Pension Investment Association of Canada

Association canadienne des gestionnaires de caisses de retraite

April 27, 2022

Mr. Trevor McGowan
Director General, Tax Legislation
Department of Finance Canada
Tax Legislation Division
140 O'Connor Street
Ottawa, Ontario
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Delivered via Email: Trevor.McGowan@fin.gc.ca

Dear Mr. McGowan,

Re: Unfair Tax Treatment for Target Date Funds

The Pension Investment Association of Canada (PIAC) is writing this letter to provide our view on tax treatment inequities for members of defined contribution arrangements in Canada.

PIAC has been the voice for Canadian pension funds since 1977 in matters related to pension investment and governance. PIAC's members manage over $2.4 trillion of assets on behalf of millions of Canadians. Our mission is to promote sound investment practices and good governance for the benefit of plan sponsors and beneficiaries.

Our Concern

The inability to merge target date funds, which have reached their expected year of retirement, with existing retirement funds with the same asset allocation used for decumulation purposes without triggering capital gains for taxation purposes.

Target date funds are widely used by Canadians saving for retirement, often through employer sponsored pension plans, as these funds allow for gradual change in the risk profile with the increase in age of the investor. These funds are organized into fund series based on expected year of retirement (e.g., 2025, 2030, 2035, etc.). Eventually members will retire and begin to withdraw money to fund their retirement and the assets of each matured fund will begin to decline. As you could imagine, operating multiple retirement funds (one for each target date retirement year) with the same asset mix until the last member draws the last dollar would be duplicative and extremely costly for these aging retirees. As a result, the maturing funds are pooled into a single portfolio. All providers of target date funds have a terminal fund (usually called “Income fund” or “retirement fund”), which all of their maturing fund series would be merged into at some point. Pooling the assets of the maturing funds provides economies of scale to allow the fund to be invested optimally, and to keep the management expense ratios low for retirees invested in the funds as they draw down on their retirement savings. PIAC supports the efficiencies in portfolio management such that Canadian retirees ultimately can retire with higher incomes.

Current tax rules do not permit tax-free mergers of a target date series into a terminal fund, even though the investment content of both funds is the same. Eliminating taxation of capital gains in situations where the target date fund provider merges two funds with essentially identical holdings would be consistent with many forms of tax-free mergers and spin-offs permitted for public corporations in Canada.

This type of transaction currently triggers capital gains for the non-registered fund investors in the fund despite the fact the underlying investments have not changed, nor has the member transacted to expect this capital gain. Investors in target date funds include employees and retirees investing both inside and outside of a registered vehicle. Most of the providers of target date funds in the industry structured their target date funds to be able to accept both registered and non-registered money in order to gain sufficient economies of scale. It is our understanding based on discussions with the largest providers of target date funds that the Canadian market is not deep enough to support separate fund series for registered and non-registered money.

These non-registered fund holders are often also registered fund members of the same plan. Many Canadian employment benefit plans have non-registered portions to allow for additional savings above registered plan limits. Many PIAC sponsors of capital accumulation plans encourage their employees to save prudently beyond the registered plans they offer to support their financial health and wellness.

The use of target date funds are increasingly popular in Canada especially in employer sponsored retirement savings plans. Even the Canadian Association of Pension Supervisory Authorities (CAPSA) is more formally supporting target date funds as default investments for capital accumulation plans. PIAC sponsors generally agree that target date funds are effective investments for their members. PIAC sponsors encourage and support their employees in their financial retirement journey. This makes it more likely that target date fund assets will continue to grow inside and outside of registered plans. PIAC would like to ensure that taxation is fair to all investors and that these financially responsible Canadians benefit from the pooling of assets and the efficiencies that merging maturing target date funds creates. This keeps costs down for all investors and puts more income in the hands of our Canadian retirees.

We would urge Finance Canada to allow for tax-free mergers of maturing target date funds. We support the creation of operational efficiencies in fund management that result from merging essentially identical funds. PIAC supports all plan members equally benefitting from the resulting lower fees, and higher retirement incomes. Individual non-registered investors should not be penalized with capital gains taxes in a maturing target date fund merger as they would still be paying capital gains taxes on redemption of shares of the merged fund.

We would be pleased to provide any further information or discuss this submission further at your convenience.

Yours sincerely,

Sean Hewitt
Chair

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