Qube Invest

INDIVIDUAL PENSION PLANS

THE STORY

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Introduction: Why a Story?

At Qube, we are passionate about a number of great topics that focus on the investment needs of Canadian business owner-managers and executives. One of our favorite topics to talk about is the Individual Pension Plan (IPP), a planning idea that has formed a large part of our practice. We manage more of these programs than any other independent investment firm in Alberta. While we published a book ("Tax and Compensation Strategies," Cardwell 2004), as well as numerous papers and seminars on the topic, we never tire of telling the story.

Which brings us to this story: the story of Al, a business opener-manager who is trying to figure out what an IPP is all about. We trust that in following Al's journey, you gain insight about these programs and maybe a touch of our inspiration and enthusiasm for managing them.

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Let's Meet Al

Al is a forty-five-year-old small business owner who has a wife, two kids, a collecting pile of paperwork on his desk, and a receding hairline that is becoming increasingly worrisome. In Al's office, there are photographs of his family and his college diploma on the wall. There is a tear-off desk calendar, which he often forgets to change.

Today is Tuesday, and Al has arrived at the office extra early for one particular reason: his weekly run with Jeff. While he waits, Al ties his running shoe and considers his position as a business owner. Over the last ten years, things have changed. Al took over his father's business, where he eliminated debt and continued to grow profits at a steady rate. A few years ago, he maximized his RSP account and began building up some corporate held investments, while still paying off the mortgage on his house. He also attended many piano concerts and track meets.

There have, however, been some difficulties. His father was an effective and beloved leader in the office; and while Al's managers seem to be happy, with turnover remaining relatively low, his father was a tough act to follow. Al did a good job of taking over the reins but seems to struggle with issues that his father never encountered. His employees don't seem to rave about him in the same way.

Al ponders all of this, sighs, and stands up to stretch, grabbing his arm across his chest.

While he's glad that his net worth is looking solid, his annual tax bills are still a great source of irritation. There must be something he can do to reduce the tax burden. He wishes that he could spend more time with his kids, a reflection that seems to occur to him more often. Both are getting older; their friends are becoming increasingly more important to them. The next phase will be University, and then what…

Jeff arrives.

"Ready Al?"

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Out for a Run - Introduction to the IPP

As they jogged through the river valley, Al hurried to keep up. Jeff was full of energy and buzzing with excitement. Being a true entrepreneur, he always had a new opportunity in mind to discuss, and Al had the feeling that he was about to hear about another one of these ideas.

On the last trip, Al heard all about the possibilities of motorcycle restoration. Jeff was intrigued by the possibility that ex-convicts could help build the product as part of a rehabilitation program. Jeff discussed potential civic and provincial grants, partnerships, his marketing plan, and financial upsides. By the time Al was ready to buy in, however, Jeff had moved on to the next idea.

On today's run, Jeff began telling Al all about a new tax-planning concept he had heard about from his investment manager, Ken. He started the conversation with a question that surprised Al asking him, "What do you think of Unions?"

That puzzled Al. He reminded Jeff that, as a small business owner, much of his success resulted because of a workforce that was collaborative rather than combative. Al felt proud that he had kept his employees relatively satisfied and unions out after all these years. They headed further into the dark valley, the sun still in her slumber, the snow reflecting the city lights.

"So, you don't care much for Unions?"

"Yeah, you could say that."

"Well, what if I told you about a great "Union Benefit" that you could offer yourself as an owner-manager?"

"I would tell you that it sounds kind of expensive," Al replied, "Where did you hear about it?"

"From Ken. He told me about a traditional pension benefit that my corporation can offer me, as an owner-manager, that allows for large tax-deductible deposits to be put into a tax-sheltered investment account on my behalf."

They stopped to walk for a short break as the sun peaked over the horizon. Jeff continued.

"Al, I am going to have to bonus down to the small business threshold this year for the first time. I know that you have had to do this a few times, but honestly, it shocked me how much tax I am going to have to pay. Ken told me that with the pension plan, my company could reduce its taxable income by making payments to the pension trust account instead of pushing taxable salary or dividends to me. This threshold will change depending on your Province of residence, but a good rule of thumb is $500,000."

Al thought about this for a moment.

"So, instead of taking extra dividends, you are going to put the money into a pension trust account?"

"Yeah, and just like the RSP program, the pension trust account is tax-sheltered, as well as creditor proof under the Provincial Pension Act, which is also really important to me."

Jeff's plan sounded kind of crazy but intriguing at the same time. They were now running along the flat bank of the river. Al felt that he had woken up a bit and had more energy. He decided to push the pace a little. Jeff carried on, chatting away, and enjoying the view of the frozen river to their left. He explained that if the company contributed to the pension plan on Al's behalf, he would be prevented from making an RSP contribution. Jeff noted, however, that this was not a problem because the Pension Plan allowed much larger deposits than the RSP program would allow anyway.

"Jeff, how can you offer yourself this phenomenal benefit without being forced to offer the benefit in some fashion to the rest of your staff?"

"Well, Ken explained that there was a reform in the pension system in the 1990s that made, in theory at least, equal opportunity for all Canadians to save for retirement. An employer offered pension benefits to a staff member would create a similar retirement benefit to the same employee putting money into an RSP account. To be honest Al, much of the details of what Ken told me went straight through! You are going to have to talk to him yourself if you are interested. But Al, while this was easy for me, it is going to be a challenge for you!"

The run had also become a bit of a challenge. They now worked their way back up the river valley towards Al's office. Their route had taken them in a wide semi-circle that finished with a long slow hill towards the end. At least they had a view; the cityscape opened up behind them as they climbed higher out of the valley.

Al was confused, "What do you mean a challenge for me?" Jeff was one of Al's best friends. Even though his response sounded harsh, it was honest and fair. Jeff knew that Al struggled with delegation and that he liked to "hold his cards" close to his chest.

They returned to the office. Al thanked Jeff for the advice and headed over to the coffee shop next door for a mid-morning treat. While walking back to his office, Al realized that the "buzz" he felt was not coffee induced but the result of his conversation with Jeff. Maybe Jeff was right; it was time to begin letting go. Besides, a number of Jeff's points intruiged him:

- The tax deductions and tax deferral the pension plan could offer his corporate year-end;
- The creditor protection it offered;
- The ability of the pension plan to strip retained earnings from his corporate books and transfer it into a personal benefit;
- The comfort it would provide him and his spouse in knowing they have a solid pension benefit building for when they retired.

As he ran up the stairs, Al already decided to book a meeting with Ken to hear about this new concept. This would be an opportunity to really work with him. Ken had only ever assisted in transactional matters like term insurance and benefits for Al's company.

Al stopped by his assistant's desk and asked her to book the meeting. He told her to let Ken know that he wanted to stop by and learn more about the Individual Pension Plan Ken had set-up for Jeff. Within the hour, Al noticed the appointment pop up in his calendar for later that same week.

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Meeting with Ken - Overview of the IPP

Even though Al had only met with Ken on a few occasions, Jeff often discussed his and Ken's most recent projects. From these stories, Al knew a fair amount about Ken's work and abilities. When Al entered Ken's office downtown, he was treated to hardwood flooring, chunky baseboards, and exposed water heating pipes.

The furnishings were beautiful and antique, with gaping 1930s windows lining the walls. Ken's receptionist, Kim, greeted Al with a smile and asked if he would like something to drink. She then led him down the hall, passing smaller offices and a large meeting room. When they reached Ken's office, he jumped up to enthusiastically greet Al. Within seconds, Al felt like a trusted friend and almost as comfortable with him as he was with Jeff. They moved to a group of leather chairs by the window to begin their discussion.

Al began, "Ken, I wanted to talk to you today about the IPP concept you described to Jeff and get more details about it. It sounds like it could be something that also applies to my situation, but I really don't understand the strategy."

"Well Al, I think it might be helpful to take a step back and review pension plans in general first. Is that okay with you?"

"Sure!"

"I will begin by explaining the difference between two types of pension planning: **Defined Contribution** and **Defined Benefit.**"

Defined Contribution Pension Plans

We'll start with what is noted to be the most common type of pension plan in Canada today: Defined Contribution Pension Plans. These pension plans have a number of key features.

Contributions are a Percent of T4 Earnings

In a Defined Contribution (DC) Program, the amount one can put into the plan is determined by government (CRA) limits. The employer offers this program to employees, and the contribution limit is based on a percentage of T4 earnings.

For example, in 2019, the contribution limit equaled 18% of T4 income, up to a maximum contribution of $27,230. This contribution is often participatory, meaning that employees will match the employer's contribution. For example, the employer may set the contribution rate at 5% of earnings only if employees match a similar contribution. In this hypothetical scenario, participating employees would then have a total contribution made to the program at 10% of earnings.

