

# Individual pension plans no longer a rare breed

By PETER MERRICK

In 2004, at the annual consultation held by the CRA on registered pension plans, the topic of discussion was how individual plans, a rare breed only a few years ago, now represent more than one-third of defined benefit pension plans.

The plan design, however, presents more compliance risk as the growth of this segment continues.

An IPP requires disproportionate attention even though it typically covers only one member, compared to plans covering hundreds.

Consequently, audit activity has been focused on the segment. As a result, the CRA's Registered Plans Directorate intends to enhance its focus to monitor IPP compliance.

Industry experts believe registered IPPs will grow to more than 300,000 representing \$200 billion in assets by 2020, given that contributions to IPPs greatly exceed RRSP payments for individuals 40 and older.

That's largely because the divide increases with age between what can be contributed into an



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IPP versus an RRSP. In 2006, maximum current service contributions that can be made into an IPP for an individual could be as high as a \$41,000, instead of the maximum RRSP contribution of \$18,000.

The other reason for the growth in IPPs is that these plans allow companies to contribute for the IPP member for years of service prior to the set-up of the plan, going back to 1991.

If the first year of the set-up of an IPP is 2006, the past service and current service funding contribution/corporate tax deduction and

tax deferral for an IPP member could be as much as \$361,000. It must be remembered that IPPs are registered pension plans that must be set up and maintained properly.

If it is determined that an IPP is not in compliance with the *Income Tax Act* regulations and CRA's Registered Plans Directorate regulations, the registration of an IPP may be revoked at anytime. To remain registered with CRA, the plans need to satisfy four criteria:

The IPP must comply with all laws and regulations governing registered plans and all filings must be up to date;

The IPP was established to create a pension plan prior to the plan being set up and/or the transferring of pension benefit assets from another defined benefit plan from another employer to the IPP;

The employee/employer have a *bona-fide* relationship between the plan member and his/her company;

If assets from another defined benefit plan have been transferred to an IPP member of the IPP can expect earnings similar to those earned as an employee.

If an IPP's status is revoked it immediately turns into a retirement compensation arrangement. The formerly registered IPP will forward 50 per cent of assets to CRA on behalf of the plan member. These funds will be refunded to the RCA plan member at a later date when money is withdrawn from the RCA.

On withdrawal of funds from the RCA taxes will be paid at the RCA beneficiary's marginal tax rate.

In the worst scenario CRA may not permit the assets from the IPP to be rolled over into a RCA and taxes will be charged on all assets held in the former IPP.

Heavy interest charges may be levied by CRA for overdue taxes owed by both the IPP sponsor and member of the plan, plus there may be large fines charged for non-compliance.

If an IPP is in violation of the

*Pension Benefits Standards Act, 1985*, provincial acts, or the *Income Tax Act* individuals can be guilty of an offence and can be fined up to \$100,000 or imprisoned for a term not exceeding 12 months, or both. In addition a corporation/ sponsor of an IPP that is convicted for violating these acts and regulations may be fined up to \$500,000.

Individual pension plans may be the best deferred income plan available in terms of tax relief but myriad pension, tax, legal and investment rules apply.

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## PAYROLL

### Questions and answers

By STEVEN VAN ALSTINE

**Q**uestion: An approximate total overpayment of \$41,000 (for expatriate allowances) has been discovered for an employee in Ontario that occurred over the past two years. What is the procedure for recovering?

**A**nswer: First, according to the *Employment Standards Act, 2000* for Ontario [Part V 13(1)], written permission from the employee must be obtained to deduct this money from any current payouts.

A cheque or money order may also be requested for the gross amount of the overpayment. Amendments to the T4 Box 14 must be done for the gross amount for both years; however, nothing else can be adjusted. The company cannot recover the CPP or the EI portions. The employee can, however, re-file and get the credit for the taxes, CPP and EI due to the reduction of Box 14.

**Q**: Our company pays an employee's B.C. Medical coverage. For 2005, the taxable benefit was not set up. What happens now?

**A**: A year-end adjustment, if possible, should be put through or an amended T4 adjusting Box 40 and 14 is required. The employee will have to absorb the tax effect when filing. Ensure that it is set up for the current year, as taxable benefits are to be processed as enjoyed, *i.e.*, on a pay period basis.

**Q**: It has been discovered that an employee has been underpaid due to an incorrect salary since their start date in 2004. The retro calculation is for more than \$18,000. How should the tax be calculated, and should the T4s for 2004 and 2005 be amended?

**A**: The tax calculation should be done using the bonus method as per instructions in the *Employers' Guide—Payroll Deductions and Remittances T4001 (E)*, page 24.

The employee can file a T1198 to request a reduction in taxes due to the nature of the payment. There is no amendment required for the T4s issued prior as the payment date is in the current year and must be reported as such.

**Q**: Do the TD1/provincial/territorial and/or Revenue Quebec (TP-1015) forms need to be completed each year?

**A**: Anyone claiming only the basic exemption on each of the forms need not, however, it is best practice to have new forms for anything other than the basic exemption. For example, the TP-1015.3 has changes for 2006 that will affect the final amount for those claiming caring for aged dependent expenses.

**Q**: Can severance deferred from the previous year be transferred to an RRSP?

**A**: Yes, it is best practice to request a written document from the employee stating that they

have room available for the transfer and including detailed account information. The cheque for the RRSP deposit must be made payable to the financial institution.

**Q**: I have an employee who works outside of Canada. Can he still submit his portion for CPP and have a T4 prepared for 2005?

**A**: Where employee and employer contributions for CPP are made for an employee who is working outside of Canada, whether all or part of the year, you must prepare a T4 slip.

See page 9 of the *Employers' Guide to Filing the T4 Slip and Summary Form* – Box 29 employment code for specific T4 reporting instructions. This must be done within the next 12-month period.

**Q**: We have recently had a new union contract signed for increased pay. The full-time January 1-15 pay period will be paid at the new 2006 rate. However, the timesheets that are being entered are for adjustments such as sick time, vacation time, *etc.* for the December 16-31, 2005 pay period. Should these adjustments for December 16-31 be paid at the 2005 tax rates, or can they be paid at the 2006 tax rates?

**A**: The 2006 tax rates must be used. As always, you have to report income on a T4 slip for the

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