Reduction in Pensionable Benefits (%)	28	58
(iii)	Annual Cost for Quebec ($M)[2]	1.7	1.7
(iv)	**Annual Cost for Canada ($M)**	**5.0**	**3.0**

Notes:

1. These case studies relate to the Jeffrey Mine and Atlas Steel.

2. Bloc Québécois did not release microdata regarding number of pensioners affected, mortality rates or average pension payment amounts.

Figure 4. Summary of Sensitivity Analysis

		High	Low
(v)	Plans Terminated Due to Financial Distress (NS & AB)[3]	5	1
(vi)	NS & AB Regulators' Share of National Registered Pension Plans (%)	8	9
(vii) = (v)/(vi)	Estimate of Canadian Plans Terminated Due to Financial Distress	63	11
(viii)= (iii)/(i)	Average Cost Per Plan Terminated in Quebec ($M)	0.9	0.9
(ix) = (vii)*(viii)	**Total Annual Cost Based on Quebec Average ($M)**	**53**	**9**

Notes:

3. These are data for Registered Pension Plans Regulated in the Provinces of Nova Scotia and Alberta.