Assets Grow Tax Sheltered

Contributions are placed into an investment account on a "pre-tax" basis. Growth is tax-sheltered until, at least, age 71 when income must start.

Various Payout Options

The program at retirement (or age 71) is converted to one of the following accounts, depending on Provincial availability:

- **Life Income Fund (LIF):** income is taken subject to plan minimums and maximums, which are indexed to increase with age.
- **Registered Annuity:** the account is annuitized immediately.
- **Registered Retirement Income Fund (RRIF)**: In many jurisdictions, the pension funds at retirement can have 50% unlocked into a regular RRIF account.

Ken explained that most employers, who were able, moved to Defined Contribution pension plans over the past 15 years from a more traditional approach called a Defined Benefit Pension Plan.

Defined Benefit Pension Plans

In the Defined Contribution program, *deposits* into the plan are defined. In the Defined Benefit plan, it is the payout, or the *benefit*, that is defined. These plans also have some key features.

An Employment Benefit

A Defined Benefit Program is another program offered by the employer to employees. In a DB plan, the amount one can put into the plan is again restricted by legislation (CRA); but in this case, determined by an actuary.

The Retirement Benefit

The benefit is defined, and the payout is designed to come directly from the Pension Trust. Here, the employer maintains a position of responsibility to ensure the Trust remains fully funded. In some cases, the employer will purchase an annuity when a member retires to guarantee the payout to the annuitant. In other cases, the employer will allow the employee to take the "commuted value" into a retirement savings account and self-manage the funds.

Individual Pension Plan

Ken went on to explain that an IPP is a subset of the Defined Benefit Pension Plans and often set-up for executives and/or owner-managers. IPPs also have some key features.

A DB Plan

As with other DB programs, an actuary is contracted to determine the plan obligations and its resulting costs. The corporation then makes contributions into a Pension Trust account on behalf of the plan member(s).

Sometimes Individual Pension Plans will be referred to as "Executive Pension Plans." The employer gains a tax deduction for the pension payment, and the money remains non-taxable to the plan member until retirement income is taken from the account. Each year, the employer's deposit is reflected on the personal tax return as a Pension Adjustment (PA). The PA limits the contribution amount the member has for RSP purposes.

Governed by Federal and Provincial Legislation

Both federal and provincial legislation and regulations govern the pension plan. The legislation includes restrictions on the amount going into the pension trust account, the amount allowed within the trust on an ongoing basis, management of the funds, and the amounts transferred out upon windup of the program. Depending on the type, one may have to register the plan in its Province of residency.

Deposits Determined by an Actuary

The actuary estimates the "current cost" of the pension, based on the present value of the benefit offered to employees at retirement. The maximum benefit can be generated from T4 or T4 related income to a maximum earnings limit.

"So," Al said, "It is the IPP or an RSP going forward because of the PA thing?"

"You got it," said Ken, "but remember, the game here is to get as much money out of your company on a tax-deductible basis and into your hands on a tax-sheltered basis. The IPP, now that you are in your 40's, is a superior tool for this. I'm sure you are wondering how much better? Well, for that I want to send you to see a friend of mine."

"I know you are a details guy, and I thought that you might appreciate hearing some of the details from an expert. He is an actuary and specializes in Individual Pension Plans. Once you have had a chance to meet him and review how the 'numbers' work, stop by your accountant's office for his or her thoughts, then come see me again."

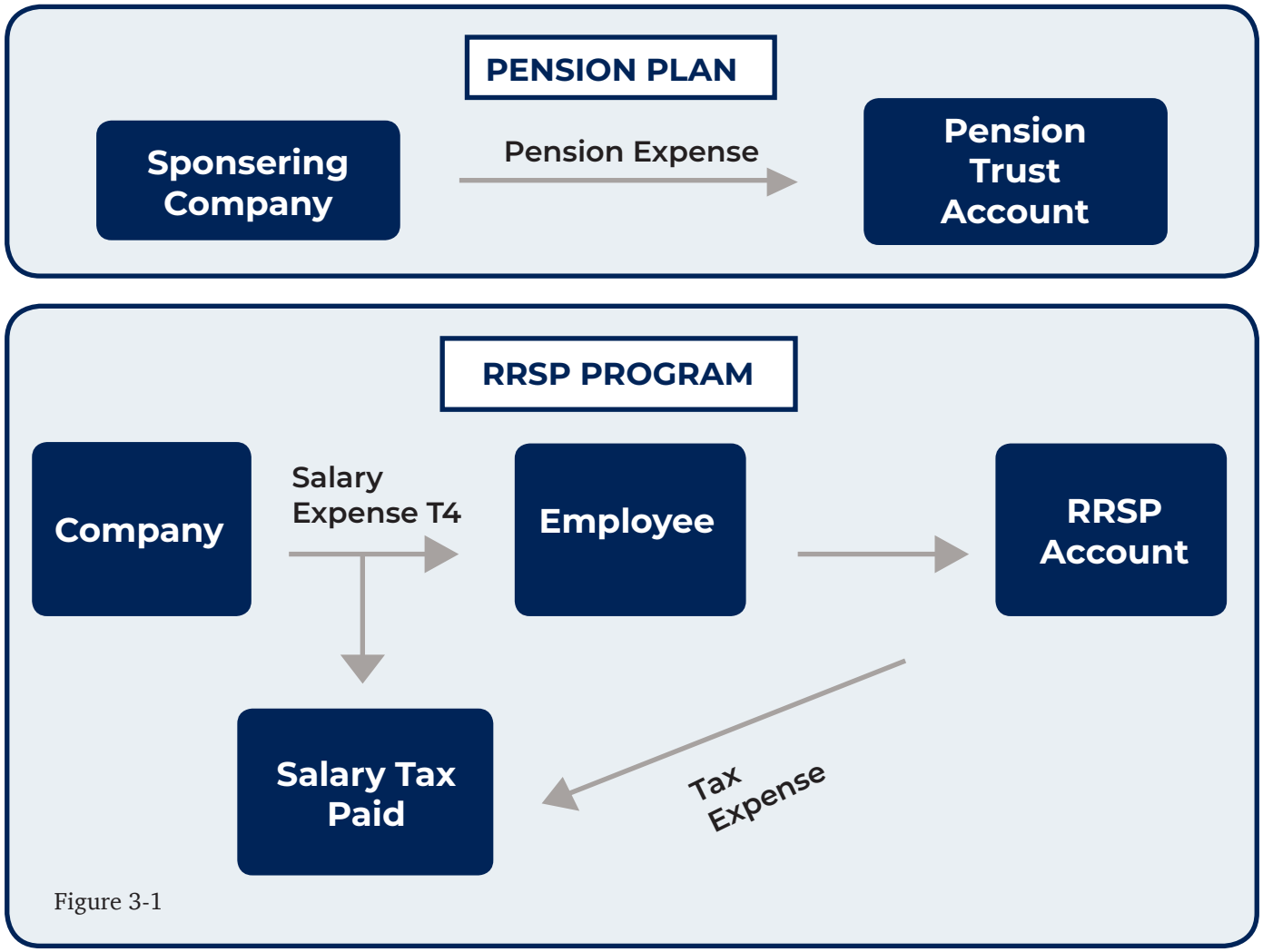


Figure 3-1

The Drive Home

Al enjoyed meeting with Ken and felt somewhat inspired by his control and organization. Jeff had spoken well of him for years, and Al decided to see the actuary Ken wanted him to meet. He was impressed that the IPP was not a shady concept, but fully disclosed and registered with Canada Revenue Agency, as well as by many of the Provinces. He also liked that this is just one type of pension plan in Canada that pre-dates RRSP programs and if you have a fully utilized IPP you cannot also have an RSP in the same year.

One comment that Ken made kept ringing in his ears. He said, "the one thing I should be able to count on, after working so many years as an entrepreneur, is a quality stream of pension income. The IPP offers my family this safety net." Excited, Al hurried back.

4

Meeting with Daniel – The Numbers

Al was pleased to hear that Daniel was able to see him on such short notice. His office was nearby, downtown, and relatively easy to find. To Al's surprise, Daniel's space was much smaller than he had anticipated. It consisted of a modest reception area and two small offices covered in stacks of files.

The desks, computer stations, chairs, floors, file cabinets—everywhere Al looked, there were files! Daniel's office was undoubtedly a change-up from Ken's place!

When Al arrived, Daniel came rushing over to welcome him. He was full of energy and enthusiasm. Even though Daniel just turned 60, he projected a much more youthful state. Al heard that he was also a competitive squash player and confirmed this to be true after shaking his strong hand. The two sat down as Daniel proceeded to share his backstory.

For most of his career, Daniel primarily worked as an actuary at an insurance company. In the late '80s, he realized that he could build a small actuarial consulting boutique. From then on, the Individual Pension Plans his central focus. Daniel's assistant moved some files off a chair and brought Al a coffee. Al at once felt at home and asked Daniel to explain the IPP story to him.

