Canadian Institute of Actuaries

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EDUCATIONAL NOTE

Reflecting Increasing Maximum Pensions Under the Income Tax Act in Solvency, Hypothetical Wind-up and Wind-up Valuations

December 13, 2023

Reflecting Increasing Maximum Pensions Under the Income Tax Act in Solvency, Hypothetical Wind-up and Wind-up Valuations

Committee on Pension Plan Financial Reporting

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The actuary should be familiar with relevant educational notes. Educational notes are not binding; rather they are intended to illustrate the application of the standards of practice. A practice that an educational note describes for a situation is not necessarily the only accepted practice for that situation nor is it necessarily accepted practice for a different situation. Responsibility for ensuring that work is in accordance with accepted actuarial practice lies with the actuary. As accepted actuarial practice evolves, an educational note may no longer appropriately illustrate the application of standards.

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Preamble

This updated educational note is intended to provide guidance to actuaries with respect to reflecting increasing defined benefit maximum pension limits under the *Income Tax Act* in solvency, hypothetical wind-up and wind-up valuations.

An educational note on this subject was originally published in June 2004 and updated in January 2015 to conform to the pension-specific standards of practice effective February 1, 2014. This educational note has been updated in 2023 to conform with references to the standards of practice effective December 1, 2022.

Process

The creation of this cover letter and educational note has followed the Actuarial Guidance Council's (AGC's) protocol for the adoption of educational notes. In accordance with the CIA's *Policy on Due Process for the Approval of Guidance Material Other Than Standards of Practice and Research Documents*, this educational note has been prepared by the Committee on Pension Plan Financial Reporting (PPFRC) and has received approval for distribution by the AGC on December 12, 2023.

Your feedback

Questions or comments regarding this educational note may be directed to the chair of the PPFRC

1. Introduction

The maximum accrual permitted for a defined benefit pension plan under the *Income Tax Act* is expected to increase every calendar year. This raises the question of whether a solvency, hypothetical wind-up or wind-up valuation performed as at December 31 of a calendar year should reflect the maximum in effect on December 31 of that calendar year, or the higher limit that would be effective the following day.

The relevant sections of the current *Standards of Practice* (SOP) are:

- General SOP – 1120 – Definitions
    - 1120.13 – Calculation date
    - 1120.61 – Report date
    - 1120.66 – Subsequent event
- General SOP – 1430 – Subsequent events
    - 1430.12 – Wording on subsequent event changing entity after calculation date when purpose of work is to report on the entity as it was at the calculation date.
- Pension SOP – 3200 – Advice on the funded status or funding of a pension plan
    - 3240.05 – Hypothetical wind-up section indicating that the actuary may assume that the wind-up date, the calculation date and the settlement date are all coincident.
    - 3240.12 – Hypothetical wind-up section indicating that the actuary may reflect subsequent events in the valuation provided that doing so either increases the actuarial present value of the projected benefits at the calculation date or reduces the value of the pension plan's assets at the calculation date.
    - 3250.01 – Solvency valuation section clarifying that a solvency valuation is typically a form of a hypothetical wind-up valuation required by law and indicating that hypothetical wind-up standards of practice apply, unless:

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        - otherwise required by law; or
        - permitted by law and stipulated by the terms of an appropriate engagement.
- Pension SOP – 3300 – Full or Partial Wind-up Valuation
    - 3310.06 – Defining the cut-off date as the date up to which subsequent events are recognized in the valuation.

This issue affects some pension plans differently, depending on the plan's provisions. We have classified the difference in plan provisions into two broad categories as follows:

1. Pension plans that provide for the maximum pension test to be applied at the time of pension commencement (for example, a deferred pension expected to commence at the member's age 65 would apply the maximum pension test in the calendar year in which the member attains age 65).
2. Pension plans that provide for the maximum pension test to be applied at the relevant calculation date (for example, a deferred pension expected to commence at the member's age 65 would apply the maximum pension test in the year of the member's termination of employment, or in determining commuted values, the year of the settlement of the pension obligation).

For pension plans with provisions generally described under item 1 above, the values determined under a hypothetical wind-up valuation or solvency valuation would not be affected by whether or not the valuation was performed on December 31 or January 1, since the actuary would be estimating the maximum pension as at the assumed date of pension commencement.

For pension plans with provisions generally described under item 2 above, the issue of whether or not to use the current calendar year pension limit, or the following calendar year pension limit does affect the calculation.

- For hypothetical wind-up valuations being performed as at December 31 in a calendar year, reflecting only the maximum accrual limit for that calendar year (for example, $3,420.00 for December 31, 2022) is in compliance with the SOP, if in accordance with the terms of the plan. However, reflecting the higher limit that would be effective January 1 of the following calendar year (for example, $3,506.67 on January 1, 2023), thus increasing the actuarial liability, is also in compliance with the SOP.
- For solvency valuations performed as at December 31 of a calendar year, the SOP for hypothetical wind-up valuations also applies, unless otherwise required by legislation. The interpretation of what will be required by the various pension regulators is outside the mandate of the PPFRC.
- For an actual wind-up valuation, the SOP is different. The cut-off date would be chosen to be as close as possible to the report date, and subsequent events would be reported up to the cut-off date.

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