Getty Images

False alarm

Pensioners and plan sponsors may have been ready to sound the alarm this past Halloween when Finance Minister Jim Flaherty announced a tax on income trusts. The tax will be effective in 2011 for existing trusts and 2007 for new trusts.

Making the front pages of the major national newspapers, the income trust tax alarm was soon reflected by a dropping market on Nov. 1, perhaps leaving pensioners wondering what would happen to their hard-earned retirement dollars. But while some investors were hit hard by the change, it had a minimal impact on pension plans.

"It's a relatively minor event for most pension plans," says David Kaposi, director of manager research at Hewitt Associates in Toronto, "mainly because income trusts are relatively a small component of their asset portfolios."

The Ontario Teachers' Pension Plan (OTTP), for example, has approximately 3% of its assets in income trusts—a crumb, compared to its diversified portfolio pie. And Alberta's Local Authorities Pension Plan "holds a below-market weight in trusts, particularly energy trusts," says Blake Walker, vice-president, investment.

"In reality," says Kaposi, "income trusts are generally just a subcomponent of the Canadian equity allocation. If your average Canadian pension plan has 30% of its assets in Canadian equities," he continues, "and the Canadian equity market went down 2.5% approximately [on Nov. 1], the plan might have lost less than 1%, or 60-odd basis points, on its portfolio. It was rough and uncomfortable to lose that, but it's no worse than many other days on the market."

The only people who would be affected are those whose pensions are in the few institutions that might have higher allocations to income trusts. "There are a few instances of that, but it's very, very rare," says Kaposi.

While income trusts may represent only a small portion of assets for a pension plan, this is not necessarily true for the sole investor. "If individuals have a strong preference for something, they buy a whole lot of it," says Kaposi. "They might buy 70%, 80% or 100% of their portfolio in a certain sector. So there are probably a lot of people out there who have most of their assets in income trusts because they were fantastic tax advantage vehicles for individuals."

Although Walker was surprised at the timing of the announcement—it was ➡

"It has to do with revenues to all governments, including the provinces. It has to do with fairness in the business system of this country and it has to do with productivity and growth in the future. We would like to get the policy right for the long term."

—Jim Flaherty, Minister of Finance, speaking in the House of Commons on the issues of taxing income trusts.

INCOME TRUST PRIMER

What it is: A type of corporate security similar to a share in a company.

Difference: Trusts generally avoid corporate taxes by paying out most of its cash flows to investors on a monthly basis.

Advantage: By paying little or no corporate taxes, the company can pass on more cash to its investors.

History: Income trusts started in the mid-1980s and were largely confined to oil and gas companies and some real estate companies. They have grown in popularity because of the tax structure.

Number: Canada has around 250 trusts worth about $200 billion in real estate, oil and gas, telecom, industrial, food processing and manufacturing sectors.

Pensions: Most pension plans have a small portion of their investments in trusts. "Income trusts offer high untaxed cash flows which we could reinvest in compound tax free over the long-term," says Blake Walker, vice president, investment with Alberta-based Local Authorities Pension Plan.

Concern: The federal government was being deprived of millions of dollars of corporate taxes and too much of the tax burden was being shifted away from corporations to individuals.

New Rule: A new tax will be applied on the money distributed to investors by newly formed income trusts. Existing income trusts will be given a four-year transition period that ends in 2011 to allow them to adjust. Gains made on trusts inside tax-protected RRSPs, pensions or other investments will not be directly affected.

← odd to see it with a minority government, the Conservatives had indicated earlier this year they would not likely tax trusts, and it was announced well before a federal budget—he was not surprised it happened.

"The government and policy makers had been looking at this for many years with finance officials. The Telus announcement, and later BCE, was obviously very high profile. The fear that more of that was going to take place obviously triggered the government to do something sooner rather than later."


Leech

The OTTP, which has been vocal in the past over government interference in pension plans, was generally unfazed. "We're pleased to the extent that the government felt it necessary to take action, that we're not discriminated against," says Jim Leech, senior vice-president, Teachers' Private Capital, OTTP. "We're not disadvantaged any more than anybody else."

In the short term, says Walker, it's negative. "Income trusts did very well because of the tax advantage. For pension plans, they were an attractive investment. You could receive distributions that were tax free, then reinvest those untaxed cash flows and reinvest them, so you get more after tax income compounding. Now with a level playing field, they're no more attractive than just a normal corporate structure."

In the long term, pension fund managers are optimistic. Although he says income trusts may not give investors the returns they once did, Leech will find other "alternative" investments for the OTTP. "And we won't abandon the area if we see value," he adds. "We'll still be a holder of income trusts."

Walker, too, looks to the future, offering that some trusts may return to a corporate strategy, or there may be renewed consolidation, with bigger trusts taking over smaller ones. Both of these may create new investment opportunities, he says. —*Brooke Smith*

People, performance, profit

By Pamela Clarke

The future of the workforce looks bleak unless dramatic changes are made. Weakened by critical labour shortages, and hobbled by the rising benefits costs of aging employees, Canadian organizations will be facing increased pressure to do more with fewer resources. The solution? Taking care of their people will improve their corporate performance which will result in greater profit, noted speakers at the 2006 *Health, Work and Wellness Conference* in Vancouver earlier this fall.

In the next decade, baby boomers will be retiring in droves, leaving a smaller pool of workers looking for full-time positions. "Faced with employee shortages, businesses will have to offer competitive benefits to attract and retain skilled resources," says Danielle Vidal, senior consultant for Aon Consulting in Montreal.

Competitive packages are also essential to maintaining or improving the health of the existing workforce. Unfortunately, says Deborah Connors, president of the *Health, Work and Wellness Conference*, many organizations focus most of their attention on the relatively few people who cost the most in sick leave, while neglecting the needs of the vast majority whose dedication, creativity, and hard work drive the organization forward.

Another issue raised is that of be baby boomers and retirement. Many will opt for flex retirement, which will change the pattern of work. Or they'll work for an extensive period of time then request a chunk of time off. Companies will tolerate this, and many will encourage it, as "competition for the most creative employees will be strong," says Estelle Morrison, director of LifeWorks Strategic Solutions with Ceridian Canada.

Many other changes will require companies to increase the flexibility of their benefits packages, particularly EAPs. "The stigma is increasing so employees are less willing to self-identify," says Morrison. "There will be a greater usage of telecounselling and e-counselling as not everyone is able to or wants to come face-to-face for support." Innovative delivery methods such as online programs should increase usage of EAPs.

There will also be an emphasis on prevention in contrast to today's benefits where Morrison says "the majority go to illness and disease, with only a small percentage to wellness."

VOLATILITY

David Brown

The Grinch who taxed income trusts.