"Of course, Al, my pleasure; but first, we must consider some assumptions."

IPP Assumptions

The Individual Pension Plan is an enhancement to other retirement savings strategies rather than a strategy unto itself. There is an underlying assumption made when setting up an IPP that the RSP program has to or will be maximized as part of the IPP implementation. You should first ensure that your basic retirement needs are evaluated and general financial planning issues addressed, such as the construction of a will. The IPP is often implemented prior to more complicated strategies, such as a Retirement Compensation Arrangement (RCA).

"Al, to grasp the IPP strategy, one must understand the divergence between the **"intent" of an IPP and the "result."**

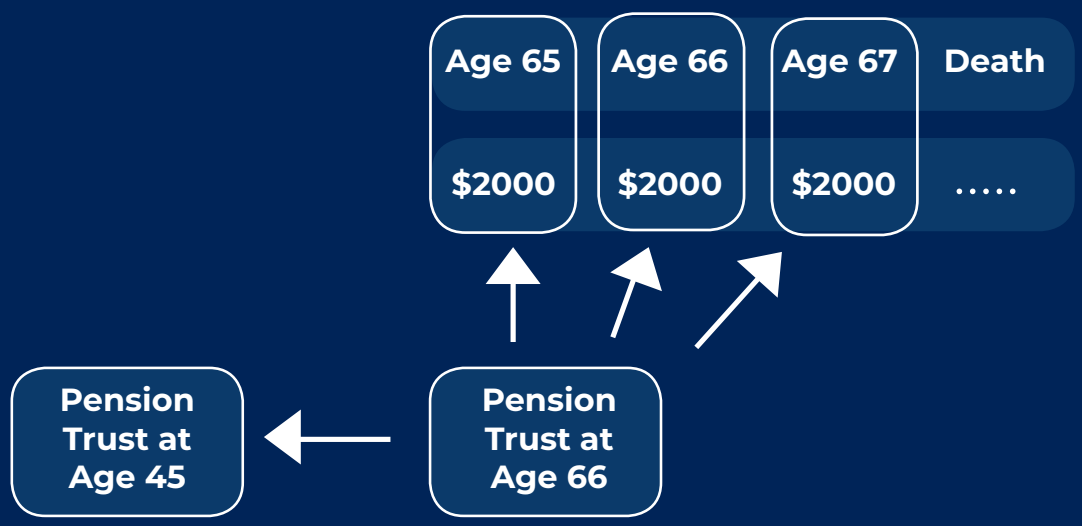
The Intent of an Individual Pension Plan

The "intent" of an IPP is often very different from the result. An IPP intends to provide a Defined Retirement Benefit at a stated retirement age based on both years of service and earned income. For example, a plan member with 10 years of service and $75,000 of annual earnings, may be offered the following classic retirement benefit (this is the common IPP "intent"):

Classic IPP Retirement Benefit:
- 2% of your best 3 years' salary
- Payable for each year of service
- Indexed at retirement (age 65) by CPI - 1%

The plan member would be looking at a retirement benefit of $10,000 per year (2% times 75,000 = $1,500. $1500 multiplied by 10 years = $15,000). Should the member have 20 years of service, the retirement benefit would be $30,000 per year. The pension plan intends to pay this benefit each year until the death of the plan member. On the death of the plan member, the benefit would commonly then reduce by one third and continue to be payable to a spouse until final death.

Figure 4-1: Actual Cost Dependent on Age



For each year of service, the "intended" retirement benefit, therefore, increases incrementally, creating incentive for a plan member to stay on staff. For each year that passes, the retirement benefit notches up a little.

One reason why the Canada Revenue Agency (CRA) requires an actuary on each registered IPP, is because these "mortality" calculations fall under the domain of an actuary. The terms of the liability that can be created by an IPP differs depending on Provincial Jurisdiction. The example above generally outlines the maximum liability an IPP can create. These plans are often referred to as "2 percent plans" (2% of income payable per year of service at retirement).

The Result of the Individual Pension Plan

As Daniel explained earlier, the result of an IPP strategy is not the same as the intent. That confused Al at first, but Daniel reassured him that if he captured his next point, the rest of the story would be easy to understand. He explained that it is the employer's responsibility to keep enough money in the Pension Trust to pay the "intended" retirement benefit. An actuary, like Daniel, needs to calculate what the "intended" benefit is worth and notify the employer in a report (called a "valuation report") how much needs to be in the pension account to cover the benefit (called a "liability").

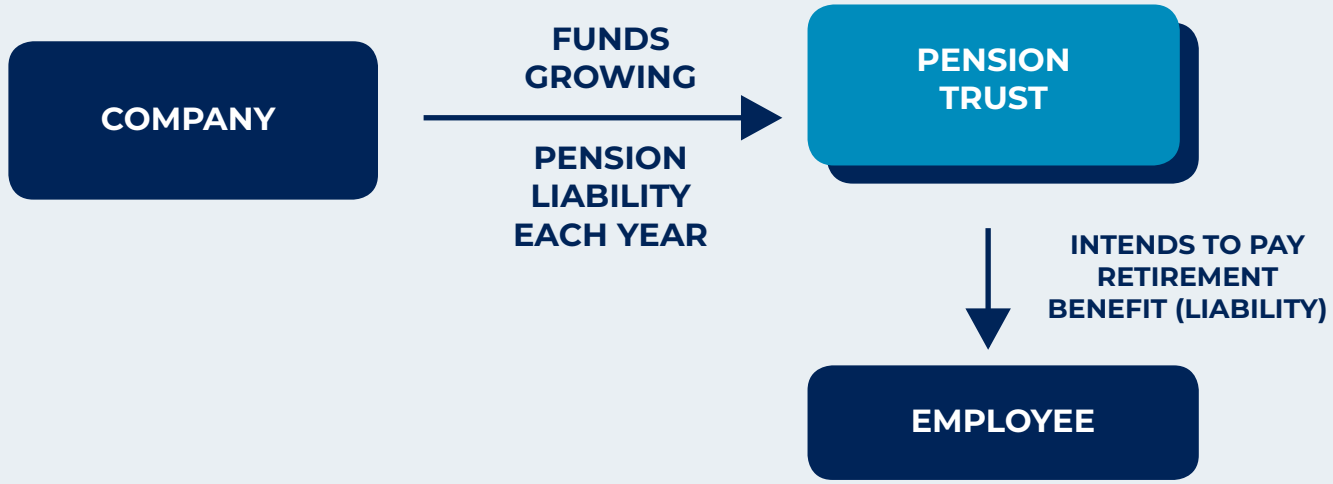


Figure 4-2: The Result of the Individual

The employer often needs to put funds into the trust each year to offset the growing commitment of the pension plan. Daniel reminded Al that as each year passes, the plan has one more year of service that it must compensate for plan members. The employer makes tax-deductible contributions to the pension trust and records the contribution as a "Pension Expense" in their books. The contributions are then held in the trust with investment growth sheltered from taxation (like an RSP).

Daniel stayed silent for a minute to allow the concept sink in.

Al clarified, “So, my company offers me a pension plan. The intention of the pension plan is to pay a Cadillac pension benefit to me at age 65. For each year I work for my company, the pension liability increases a little. You, as the plan actuary, tell me how much this is worth, and my company puts money into a tax-shelter called a pension trust account to ensure there are enough funds to pay this intended benefit. The result is that I have a Pension Trust account with a whole bunch of money in it?”

“Correct,” said Daniel.

“But then what?” Al wondered. “How much is this is going to cost my company?”

Daniel leaned back in his chair. “Well then, let’s continue our story.”

Creditor Proofing

He took a moment to explain that slightly better than most RSP accounts, the money in the Pension Trust is “largely” creditor proof. A divorce or the tax authority could get at the money, as with other similar creditor proof strategies. Otherwise, the account cannot be seized nor can income from the account be garnished. Al liked this, as the threat of a lawsuit seemed to always be in the back of his mind.

Actual Cost Dependent on Age

Daniel explained that the amount Al’s company could put in the trust is, in part, dependent on Al’s age. The cost for the “retirement benefit” would depend on how long he had until retirement.

“If the liability of the plan increased this year by 2% of your income, that means that we need enough money in the trust to fund this liability from your age 65 to death. If you are 45, we have 20 years for our contribution to grow in the pension trust account before the payments begin. If you are 60, we would only have five years. Therefore, the deposit required for a 45-year old will be smaller than for the 60-year-old. Age is a good thing when it comes to pension plans!” Daniel grabbed a pen and drew a diagram to illustrate this point.

“At about age 40, the available deposit to an IPP becomes larger than what is available with an RSP. Being that the two programs are mutually exclusive, the IPP becomes the desirable choice after age 40, explaining why one doesn’t see many IPPs for those under the age of 40.”

