Permitting Additional Types of Annuities Under Registered Plans

The tax rules allow funds from certain registered plans to be used to purchase an annuity to provide income in retirement, subject to specified conditions. In exchange for a lump-sum amount of funds, an annuity provides a stream of periodic payments to an individual (i.e., the annuitant), generally for a fixed term, for the life of the annuitant or for the joint lives of the annuitant and the annuitant's spouse or common-law partner.

To provide Canadians with greater flexibility in managing their retirement savings, Budget 2019 proposes to permit two new types of annuities under the tax rules for certain registered plans:

- advanced life deferred annuities will be permitted under a registered retirement savings plan (RRSP), registered retirement income fund (RRIF), deferred profit sharing plan (DPSP), pooled registered pension plan (PRPP) and defined contribution registered pension plan (RPP); and
- variable payment life annuities will be permitted under a PRPP and defined contribution RPP.

The measures will apply to the 2020 and subsequent taxation years.

Advanced Life Deferred Annuities

The tax rules generally require an annuity purchased with registered funds to commence by the end of the year in which the annuitant attains 71 years of age.

Budget 2019 proposes to amend the tax rules to permit an advanced life deferred annuity (ALDA) to be a qualifying annuity purchase, or a qualified investment, under certain registered plans. An ALDA will be a life annuity the commencement of which may be deferred until the end of the year in which the annuitant attains 85 years of age.

Qualifying plans

An ALDA will be a qualifying annuity purchase under an RRSP, RRIF, DPSP, PRPP and defined contribution RPP. An ALDA will also be a qualified investment for a trust governed by an RRSP or a RRIF. Qualifying plan terms may need to be amended in order to permit the purchase of an ALDA under such plans.

The value of an ALDA will not be included for the purpose of calculating the minimum amount required to be withdrawn in a year from a RRIF, a PRPP member's account or a defined contribution RPP member's account, after the year in which the ALDA is purchased.

Limits

An individual will be subject to a lifetime ALDA limit equal to 25 per cent of a specified amount in relation to a particular qualifying plan. The specified amount will equal the sum of:

- the value of all property (other than most annuities, including ALDAs) held in the qualifying plan as at the end of the previous year; and
- any amounts from the qualifying plan used to purchase ALDAs in previous years.

In practice, this limit will apply only when an ALDA is purchased or when an additional amount is added to an existing ALDA contract. As a result, an individual will not be required to surrender or dispose of ALDAs in situations where the value of ALDA purchases in previous years exceeds the individual's lifetime ALDA limit for a particular year due to a decline in qualifying plan assets.

An individual will also be subject to a comprehensive lifetime ALDA dollar limit of $150,000 from all qualifying plans. The lifetime ALDA dollar limit will be indexed to inflation for taxation years after 2020, rounded to the nearest $10,000.

Annuity requirements

In order to qualify as an ALDA, the annuity contract will need to state that it intends to qualify as an ALDA and will need to satisfy certain requirements. These include the requirements that the annuity contract:

- provide annual or more frequent periodic payments for the life of the annuitant, or for the joint lives of the annuitant and annuitant's spouse or common-law partner, commencing no later than the end of the year in which the annuitant attains 85 years of age;
- provide, when the annuitant under a joint-life contract dies prior to commencement, payments that commence to the surviving spouse or common-law partner no later than the time at which the payments would have commenced if the annuitant had not died, where the value of the periodic payments must, if the payments commence before that time, be adjusted in accordance with generally accepted actuarial principles;
- provide periodic payments which are equal, except to the extent they are
  - adjusted annually to reflect in whole or in part changes to the Consumer Price Index or a fixed rate specified in the annuity contract not to exceed two per cent per year, or
  - reduced on the death of the annuitant or the annuitant's spouse or common-law partner;
- provide that, following the death of the annuitant, a lump-sum death benefit (if any) provided to a beneficiary does not exceed the premium paid for the annuity less the sum of all payments received by the annuitant or, in the case of a joint-life contract, the sum of all payments received by the annuitant and the annuitant's spouse or common-law partner prior to death;

- permit a refund to the annuitant of any portion of the premium paid for the contract to the extent that the premium paid for the contract exceeded the annuitant's ALDA limit; and
- provide no other payments, such as commutation or cash surrender payments, or payments under a guarantee period.

