

Pension plans for the exclusive benefit of persons connected with the employer

Explanatory note

Introduction

In November 2000, the Québec National Assembly passed the *Act to amend the Supplemental Pension Plans Act and other legislative provisions*. The *Act* updates and simplifies the legislative framework for supplemental pension plans. One of the simplification measures already in force affects pension plans that are for the exclusive benefit of persons connected with the employer. From now on, under certain conditions, those plans will be exempted from the application of virtually all of the provisions of the *Supplemental Pension Plans Act*. This measure is provided for in sections 2.1 and 288.0.2 of the amended *Act*. A copy of the provisions accompanies this document. Thus, plan administrators will have the information needed to determine if their plans are affected by the new measure.

Affected plans

For the most part, the measure primarily affects plans with very few members. Although there is no maximum number of members, the plans concerned rarely have more than 10 members and all members must be "persons connected with the employer" within the meaning of the *Income Tax Regulations*. In this type of plan, for most members, the distinction between "member" and "employer" is often blurred and the framework of the *Act* does not always reflect the wishes of the parties to such plans. That is why the lawmakers decided to exempt such plans from the application of the *Act*. However, in the case of plans already registered with the Régie, exemption is not allowed unless the plan administrator proposes it and all the plan members and beneficiaries accept the proposal.

Generally speaking, a person connected with an employer holds at least 10% of the stock of the employer who is a party to the plan. Moreover, a member connected with a person who is connected with an employer (e.g., that person's spouse or child) is often deemed to be a person connected with the employer even if he or she holds less than 10% of the employer's stock. For more details about this, you can refer to the *Income Tax Regulations (Consolidated Regulations of Canada [1978], chapter 945)*, more particularly subsection 3 of section 8500. The administrator should, if in doubt, seek the advice of the plan's consultants or the Canada Customs and Revenue Agency.

Effects of the measure

Under certain conditions, a plan may be exempted from the application of the *Act*, except for five of its provisions (which are described in the following section). Such a plan will no longer have to be registered with the Régie, but will remain fully subject to the taxation rules that may govern its operations. Moreover, the plan will no longer be subject to the supervision of or control exercised by the Régie. Furthermore, the provisions of the pension plan and its administration will no longer have to meet the requirements of the *Act* and its regulations.

From now on, the plan administrator will no longer have to file an annual information return with the Régie or pay the related fees (generally 250 \$ per year). Moreover, where a plan is a defined benefit plan, no actuarial valuation report will have to be sent to the Régie. Although a report will have to be submitted to the Canada Customs and Revenue Agency, a valuation of the plan's solvency will no longer be required. Consequently, it may be possible to reduce contributions and the work related to preparing the report, which may result in lowered administration costs. Since funding of such plans will be much less closely controlled, funding flexibility will be increased.

Plan amendments will no longer have to be submitted to the Régie. Therefore, since the *Act* will no longer apply to such plans, they will not have to be amended as at 1 January 2001 to be brought into conformity with the provisions of the *Act* that are a result of the passage of Bill 102.

In the event that such a plan is terminated, no notice or report will have to be submitted to the Régie. Moreover, the Régie will not carry out any supervision of such plans and will not be able to intervene in the event of a dispute, at least to the extent that the plan is exempted from the application of the *Act*. The plan's administration, modification and termination will from now on only be subject to the rules provided for in the plan text, the *Civil Code of Québec* and in the taxation laws.

Exemption from the *Act* – Exceptions

Where all the conditions are met, a plan for persons connected with an employer is exempted from the application of the provisions of the *Act*, except for the provisions listed below. In all cases, any application of the *Act* must be adapted as required as a result of the fact that the rest of the *Act* and its regulations do not apply.

Notion of contract

Section 6 of the *Act* continues to apply to such plans. Thus, a plan for persons connected with the employer is still a contract and the pension fund is still a trust patrimony that is separate from the patrimonies of the employers and the members. The rules applying to contracts, trusts and the administration of the property of another under the *Civil Code of Québec* will continue to apply to plans exempted from the application of the *Act*.

Designation of beneficiaries

Section 64 of the *Act* will also continue to apply. Thus the designation and revocation of beneficiaries will continue to be governed by the *Civil Code of Québec* (articles 2445 to 2459). Obviously, this is the case only for plans that still provide for payment of a pension benefit to a beneficiary of a plan member (generally, a death benefit).