Current Cost Estimate for 2019

Being that Al is 45, he wanted to see some numbers. Daniel explained that each IPP is somewhat case specific, but a general guideline to approximate contributions for 2019 are:

Annual Current Cost Estimate for 2019

Age	2019	2020	2029
45	$30,256	$32,398	$34,854
50	$33,130	$35,590	$38,390
55	$36,458	$39,102	$42,094
60	$40,089	$43,091	$46,303
65	$44,022	$43,251	$44,620
70	$37,214	$38,782	n/a*

*Retired

These figures assume an annual T4 that meets or exceeds $151,278. Remember that participation in the IPP creates the PA (removing the RSP opportunity).

Figure 4-3: Annual Current Cost Estimate for 2019

Past Service Cost Estimate for 2019

While these numbers appeared to be pretty good, Al was still confused. An excess of $5-10,000 per year above the maximum RRSP contribution room was simply not enough of an advantage to catch his interest. Al posed his concern to Daniel, and he smiled.

“Good,” Daniel said, “you are catching on. The real benefit to an IPP comes in the past service. When setting up an IPP program, a plan sponsor has the option to offer pension benefits retroactively to plan members. As pension legislation changed in 1991, most plan sponsors will only go back to 1991 for simplicity.”

He explained that back-dating the pension plan is not that complicated and creates tax deductions that should interest people like Al.

The procedure for setting up the plan "retroactively":

- Register the plan offering past service benefit to 1991.
- Physically transfer an estimated deposit value of the RSP deposits made during the past service period into the Pension Trust account (called qualified transfer).
- Determine the current cost of the past service benefits to determine the plan obligations for this past service period.
- Make tax-deductible contributions to the trust to offset this liability. The liability can be paid in full or amortized over the life of the plan.

While past service contributions are dependent on case specific circumstances, Daniel provided the following table to provide a general idea of what can be accomplished in the first year of an IPP program:

Past Service: Past Service Since 1991

Age	2019
45	$166,308
50	$249,559
55	$341,007
60	$441,457
65	$551,797
70	$938,819

Assumptions to this table are as follows:

- Full past service benefits are applied for (1991);
- The required "Qualified Transfer" of $679,320 would be completed from the RSP account (in addition to the corresponding past service contribution above).

Instead of past service back to 1991, the following table illustrates the past service liability for 10 years of service:

Estimated Past Service: 10 Years Past Service

Age	2019
45	$43,710
50	$73,443
55	$106,102
60	$141,978
65	$181,385
70	$256,619

Assumptions to this table are as follows:

- Past service benefits are applied for the most recent 10 years;
- The required "Qualified Transfer" of $258,300 would be completed from the RSP account (in addition to the corresponding past service contribution above).

“So,” Al confirmed, “the past service represents the extra amount we just saw on an annual basis for each year, going back to 1991, payable by my company to the pension trust in one lump-sum amount?”

“Sure,” replied Daniel. “You can make this payment in one tax-deductible lump-sum or amortize the amount over several years. You could even amortize the amount over the life of your plan.”

“That’s not too complicated,” Al thought. “Explain to me the justification for the RSP transfer though.”

Daniel explained that the qualified transfer represents the RSP deposits made over the years the pension plan is backdated.

“One is not allowed to have both a pension plan and an RSP program in the same year; so, the qualified transfer removes the RSP deposits and prevents potential “double dipping.” Some members are less comfortable with the qualified transfer, as it effectively converts RSP money (not locked-in) into pension money (at least partially locked-in). In some cases, the qualified transfer can be “optimized” by finding a reasonable balance between the largest past service contribution available for the smallest Qualified Transfer.”

“Hmmm...it seems to me that most of my decision to do an IPP would, therefore, rest on the past service, as it creates the largest immediate tax deductible deposit to my plan, Al replied.”

Daniel confirmed this observation but challenged Al to consider another source of deposit—the Terminal Deposit.

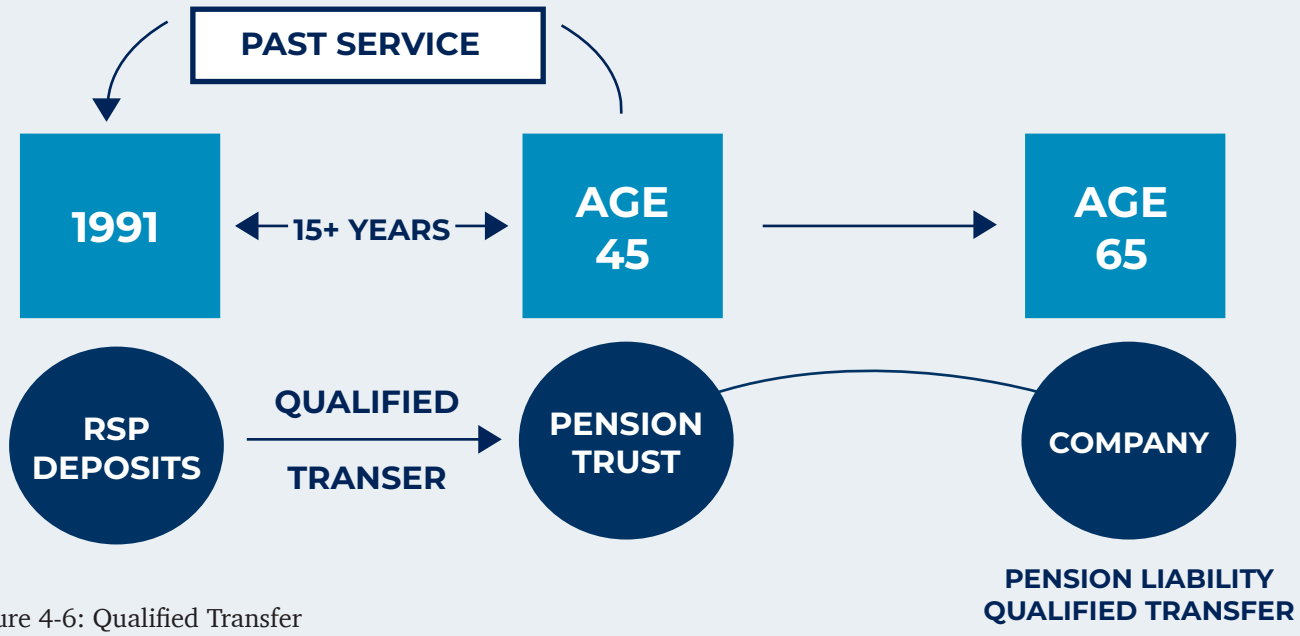


Figure 4-6: Qualified Transfer

Terminal Deposit

He explained that another option a plan sponsor can provide is retirement enhancements when terminating an IPP; kind of like offering a "retirement package" paid into the Pension Trust.

Packages can represent the following "intended" plan enhancements:

- An early unreduced retirement prior to age 65.
- Improving the pension payout to full indexation from CPI-1%.
- "Bridging" the equivalent CPP payout until age 65 paid from the pension plan.