Tax treatment on death

Annuity payments to the surviving spouse or common-law partner of a deceased annuitant under a joint-life contract will be included in the income of the surviving spouse or common-law partner for tax purposes.

If the beneficiary of a lump-sum death benefit (i.e., a return of all or a portion of the premium paid to purchase the annuity) is the deceased annuitant's surviving spouse or common-law partner, or a financially dependent child or grandchild of the deceased annuitant, the lump-sum death benefit will be included in the income of the beneficiary for tax purposes. All or a portion of that amount will be permitted to be transferred on a tax-deferred basis (or "rollover" basis) to the RRSP, RRIF or other qualifying vehicle of the beneficiary provided that, where the beneficiary is a financially dependent child or grandchild, the beneficiary was dependent on the deceased annuitant by reason of physical or mental infirmity.

If the beneficiary of a lump-sum death benefit is neither the deceased annuitant's surviving spouse or common-law partner nor a financially dependent child or grandchild of the deceased annuitant, the lump-sum death benefit paid to a beneficiary will be included in the income of the deceased annuitant for tax purposes in the year of death.

Non-compliance

If an individual purchases ALDA contracts in excess of their ALDA limit, a tax of one per cent per month will apply to the excess portion. All or some of the tax on the excess portion may be waived or cancelled if the annuitant establishes the excess portion was paid as a consequence of a reasonable error, and the amount of the excess portion is returned to an RRSP, RRIF or other eligible vehicle of the annuitant by the end of the year following the year in which the excess portion was paid.

If an annuity contract that is intended to qualify as an ALDA does not comply with the ALDA requirements, it will be considered to be a non-qualifying annuity purchase or a non-qualified investment, as the case may be, and will be subject to the existing rules and taxes that apply to such purchases and investments.

Additional rules

Additional rules will be included, as necessary, in the draft amendments for the measure to be released for public comment.

Variable Payment Life Annuities

The tax rules generally require that retirement benefits from a PRPP or defined contribution RPP be provided to a member by means of a transfer of funds from the member's account to an RRSP or RRIF of the member, variable benefits paid from the member's account or an annuity purchased from a licensed annuities provider. However, in-plan annuities (annuities provided to members directly from a PRPP or defined contribution RPP) are generally not permitted under the tax rules.

Budget 2019 proposes to amend the tax rules to permit PRPPs and defined contribution RPPs to provide a variable payment life annuity (VPLA) to members directly from the plan. A VPLA will provide payments that vary based on the investment performance of the underlying annuities fund and on the mortality experience of VPLA annuitants.

Annuities fund

PRPP and defined contribution RPP administrators will be permitted to establish a separate annuities fund under the plan to receive transfers of amounts from members' accounts to provide VPLAs. Only transfers from a member's account will be permitted to be made to the annuities fund. Direct employee and employer contributions to the annuities fund will not be permitted.

A minimum of 10 retired members will be required to participate in a VPLA arrangement in order for a plan to establish such an arrangement and it must be reasonable to expect that at least 10 retired members will participate in the arrangement on an ongoing basis.

Annuity requirements

VPLAs will be required to comply with certain existing tax rules applicable to PRPPs and defined contribution RPPs, as well as additional requirements. Specifically, a VPLA must:

- commence payments by the later of the end of the year in which the member attains 71 years of age and the end of the calendar year in which the VPLA is acquired;
- provide annual or more frequent periodic payments, after commencement, for the life of the annuitant, or for the joint-lives of the annuitant and the annuitant's spouse or common-law partner;
- provide periodic payments that reflect the value of the amount transferred from the member's account to acquire the VPLA, in accordance with generally accepted actuarial principles;
- provide periodic payments which are equal, except to the extent they are
  - adjusted annually to reflect in whole or in part changes to the Consumer Price Index or a fixed rate specified in the annuity contract not to exceed two per cent per year,
  - reduced on the death of the annuitant or the annuitant's spouse or common-law partner, or
  - adjusted to reflect the investment performance of the annuities fund and the mortality experience of the pool of VPLA annuitants;