Transfer of benefits between spouses

Section 107 of the *Act* also continues to apply. That section concerns partition, following legal separation, divorce or civil annulment of marriage, of the benefits accumulated by the member in a pension plan. However, since the plans concerned are not subject to Chapter I of the *Act*, the rules for transferring benefits that are set out in sections 32 to 56 of the *Regulation respecting supplemental pension plans* no longer apply. Section 107 is maintained solely to continue treating exempted plans as being part of the family patrimony, subject to partition following marriage breakdown.

The first paragraph of section 110 of the *Act* also continues to apply. That provision concerns partition of benefits between de facto spouses, where such spouses have agreed thereto. It should be noted that the definition of de facto spouse is still the definition found in the *Act*. The definition of spouse found in section 85 applies only in this specific case. For other purposes, the plan can provide another definition (subject to applicable taxation rules).

Finally, the first paragraph of section 110 is amended by Bill 102 (the deadline for applying for partition has been extended from 6 months to 1 year). The new deadline must be applied.

Investment rules

The investment rules in the *Act* do not apply, except for the one added by section 171.1. A plan's investments will therefore be governed by the rules in other laws and that section's rule. Section 171.1, which comes into force on 1 January 2001, provides as follows: "Unless it is reasonable in the circumstances to act otherwise, the pension committee must endeavour to constitute a diversified portfolio so as to minimize the risk of major losses."

Transfer of benefits

The second paragraph of section 2.1 of the *Act* provides that for the purposes of applying section 98, where a plan referred to is a plan for persons connected with an employer, it is deemed not to be a plan governed by the *Act*. In other words, where such a plan is exempted from the application of the *Act*, it is not possible to transfer to it funds coming from a plan that is governed by the *Act*.

Changes in membership rules

A plan remains exempted from the application of the *Act* so long as the conditions stated in section 2.1 are met. If the plan is changed so as to no longer meet those conditions—mainly if eligibility for membership is extended to persons other than those referred to—the plan becomes fully subject to the *Act*. That can have important consequences for the parties to the plan and for plan administration. It would be prudent to consult competent advisors before making any changes to the rules on membership eligibility or before accepting a new member.

General conditions

Section 2.1 of the *Act* provides four conditions for exemption from the *Act* of a plan for persons connected with an employer:

- Membership in the plan must be optional. No one can be compelled to join.
- Only persons connected with an employer can be members of the plan and new memberships must be limited to persons who are connected with the employer. Thus, the wording of the plan must be in conformity with this condition. Moreover, it is essential for the plan to be rigorously administered in accordance with this rule. In fact, as soon as a person who is not connected with the employer participates in the plan, even for a short time, the plan becomes subject to the *Act*. The only way to avoid this is to set up another plan for such a person.
- In addition to being limited to persons connected with the employer, membership must be exclusively for "Québec employees" referred to in section 1 of the *Act*. The benefits of workers not governed by the *Act* are subject to other supervisory laws, which, while comparable in many respects to the *Act*, do not allow, at least for the time being, for a plan to be exempted from their application.
- Finally, the plan must provide that as soon as a member ceases to be considered to be a person connected with the employer, the member must cease to accumulate new pension benefits and must cease to be an active member of the plan. In other words, once a plan is exempted from the *Act*, all pension benefits accumulated thereafter must have been accumulated during a period when the member was a person connected with the employer.

Specific conditions for plans that are already registered

Although section 2.1 of the *Act* automatically exempts plans for persons connected with the employer which meet the rules, there are some additional conditions for plans already registered with the Régie. Those conditions are found in section 288.0.2 of the *Act* and are the following:

Application by the administrator

Before a plan can be exempted, the plan administrator must make an application to the Régie. An application form is enclosed with this document. It must be signed by the plan administrator. If an application is not filed, the plan remains fully subject to the *Act*. It must be noted that plans that remain subject to the *Act* will have to be amended no later than 31 December 2001 to be in conformity with the new provisions of the *Act*.

Consent of the members

Since exemption from the *Act* is likely to affect the rights of members and beneficiaries, the *Act* provides that all those persons, without any exception, must be notified of the administrator's application and must consent to it. The application form is designed so that it can be signed by the members and beneficiaries and thus meet the requirements of section 288.0.2. They do not have to sign any other document.