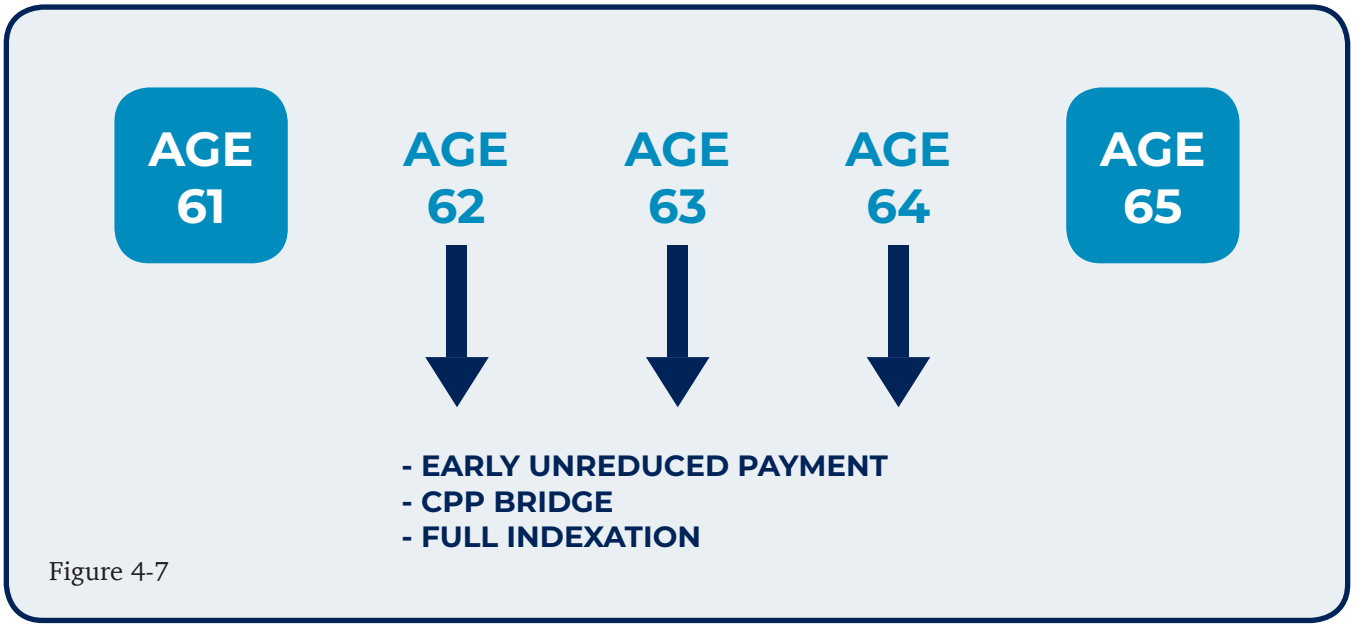


Figure 4-7

Here again, is an example of the difference between a plan's "intent" and "result." Retirement enhancements cause the "intended" obligations of the plan to grow, increasing the funding requirements of the plan, as well as the tax-deductible contributions of the plan sponsor. Funding comes from the company (tax-deductible contribution) and goes into the tax-sheltered Pension Trust on behalf of its member(s). Often the plan is wound-up after this contribution (not a requirement) and will depend on case-specific circumstances.

"This sounds crazy! Daniel, you are telling me that as an owner-manager, I can set-up a pension plan between my company and myself? The company becomes liable to fund plan obligations. Then, I can negotiate with basically myself to increase these obligations by offering myself a retirement package?"

"You got it," said Daniel. He then reminded Al that terminal contributions are a tax-deductible expense to the host corporation and showed him the following table of estimates regarding what these retirement packages could be worth.

Estimated Maximum Terminal Funding			
Age @Inception	Retire @60	Retire @62	Retire @64
45	$548,057	$586,178	$622,660
50	$370,577	$398,671	$425,126
55	$246,233	$266,907	$286,555
60	n/a	$175,046	$189,624
65	n/a	n/a	n/a
70	n/a	n/a	n/a

Again, with only 10 years of plan service the terminal deposit could be approximated as follows:

Estimated Terminal Funding 10 Years' Service			
Age @Inception	Retire @60	Retire @62	Retire @64
45	$318,638	$351,707	$344,686
50	$195,041	$291,269	$242,929
55	$111,924	$129,641	$147,150
60	n/a	$70,018	$82,961
65	n/a	n/a	n/a
70	n/a	n/a	n/a

Al could now see that the while annual contribution was better than an RSP for those over age 40, it is the past service benefits that really make the pension plan of interest.

An owner-manager must address the divergence of what an IPP "intends" to do, and what the "result" actually is. The intent is a formula that increases the liability Al's company has to cover for each year of service credited to him. This liability would significantly increase if he back-dated the plan or offered himself retirement benefits upon plan wind-up. Al felt good about a qualified actuary working on his file. What he still struggled with was the exit strategy. Daniel did an excellent job explaining how money got into the pension trust account; now, Al wanted more information on how to get it out. For this, he decided to ask his accountant, Stacey, to drop by.

Daniel warned Al that life is not quite that simple when it comes to such plan amendments. For example, there are prescribed maximums that can be transferred out from a pension trust (Tax Regulation 8517), sometimes leaving part of the trust taxable on plan wind-up. Many decide that, if they take this terminal funding, to leave the plan in place and take retirement income directly from the trust so as not to trigger taxable surplus.

Contemplation from the Visit

Al enjoyed his meeting with Daniel. As he pulled out of the downtown parkade and began his slow push towards home, he reflected on the meeting.

Daniel had helped him in seeing that an IPP has three sources of deposit: the annual contribution, past service benefits, and terminal enhancements.

5

Meeting with Stacey
The Accountant

Al looked forward to Stacey's visit. They had worked together for many years (since his father selected her firm for their audits), and she had lots of experience. Al was glad she agreed to come in and explain to him possible exit strategies, should he decided to proceed.

On the phone, Stacey mentioned how her firm recently took another look at the IPP program to provide better insight to clients like Al. Unfortunately, when she arrived, Al's office was in a flurry. Al had another manager quit, as well as three people call in sick that morning. He was taking calls in his office and doing his best to keep his head above water, which meant working 7 am to 7 pm for the past week. The next thing he knew; his assistant was ushering Stacey into his office for their meeting.

Target Profile

Al was caught off guard, so he hit her with an easy question to get the conversation rolling.

"What do you think, Stacey? Am I a candidate for the IPP program?"

Stacey smiled, "Hello to you too!" She threw her coat over the back of the chair and sat down.

Al smiled back, slightly ashamed. "I'm sorry Stacey! Things have been a bit crazy around here. How are you?"

"I'm good Al! I am excited to answer your question. Do you have time to sit and talk for a bit?"

"Absolutely! I need the help!"

"Ok then. The first thing you should know is that I look for a certain profile when deciding if the IPP is a good fit."

Specifically, a Plan Member that:

- Is at least 40 years of age;
- Has a relatively steady T4 or T4 related income of $50,000 plus per year;
- Has already maximized the tax sheltering available with RSP programs or is willing to catch up on the unused carry-forward room;
- Can handle a structured approach to retirement savings;
- Is an owner/manager of an incorporated business or;
- Is a professional with a professional corporation or;
- Is a key person who is involved in corporate governance.

"Why don't all taxpayers consider the IPP strategy?" Al asked.

"Pension plans cannot be registered to partnerships or people. A pension plan requires an incorporated entity to sponsor the plan. Therefore, the IPP strategy works best for small business owner/managers like yourself."

Al thought this was an interesting point. For once, there was a tax strategy that could be designed just for him as a business owner.

Signals to Review

Stacey explained that an IPP candidate has probably made the following statements:

- "My company has lots of cash."
- "My salary income has been very high over recent years."
- "I want to boost my retirement savings!"
- "My company has lots of cash."
- "I want to keep some key high-income earners from leaving."
- "I have a successful consulting business in addition to my job."
- "I want to sell or wind down my company."

Retirement Planning & Payout Options

Al, next, confessed to Stacey that he really needed help understanding the exit strategy of an IPP. He had seen Daniel (the actuary) and learned how money gets into the program, but remained somewhat uncomfortable on how the money got out.

"Al, I believe that a good tax strategy must have a good exit. In the event things go bump in the night, you need to understand what options you have fully. With an IPP, you should first understand that retirement can be taken anytime between the minimum retirement age stated in the Provincial jurisdiction (often around 55) or as late as age 71. This dynamic is similar to an RSP program. Both programs require income to start no later than age 71. Now, let's discuss some of the common exit strategies that are available under an IPP program."

A Pension Trust grows due to tax deductible deposits made by the employer. When pensionable service ends for a member, the payout phase begins.

Four common exit strategies are employed:

Option 1: Investments remain in the trust account with income drawn directly from the trust. The Pension Plan and Pension Trust remain active.

Option 2: The bulk of the investments (Commuted Value) are transferred to a LIRA account (if prior to age 71). The LIRA converts to a LIF at age 71. Remaining assets are taken into cash or through term certain annuities. The Pension Plan and Pension Trust are wound-up.

Option 3: The bulk of the investments (Commuted Value) are transferred to a LIF account and income taken subject to account minimums and maximums. Remaining assets are taken into cash or through term certain annuities. The Pension Plan and Pension Trust are wound-up.

Option 4: The investments are used to purchase a life annuity in accordance with the plan text. The Pension Plan and Pension Trust are wound-up.

"Which are the most popular, Stacey?"

"Most members choose Option Two, as a good age to terminate pensionable service ranges for between ages 65 and 71. Those who terminate their pensionable service also want to terminate the pension plan and simplify their lives." See below.

Figure 5-1: Option 2

"Under Option Two, most of the plan's assets transfer to a much simpler account (LIRA), which is very similar to an RSP account. The only difference is that the money is less liquid in most Provinces."

"What do you mean by less liquid?" Al asked.

“Well, you can manage the investment’s just like an RSP, but you cannot withdraw more than a prescribed amount in any one year. Canada Revenue Agency wants the investment to create income during your retired years and governs how much income you take from the account to ensure you won’t run out of money before age 90. This isn’t bad news because you are going to need income during your retired years, and you can look at the LIRA as your safety net. A recent change is that many jurisdictions will allow 50% of your LIRA to be unlocked at retirement. This means that half of the LIRA money can become RRIF money and the other half LIF/L-RRIF money when you retire.”

“So,” Al asked, “Option Two converts the IPP to a LIRA, which can then grow like an RSP until age 71. At any time, but no later than age 71, I can convert the LIRA to a LIF, which then causes me to draw a potential range of income each year from the account. Option Two becomes Option Three at that point?”

