Special Notice

August 12, 2020

Accounting for municipal sector pension plans: Tax relief measure to limit the effects of COVID-19

Announcement by the *Ministère des Affaires municipales et de l'Habitation*

Since the beginning of 2020, lower interest rates and disappointing stock market returns[1] as a result of COVID-19 have contributed to significant financial loss for defined benefit pension plans.

In response to this extraordinary situation, on July 13, 2020 the Ministère des Affaires municipales et de l'Habitation (MAMH) announced a new tax relief measure (the "Measure") to reduce the potential impact of COVID-19 on the tax burden related to municipal sector pension plans and limit potential volatility.

Although its application differs in a number of technical aspects, the Measure is fundamentally similar to the one put in place at the time of the 2008 financial crisis. During that time, 37 municipalities took advantage of the relief measure available to nearly 100 eligible municipal bodies.

1. As at June 30, balanced funds had a **median gross return of -0.55%**, according to the Eckler balanced funds index.

Scope of the Measure

Under the Measure, it is possible to defer the effect that total net actuarial losses (i.e. the loss on the obligation as well as on the asset) arising in 2020 will have on the required taxation. However, any amounts deferred under this Measure will be recorded as recognized expenses to be taxed or provided for (*dépenses constatées à taxer ou à pourvoir*, or “DCTP”) and will be subject to future taxation.

The Measure pertains to tax treatment for taxation purposes only for:

- funded defined benefit pension plans; and
- unfunded supplementary pension plans (to simplify application of the Measure since these plans are presented with funded plans in the financial report).

The Measure does not pertain to:

- capitalization and financing rules;
- the accounting rules governing the preparation of financial statements; and
- the tax treatment applicable to employee future benefit plans other than pensions (for example, life insurance and post-retirement health care coverage).

Criteria and conditions for application of the Measure

The main technical elements of the Measure are detailed below:

- The amounts carried forward and accounted for under DCTP must be completely reversed, and appropriately taxed, within 10 years (i.e. by the end of 2030 at the latest.)
- The period of use of the Measure corresponds to the period of smoothing of actuarial gains/losses on assets applied by the municipal body for accounting purposes, plus two years (i.e. if there is no smoothing, the maximum period of use is 3 years and if there is smoothing over 5 years, the maximum period of use is 7 years).
- The potential utilization amount is based on the effect on the accounting expense of the total net actuarial losses (i.e. loss on both the obligation and the asset) arising in 2020. Thereafter, if actuarial gains/losses on assets are smoothed, it will be possible to use the Measure for net losses related to smoothing. In this case, actuarial gains from 2021 on both obligations and assets reduce potential use of the Measure.
- Use of the Measure is limited to the amount determined under the previous point that exceeds the following thresholds, which are based on the employer’s current service costs (CSC) for the fiscal year: 0% of CSC in 2021, 5% of CSC in 2022 and 10% of CSC thereafter.
- Reversal of the deferred amounts recorded as DCTP under this Measure shall be made using a straight-line amortization method over the remaining term of the Measure, not to exceed 2030, beginning in the year following each bracket of use. However, it is possible to accelerate the process of reversing the deferred amounts recorded as DCTP under the Measure.

Impact

The Measure will certainly be an interesting financial tool for municipal bodies for budgetary and financial purposes, and will have even more significant impact for municipal bodies with little or no latitude, i.e. those:

- **Not using an asset smoothing method** since, without the Measure, the actuarial losses in 2020 could have a material effect on the accounting expense and on taxation starting in 2021 (approximately 25% of municipal bodies do not smooth their assets depending on the accounting method used).
- **Having few or no constructive obligations recognized in their financial statements**[2], as these organizations have little or no margin to offset actuarial losses.

To access the details of the Measure, go to the *MAMH* link. *French only

If you have any questions or concerns, please do not hesitate to contact Eckler for more information.

2. Other than those recognized under a restructuring reserve.

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