Amendment of the plan

As a general rule, a plan already registered will have to be amended to meet the conditions for plan membership and eligibility for membership for new members. The administrator will have to see to the amendment and obtain the consents provided for in the plan for that purpose. Although such an amendment is usually essential, it is not necessary to submit the amendment to the Régie (provided the other conditions are respected). However, the administrator must be prepared, if requested, to provide the Régie with the amendment. You will find an example of such an amendment at the end of this document.

Fees payable to the Régie

All fees related to the fiscal year immediately preceding the application for exemption from the *Act* to the Régie must have been paid in full (in particular, fees related to an annual information return or a total termination report as well as additional fees for delays in submitting documents or payment of fees).

For example, in the case of a plan whose fiscal year ends on 31 December, if the administrator files an application for exemption with the Régie in March 2001, the fees (usually 250 \$) that are owing for the fiscal year ending on 31 December 2000 will have to be paid to the Régie in March 2001 even though the administrator would usually have until 30 June 2001 to pay them.

Documents to be submitted to the Régie

New plans

New plans that are in conformity with the conditions provided for in section 2.1 of the *Act* are automatically exempted from the provisions of the *Act* and no document or application has to be submitted to the Régie. If in doubt as to whether the plan is covered by section 2.1, the plan's advisors or the Régie should be consulted.

Plans already registered with the Régie

Unless you are informed otherwise, the only document that has to be submitted to the Régie to obtain the exemption referred to in section 288.0.2 of the *Act* is the form signed by the administrator and all the members and beneficiaries. The form must be accompanied with any fees owing to the Régie. It is important to note that on receipt of an acceptable application, all matters pending before the Régie with respect to the plan will be dropped. Thus, the Régie will not follow up on applications for plan registration, amendments or total or partial terminations. Generally speaking, any application already being processed by the Régie will be null and void. For example, the Régie will cease to require the production of an annual information report, including the report for the year preceding the application for exemption. Nevertheless, the fees related to any documents that are incomplete or that have not been submitted will still have to be paid in full.

Exemption from the *Act* (subject to the exceptions referred to in section 2.1) will take effect as soon as the Régie revokes the plan's registration. The administrator of the plan will receive a copy of the Régie's decision to revoke the plan's registration.

Special case

If a plan for persons connected with an employer is not already registered by October 2000, it may not meet all the conditions referred to in section 2.1 of the *Act* (for example, because membership eligibility is not limited exclusively to persons connected with the employer). Such a plan will therefore have to be registered with the Régie. If thereafter the plan is amended to be in conformity with section 2.1, an application for exemption from the application of the *Act* may then be submitted to the Régie, in accordance with section 288.0.2.

In such cases, an additional condition is imposed by the second paragraph of section 288.0.2 of the *Act*. If in the past, sums have been transferred from another pension plan (including an LIRA) to the plan affected by the application for exemption, all those previously transferred sums will have to be transferred again, to another pension plan, for example, an LIRA. The plan cannot be registered before such transfers have been made.

Example of an amendment

As mentioned before, a plan already in effect will generally have to be amended to be exempted from the *Act*. We are giving below the wording of such an amendment that would be sufficient in many cases to be in accordance with section 2.1 as to plan membership and membership eligibility. Plan administrators can adapt it for use in amending their plans. However, it is strongly recommended that competent advisors be consulted to ensure that the proposed amendment is suitable for the plan.

"Notwithstanding any other provision of this plan:

- (1) only employees referred to in section 1 of the *Supplemental Pension Plans Act* (L.R.Q., chapter R-15.1) may join and participate in the plan;
- (2) membership for such employees is optional and limited to persons connected with the employer within the meaning of subsection (3) of section 8500 of the *Income Tax Regulations (Consolidated Regulations of Canada [1978], chapter 945)*;
- (3) a member's active membership in the plan (within the meaning of section 36 of the *Supplemental Pension Plans Act*) ceases on the date on which he is no longer a person referred to in subparagraph (2) and no pension benefit may be constituted with respect to any period in which a member is not such a person;
- (4) no sum may be transferred to the plan through the application of the *Supplemental Pension Plans Act*."

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