“That’s correct,” she confirmed.

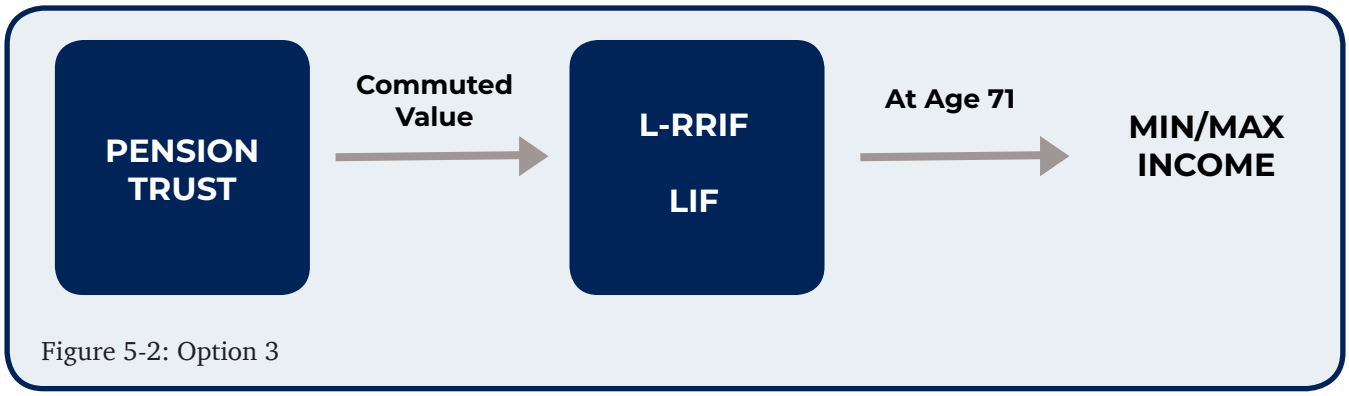


Figure 5-2: Option 3

“Why would anyone take Option One? Why would they keep the pension plan alive when they are finished putting deposits into it?” Al asked.

“Well, you’re right,” Stacey replied. “Most people take Option Two and Three. Historically, few chose Option Four (to purchase an annuity with the investments) with interest rates so low right now. Those who are generally more conservative with their investments will choose Option One, or those wishing to defer any deemed plan surplus (also called “excess amounts” on windup).”

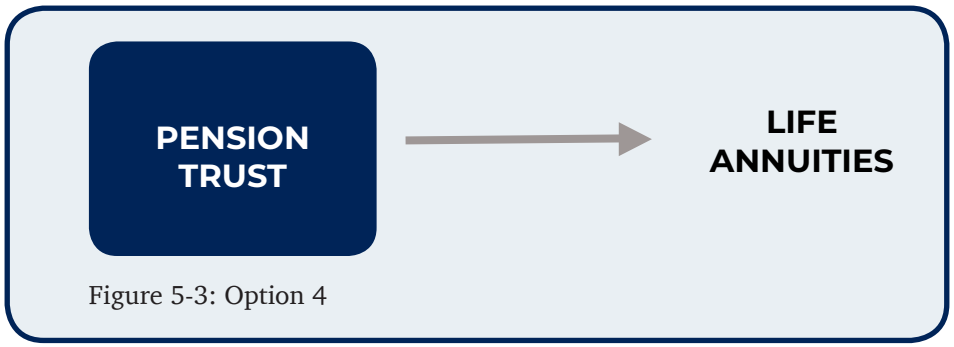


Figure 5-3: Option 4

You see, while the pension trust exists there is a 7.5% rate of return assumption. A GIC investor will not earn 7.5% on the investments, and the sponsor company will then have to "top up" the pension trust every three years, creating an additional tax-deductible opportunity for the employer. This will carry forward beyond age 71, meaning the trust will have to pay taxable income to the member at the same time that the employer may be able to make tax-deductible deposits to the trust. It can become a cash stripping strategy for the company."

"Interesting," Al thought out loud. "I need to hear more on the investments because it sounds like there are some differences between what I can do with the IPP Trust and what I can do with an RSP account."

Investment Management

"Well, the investments inside a pension trust account are subject to similar rules that govern RSP accounts, but not exactly the same. Many Provinces have rules related to eligible investments of a pension trust, as do Federal Regulations.

Some Good Rules of Thumb Include:

- No more than 10% book value can be invested in any one investment (not including mutual or segregated funds).
- Investments must be income producing, not speculative.
- If the RSP cannot hold it, the IPP likely cannot as well."

"Okay, I can handle these restrictions, as I consider this pension plan a conservative and balanced portfolio. If the pension trust is designed to do 7.5%, what happens if my investments fail to earn this?"

"Another great question," Stacey replied. "Every three years your plan actuary will do a valuation report. This report will review a number of things including your investment return.

If you did not earn 7.5% per year over the three-year period, you will have what is called an experience deficiency. The employer then has to fund against this plan deficiency either through one lump sum or amortized over the life of the program.

If you exceed the 7.5%, the report will outline how future deposits will be reduced as the plan had generated a surplus."

"Interesting, the valuation report comes out every three years. What other paperwork will have to be done with regards to the pension plan?"

Paperwork

"Good news," Stacey replied. "Your plan consultant or plan actuary will probably do most of the paperwork on your behalf. As your accountant, we need to ensure notes to your financial statements are done outlining the plan and its activity. We also need to ensure your T4 slips report that a plan has been offered to you. I recently researched the paperwork requirements of an IPP to see if we could handle the work for our clients and decided to leave it with the experts." Stacey then briefly reviewed what she had learned:

T3P (Employees' Pension Plan Income Tax Return)

The Form T3P must be filed no later than 90 days from the end of the tax year. According to the CRA, "Tax year refers to the calendar year for a trust and to the fiscal period for a pension corporation." If the form is filed late, CRA may impose penalties for the late filing. T3Ps are to be filed by the trustees and required only for plans that are governed by a Trust Agreement.

T1007 (Connected Person Information Return)

This form is used at plan registration to identify the connecter person. It is required within 60 days of plan registration.

T244 (Registered Pension Plan Annual Information Return) Form

For provinces that exempt IPPs for connected persons and high-income earners (i.e. B.C. and Manitoba), the plan is only required to file the CRA T244 Form. The filing deadline for Form T244 is within 180 days of the end of the tax year. If this form is filed late, CRA may also impose penalties for the late filing. For IPPs that are subject to federal/provincial registration, an annual information return must also be filed with the pension regulator. CRA allows a joint return with the federal and certain provincial pension regulators to be filed in place of the T244.

Annual Survey of Trusteed Pension Funds

These forms are issued by Statistics Canada and are due May 1.

Pension Adjustments (PA)

A PA needs to be reported in Box 52 of each participating members T4 slip. The plan registration number should also go into box 50. If this is not done, the T4 slips need to be amended and re-filed.

The PA formula in 2019 is: (2% of T4 Earnings * 9) - $600

Provincial Requirements

Currently, with few exceptions (British Columbia, Manitoba, and Alberta) Provincial jurisdictions require registration and annual reporting of Pension Plans, as well. Each province will have a Pension Authority that requires similar documents to the Federal office, as well as various other registration and annual forms.

Actuarial Valuations

Most IPP programs require an actuarial review of the plan no less frequent than every three years. This review ensures the program is fully funded and adjusts the annual deposit schedule in response to the position of the plan. The review looks at the program, in most cases, from both a "going concern" perspective, as well as a "solvency" basis.

Plan Amendments (T-920)

The plan administrator is required to file a T920 when requesting acceptance of an amendment to a registered pension plan. It is required within 60 days of the amendment. Plan amendments may be required from time-to-time as legislation changes (both provincially and federally). Amendments are also required when the trustee or actuary changes.

Review of Our Meeting

"So," Al asked in conclusion, "what do you think? Should I do it?" Al knew he could count on Stacey, as she always clearly told him what he needed to do.

"Well," she started slowly, "you have trouble with delegation." "Look at yourself, you had a bump in your staffing and are now working the phones. You have got to learn to pass more responsibility to your staff. When was the last evening you went bike riding with your kids? An IPP requires that you delegate this to your actuary, consultant and other advisors."

She paused, allowing this to sink in, and continued.

"Outside of that, I think it is a good fit. The alternative to the IPP program is to simply stay with an annual RRSP deposit. In simple terms, the IPP will allow you a much higher cumulative deposit than what an RSP program would ever allow. At the end of the day, you will have a much larger retirement account that has been funded by tax deductible deposits from your company. You have other investments, so having this account locked-in and designated for income purposes should not be a problem."

"Okay, thanks. Other than that shot about my inability to delegate, you were very helpful."

