

# Upgrade yourself

## INDIVIDUAL PENSION PLANS OFFER A CCRA-SANCTIONED SOLUTION FOR THE WEALTHY PERSON'S RRSP NEEDS

Incorporated businesses looking to add a benefit for their owners and top executives might want to consider a little known tax-avoidance structure called the individual pension plan. IPPs are a wealthy person's answer to registered retirement savings plans. They are sanctioned by the Canada Customs and Revenue Agency and offer the best tax and retirement savings solution for individuals

40 years old and older who have a T4 income of more than \$100,000 and have historically maximized their RRSPs and pension contributions.

The existing RRSP legislation was created in 1957, at which time inflation and indexing were not taken into account. As a result, RRSP contribution limits are woefully inadequate for high-income earners. In 1991, the federal government remedied the situation by enacting the IPP legislation (in the Income Tax Act of Canada, subsection 147.1)

to compensate high-income earners disadvantaged by RRSP rules.

In a nutshell, the IPP is essentially an RRSP upgrade, with three main differences: IPPs have significantly higher limits to contributions; they have creditor proofing; and they have restricted collapsibility options. IPPs cannot be fully collapsed unless the plan holder is critically ill, severely disabled or has fallen on financial hardships. In essence, IPPs effectively guarantee the holder an income for retirement.

All IPP contributions, setup fees and maintenance fees made by a corporation on behalf of the key person are fully tax deductible to the corporation and treated as a non-taxable benefit to the employee. Interest on funds borrowed to top up IPPs are also fully tax deductible by the contributing company.

At retirement, the IPP member owns any actuarial

### IPP contribution room versus RRSP contribution room

IPP contribution room for executives with your firm or client's since 1991

Age	2003	2004	2005	2006
40	\$45,478	\$18,200	\$19,565	\$21,032
45	\$66,429	\$19,992	\$21,491	\$23,103
50	\$89,452	\$21,960	\$23,607	\$25,378
55	\$114,743	\$24,122	\$25,931	\$27,875
60	\$142,512	\$26,497	\$28,484	\$30,620
65	\$158,873	\$27,895	\$29,987	\$32,236

### Compare with RRSP contribution room

	2003	2004	2005	2006
	\$14,500	\$15,500	\$16,500	\$18,000

surplus. It may be used to upgrade pension benefits, or the plan holder may pass it on to a spouse, heirs or estate. Spousal pension benefits may be upgraded to 100% in the event that a plan member retires or passes away.

Many executives and owners want a tailor-made benefit package that best suits their individual needs. IPPs have a number of practical applications. For one, they are useful tools to upgrade defined benefit pension plans (DBPP), defined contribution pension plans or group RRSPs.

And by using an IPP as part of a total executive benefit package, your firm or client's company can attract people who are currently employed and are members of a DBPP. Traditionally such candidates may not have wanted to leave an employer or DBPP before retirement because tax rules prevented them from transferring the full value of their pension credits to a locked-in RRSP. Your firm or client can avoid such an obstacle by creating an IPP for such employees and transferring existing pension plans to the new IPP without tax implications.

#### IPPs versus non-IPPs

Imagine you have a 55-year-old client, John Doe, who has owned an incorporated business since 1991 with a T4 income of more than \$100,000 and a marginal tax rate in Ontario of 46.41%. This client is serious about saving for retirement and in the next 10 years, when he reaches 65 he plans to retire. By creating an IPP for him this year, your client will be able to defer \$114,743 immediately from taxes from his company's and his personal income. This money will then be compound tax-free. The next year John Doe will be able to contribute an additional \$24,122

into his IPP and his contribution room will increase by 7.5% annually until he retires (the investment chosen for this example are bonds earning 7%). When John Doe reaches 65, he will have accumulated \$632,384 in his IPP.

If this client decides not to create an IPP for himself and instead chooses to take this same amount of money out of his business, after having paid the personal marginal tax rate of 46.41%, for the purpose of saving for retirement, then his financial situation becomes much different. The first year after taxes, John Doe will be left with \$61,490 to invest. The following year, after taxes, he will make a \$12,927 contribution to his non-IPP; and this contribution will grow at 7.5%. At age 65, he will have an accumulated value in his non-IPP of \$276,435. Based on the stated assumptions, this particular client's IPP will be \$355,949 greater than his non-IPP.

Many employers in the IPP setup stage ask how can their company mitigate the potential liability of being responsible for maintaining an employee IPP benefit for an unspecified period until the employee or his or her spouse die. Employers have several options available to them. The employer, as a condition of opening and maintaining the responsibility for an executive IPP for a key person, may negotiate to have the key employee guarantee to work for the employer for a stipulated period of years in advance of promising to allow him or her to keep the IPP at their company. For example, a company may promise to continue to keep the pension on the company's books provided this individual works another five years or promises not to retire before he or she turns 55 years old.

Alternatively, the employer can nego-

tiate to have the employee do one of two things should he or she resign if the above conditions are not met. The executive can transfer the IPP to another company or convert the IPP into a locked-in RRSP or buy an annuity. What employers usually find preferable for long-term employees is to convert their IPP to an annuity at retirement because the responsibility of funding the pension benefit is then shifted from the employer to an insurer. For employees who have a short term of service with the company, employers usually prefer that their former employees transfer their company IPPs to a locked-in plan.

Many individuals 45 and older, who believe they have many more years to work, find the option to transfer their IPP appealing because they can continue to control how the assets are invested. In addition, employees who decide to transfer an IPP to their own company or another employer will continually see their contribution room increase compared to what they would receive if they had only a DCPP or RRSP option to defer taxes from their income.

How can your firm or corporate client finance IPP contributions? There are several ways. They can use funds that have accumulated in retained earnings company. They can use outstanding bonuses owed to key people by making the employee's contribution for him or her. Or employers can obtain financing from a financial institution specializing in funding IPPs.

Whatever option you chose, all interest on loans to fund an IPP are a tax-deductible expense for employers and a non-taxable benefit for IPP members. RRSP loans do not have this benefit.

IPPs require specialty in such areas as tax, actuarial, pensions, employment, and law. In fact, there are only one or two companies across Canada that specialize in the creation, implementation and maintenance of IPPs. It would be well worth it to explore whether IPPs are the right fit for you, your firm or your corporate clients.

*Peter J. Merrick, FMA, CFP, FCSI is president of Merrick Wealth Management Inc. in Toronto. He can be reached at (416) 677-6611, peter@merrickwealth.com or www.merrickwealth.com*

*Technical editor: Ian Davidson, MBA, CFP, CA, RFP, senior financial adviser and VP at Assante Capital Management in Toronto*

ELECTRONIC PAYMENTS

The future of payment systems today!

**TelPay**  
e payment services

www.telpay.ca

e payments since 1985