

CORPORATE PLANNING

Individual Pension Plans

a) *What Is It?*

An Individual Pension Plan allows a company to make substantial contributions to a Defined Benefit Pension Plan on behalf of its older shareholder/employee(s). The company makes tax-deductible contributions to a non-contributory pension plan. Contributions are not included in the individual's income, but do reduce the RRSP room available.

The net result is larger contributions made to tax deductible registered plans than through RRSP alone.

b) *Types of Pension Plans**Defined Contribution*

- The contribution is defined.
- The pension is the result of the accumulated value of employee and employer contributions converted to pension at retirement.
- The benefit will be unknown.

Defined Benefit

- The benefit is known.
- Usually defined as a percentage of income (ex. 2%) for each year of service multiplied by the average of the best 3 to 5 years of income from the company.
- The cost is unknown and is based upon a tri-annual actuarial report assessing whether the plan will be able to meet its obligations.
- At older ages, as less of the cost of the pension can be met through accumulated earnings, the cost of the benefit is larger than the maximum RRSP contribution, thus allowing the larger tax deductible contribution.

c) *The IPP is for the Client Who...*

- Is over age 45.
- Is a shareholder in a corporation and owns more than 10% of the shares.
- Has been a shareholder for a few years.
- Has annual earnings from the company in excess of \$100,000.



d) Advantages of an IPP

- Contributions can be 25% to 70% higher than current RRSP contributions
- Creditor proofed under both federal and provincial legislation
- Interest on money borrowed by the company to make the contribution are tax deductible to the company
- Surpluses at death are paid to the beneficiaries designated by the pension holder
- Top up funding when investments perform below the assumptions
- Expenses to establish and administer plan are tax deductible to the employer
- Costs are based upon 7.5% earnings assumptions. Should the plan not match these expectations the plan can be topped up with additional tax deductible contributions
- Retirement as early as age 55 and as late as age 69 is permitted
- Past Service benefit purchases can create a large one time additional deduction
- Investments allowed are similar to those allowed in RRSPs and are under the direction of the employer
- If circumstances change the Plan can be terminated at any time. Plan assets are then transferred to the pension holder's personal 'locked in' RRSP.
- Large contributions can provide efficient exit strategy for owner

e) Disadvantages of an IPP

- **Locking in pension benefits legislation applies**
 - The funds must be applied to provide a lifetime pension although rollover to a modified RRIF payout is permissible. No de-registration is allowed.
 - The funds must be passed to a surviving spouse unless the spouse predeceases the pension holder when the estate may be the beneficiary
- **No Spousal contributions are allowed which limits income splitting potential**
- **Contribution flexibility is limited**
 - Contributions are required annually – no carry forward of unused contributions
 - Can be expressed as a percentage of earnings so reduced contributions in low earning years is possible
- **Expense – triennial and annual reporting is required**
- **Complexity can create misunderstanding**





f) Past Service Benefits

What is Past Service?

This is continuous and unbroken periods of service during which the employer did not provide the promise of defined benefits. Due to changes in the Income Tax rules, the period is generally limited to service since 1st January 1990.

The employer is able to add these years into the formula of years of service for the purposes of defining the benefit to be paid. This results in additional costs to fund this period of service.

If the employer is not in a position to be able to afford the lump sum contribution or is concerned the increased liability will make the plan subject to required contributions in the future, the years for which past service may be recognized can be phased in.

RRSP Funds Transfer

In order to prevent a double deduction, (ie. RRSP contributions already made for past service years plus an employer contribution for pension) the amount of RRSP contributions made during those years must be transferred to the IPP, or be withdrawn and taxed in the hands of the individual.

The advantage of this approach is that only an amount equal to the contribution must be transferred. Contributions made that have earnings will leave the earnings with the RRSP.

Past Service Contributions

The employer or employee may make tax deductible contributions based on the past service. The past service contribution amount is calculated as the cost of providing the benefits minus the RRSP contributions transferred to the IPP or withdrawn by the individual.

The past service contribution can be a fairly substantial amount, particularly at the older ages.

n) Contribution Calculations

Samples of Maximum Contributions in 2005¹

Age in 2003	Past Service from 1 st January 1990 ²	Current Year's Service
35	\$36,105	\$17,075
40	\$60,229	\$18,758
45	\$86,658	\$20,601
50	\$115,702	\$22,627
55	\$147,753	\$24,862
60	\$182,969	\$27,319
65	\$221,626	\$30,015

¹ Based on Maximum Earnings updated in 2005 of \$100,000 per annum

² Plus RRSP transfer of \$208,700