"You know," she replied "maybe you should talk with Adrian. He is a contact of mine that works for a large insurance company. He has always been a resource to our firm on pension plans. I am sure that he would be happy to have coffee with you. He could probably give you a better background on the history of pension plans. He has worked with them longer than any of us."

"Maybe I will do just that. Thanks again, Stacey."

6

Talking with Adrian
The IPP Environment

Stacey highly recommended that Adrian be the one to inform Al on the environment and history of Individual Pension Plans. Adrian had humble beginnings and started his work life at a young age. Similar to Al, he was one of the last of a generation who gave their careers to the family firm.

He started in the file room and earned each promotion, working his way up over the past 30 years. What Stacey liked most about Adrian was that after all that success, he still retained a humble charm, and she felt that Al would probably like him a lot—she was right.

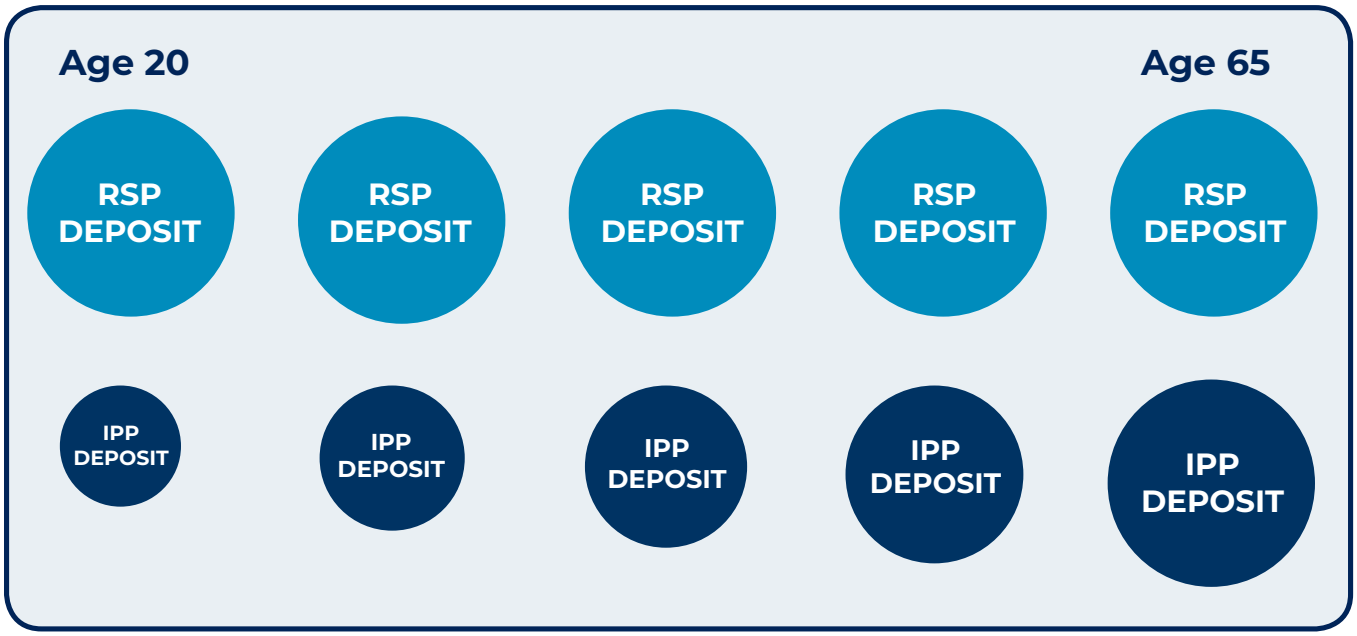
When Adrian answered the phone, he had already been briefed. He told Al that he was predicting a resurgence in IPP programs and would be happy to chat with him about the programs. He added that he hoped Al would remember his company when the time came to pick the provider of his pension trust account. Al reassured him that he would be happy to do that.

1991 Pension Reform

"First off, Adrian, what do you mean by a "resurgence" of IPP programs."

"Well Al, I'll need to start at the beginning. While there are amendments and adjustments made on a regular basis to Pension legislation, the last major federal pension reform occurred in 1990/1991 with the goal to revamp legislation and end an era of "creative manipulation" by consultants and actuaries. In 1991, all IPP programs had to conform to the same underlying assumptions, including the rate of return assumption of 7.5%."

Adrian continued, "The 1991 Pension Reform was also formed to help equalize various retirement programs and act on the principle that all Canadians should have the same opportunity to save for retirement, independent of where or for whom they are employed. The theory was that a young Canadian starting a career should be able to save the same amount for retirement over his/her lifetime using an RSP program as could be saved using an IPP or other DB Pension program.



The RSP program allows a (somewhat) level deposit over the years, whereas an IPP program enables deposits on a "current cost" basis. Contributions start quite small with the IPP but grow over time as the member ages.

Another result of this reform was called the relaxation of "connected individual" rules. Post-1991, there was the theory that all Canadians had equal opportunity to save for retirement. So there was, therefore, no longer the need to prevent business owners/executives from exercising what once was considered "preferential" treatment by setting up selective pension programs.

After 1991, a business owner could make a somewhat simple decision to implement a pension strategy without making provisions for the retirement needs of the other employees.

Adrian explained to Al that this really opened the door to a new style of IPP programs (simple programs). He shared some crazy stories of the final days selling plans under the old legislation. He became active in the years following, setting up pension plans under the new rules with success. Al was gaining the impression that Adrian could be successful in any environment; his enthusiasm was infectious.

1994 & 1996 Limit Freezes

Adrian then told Al that in 1994, and again in 1996, the CRA suspended planned increases to retirement savings programs (RSP and IPPs). Although the effects on the RSP programs were minimal, the impacts on IPPs were not. Being a "Defined Benefit" plan, the IPPs had been funding for future liabilities that assumed earning limit increases. With the sudden freeze to planned increases, these plans were over-funding.

Plans immediately went into a surplus position, hindering the ability to add new deposits. The second time this happened (1996), many plans were pushed so far into a surplus position that taxable refunds were required. The environment for IPPs had soured, causing interest in IPPs, by the planning community, to disappear. Many actuaries moved to other areas of work, including Adrian himself until 1999-2000 when the tax deductions began to return to members of IPP programs.

Figure 6-2: 1994 & 1996 Limit Freezes

2003 Surprise Limit Increase

Al was still confused, and Adrian explained that the federal budget of 2003 might provide a good example of how the numbers can change. In 2003, CRA offered a small surprise with increases coming one year early for retirement programs. RSP programs were offered an increase to $14,500 one year ahead of schedule, and similar increases were offered to DB pension plans. Relative to the 1994 and 1996 freezes, this had the reverse influence on funding. The earnings limit was now higher than expected, and employers were funding for a smaller pension plan than was then allowed. This meant that the pension trust would not have enough money for retirement as it could have.

A member joining an IPP at age 60 in 2003 (member has full past service (1991) with maximum earnings), saw an extra $28,356 available into the plan in its first year. The average IPP program saw a bump of about $1500/year in deductible annual contributions.

2011 Federal Budget

Even though the pension industry has used the term Individual Pension Plans since 1990, it was not until 2011 that the term officially became legislated. Additionally, plan members over age 71 were now required to receive a minimum payment from the IPP such that the total annual payment not less than the minimum amount payable from an RRIF in that year. Finally, a plan member's RSP balances going into the pension registration could now impact past service calcualtion. For those with large RSP balances, past service opportunities with an IPP saw reductions.

The IPP Environment Today

Al tried to keep up and asked Adrian what he thought about the coming years. "Are we going to see more good or bad news?"

Adrian laughed, "remember Al, nobody has a crystal ball when it comes to CRA and tax policy. However, in my opinion, things are looking pretty good. In 2006, experts expected RSP and Pension limits to be indexed to the average industrial wage rate (which has grown at 2.7% annualized in the last 30 years). The good news is that since 2006, RSP and Pension limits have actually increased more than we expected – at 3.7% annualized. The bad news is that much of this growth resulted from one time increases. At present, limits are indexed to inflation, which has seen muted growth in recent years. The federal government will need to increase these growth rates if it still intends to level the DB/DC 'playing field'.

Note that in 1976, Defined Benefit pension programs could provide a pension on earnings up to $85,750 (the DB limit in this year was $1715; equal to 2% of $85,750). In comparison, adjusting for inflation, DB pension programs today can provide a pension on earnings up to $35,289.44 in constant 1976 dollars. Retirement benefits are, in real terms, therefore, significantly less than they were in the 1970's.

Growth of Pension Earnings Limit vs. Growth of Average Industrial Wage

Year	AIW	Earnings Maximum (EM)	EM/AIW
1976	$11,058	$85,750	7.8
1990	$26,667	$86,111	3.2
1996	$30,801	$86,111	2.8
2000	$33,488	$86,111	2.6
2006	$39,939	$91,355	2.3
2010	$44,952	$102,281	2.3
2016	$49,504	$145,722	2.9

In recent years, Adrian explained that there had been several changes to the legislation affecting IPP programs. First, an IPP cannot offer lower taxable income at retirement than what an RRIF account provides. This change was made to ensure similarity between the tax treatment at the retirement of IPPs and other retirement plans. Second, there are new complicated rules that, in essence, limit the total benefit an IPP beneficiary can gain in setting up an IPP. Very generally, when an IPP beneficiary has an RSP account prior to setting up the IPP with a market value greater than $750,000, the past service opportunity of the IPP becomes capped. These new rules now cause planners to carefully review RSP balances before implementing the IPP.

Maximum pensions payable from a registered pension plan were largely unchanged between 1976 and 2002, after which time we began to see varied increases to these limits. Note that had levels been indexed at 3.0% annually since 1976, pension plans would today cover earnings up to $279,719 and would deliver pensions that are equivalent to RRSP contributions of about $50,350.

Other Trends

Another trend in the pension environment today is the ability to "un-lock" pension assets. Adrian later emailed Al a white paper, written by Alberta Finance in 2004, discussing taxpayer access to locked-in accounts. Alberta now allows access for financial hardship and potential health issues, causing adjusted mortality. They also changed their legislation to allow 50% "unlocking" of retirement accounts with spousal permission after age 50. Plans in existence for less than two years in many Provinces, including Alberta, are not subject to locked-in rules.

In April of 2002, the Province of Saskatchewan changed their legislation to allow the "unlocking" of retirement accounts, with spousal permission, at retirement. Most other jurisdictions, including federal plans, allow 50% unlocking of funds at retirement.

Many Provinces are also moving to release the requirement of Provincial registration of such plans. This reduces the regulatory and administrative burden of using this strategy.

International Competitiveness

"Thanks, Adrian. I now feel considerably more comfortable about the IPP environment."

"That's great, Al! I'll leave you with one more example of why I see a positive future for retirement tax sheltering in Canada.

If annual increases in contribution limits were implemented in 1984, as the government at that time proposed, today's limits would be comparable to those found in the United States and the United Kingdom. To keep pace with our global peers, Canada needs to continue increasing the pensionable earnings limits.

Summary Thoughts

"Thanks, Adrian, I really appreciated hearing your perspectives. I was surprised to hear how environmentally sensitive IPPs are and that tax deduction can change depending on how the CRA stands up to the assumptions it requires plan sponsors to use."

Al said goodbye and left Adrian's office to head home. While he could now see the tax risk, he also felt comfortable with knowing that IPP programs are highly regulated and not an area of tax planning that should irritate an auditor. He felt ready to go back to Ken and discuss some practical topics in regards to the IPP, as well as make a decision on what to do with his file.

7

Al Debriefs with Ken – Putting it All Together

It had been an interesting few weeks meeting with the various contacts that Ken had put Al in touch with to research the IPP concept. Al felt that he now had enough background on the topic to meet with Ken again and discuss more practical items related to the strategy, as well as the feasibility of moving forward. He decided not to leave the meeting until he understood the downside of an IPP. At this point, it was difficult to see why he wouldn't sign on.

Al arrived at Ken's office for an early morning coffee, and again, he was impressed by Ken's corporate operations. This time one of his planning assistants, John, met him at the door. John treated Al as if he already knew him. He then led Al to Ken's office where Ken sat waiting to hear about Al's IPP adventure.

Al told him about meeting with Daniel, Stacey, and Adrian, and he was pleased to hear that Al had learned so much. Al then decided to clarify from Ken if he could have both an IPP and an RSP. He remained a little confused on this issue.

Can I have both an IPP and an RSP?

Ken told him that while one could certainly have both an IPP and an RSP, contributions made to an IPP would reduce the contribution room available in the RSP for any particular year. Deposits into a Defined Benefit Pension Plan created a Pension Adjustment (PA) on the personal tax return. This PA reduces the room for RSP contributions in that tax year.

The formula for the Pension Adjustment (PA) on a 2% (maximized IPP) plan is:

Pensionable Earnings x 2% x 9 - $600 = PA

Ken pulled out a note pad and took Al through the calculations using the 2017 earnings limit.

$145,722* 2% * 9 - $600 = PA
$2914.44 * 9 - $600 = PA
$26,230 - $600 = PA
$25,630 = PA

Ken explained that the $25,630 PA, reported on Al's T4 slip, would reduce the RSP contribution available for that calendar year. On $145,722 of earnings, Al's RSP contribution would start at $26,230 (18% times $145,722), and then be reduced by the $25,630. He would be left with an RSP deposit of $600. It is often the employer who controls access to a company-sponsored pension plan, so this made sense to Al. If the employer does not offer participation or participation at a lower rate, the taxpayer could then access an equivalent amount of retirement tax-sheltered savings from the RSP program.

How early can I retire from an IPP?

Ken explained that the early retirement age is based on provincial pension regulations. In most provinces, one can retire as early as age 55 from such a plan.

How late can I retire from an IPP?

Ken then explained that Federal legislation requires retirement plans to end the accumulation phase and enter the payout phase by the end of the year that the taxpayer turns 71. This is the same for RSP plans.

What if I cannot afford the contribution to the IPP?

"Previously, this was a problem in many Provinces with cyclical economies. Currently, some Provinces do not require Provincial registration, and in these jurisdictions, there are no minimum funding requirements. One could theoretically suspend contributions in a tough year in such jurisdictions as B.C., PEI, Manitoba, and Quebec. In other jurisdictions, one needs to make an annual contribution to the plan as the provincial regulator restricts the ability of a plan sponsor to leave an unfunded liability with the IPP."

What happens to the IPP if I die?

"Unlike the perception of other Defined Benefit Pension plans, IPPs carry virtually the same estate planning options as RSP programs. The IPP assets can rollover, tax-exempt to a spouse. Should this not be available, the program can be paid to a stated beneficiary. Unlike RSP programs, the proceeds are taxable to the beneficiary and not the estate of the deceased. This may open up planning opportunities for some. There are some planning opportunities available for a family business, but the tax advantages are somewhat suspect."

Can I have the IPP in my Holding Company?

"Many consultants, such as myself, prefer to see IPPs at the holding company level because they can more easily coordinate high contribution years with high taxation years (e.g. the year in which the operating company is sold). Although desirable, a holding company is not a requirement. Should a member receive T4 earnings from multiple related corporations, each corporation could be listed as a sponsoring member of the IPP. Deductible contributions created from the T4 earnings go to the corporation paying the earnings. While one can have multiple related sponsors of a pension plan, one cannot have multiple pension plans with related sponsors."

What recent legislation changes affected IPP plans?

In recent years we have seen a number of changes to the legislation affecting IPP programs. First, an IPP cannot offer lower taxable income at retirement than what an RRIF account provides. This change was made to ensure similarity between the tax treatment at the retirement of IPPs and other retirement plans. Second, there are new complicated rules that, in essence, limit the total benefit that an IPP beneficiary can gain in setting up an IPP. Very generally, when an IPP beneficiary has an RSP account before setting up the IPP with a market value greater than $750,000, the past service opportunity of the IPP becomes capped. These new rules now cause planners to review RSP balances prior to implementation of the IPP carefully.

Summary Thoughts

Al was impressed that Ken, being an investment advisor/insurance agent, could hold a similar level of understanding to the actuary, accountant, and pension wholesaler. Al asked him, "Ken, why do you stretch yourself to understand the IPP programs as well as you do?"

"Well, Al, I have always liked learning about technical details. I enjoy trying to understand concepts like the IPP, but more importantly, it allows me to quarter-back the program for my clients. They understand that I will take care of the plan registration, actuarial valuation, arranging and management of the plan assets, as well as assisting with financial reporting and any other matters that may come up regarding the IPP. They understand that I turn around and contract the actuary and plan trustee, as well as help assist their tax planner. Basically, I keep things simple for the client, and that allows me the privilege to manage more investments (which is how I get compensated)."

"So, you are telling me that if I want a pension plan, I will, therefore, need an investment manager, to assist with the pension trust? You are doing that work in addition to coordinating all other matters with the IPP?"

"You got it," he said, "I earn the right to manage your pension trust by taking the responsibility of assisting you with all related decisions of the plan and its trust."

"Cool, I can see your value proposition. I want to talk more specifically with you about my case, and I do not believe that the recent legislation changes affect my situation."

"Great!" He exclaimed. "I was hoping you would say that!"

8

Al Debriefs with Ken– Sharing Some Case Examples

Al was impressed enough that he had asked Ken to run some numbers for him. As interesting as the past few weeks had been, he was just too busy running his own business to worry about managing the IPP, as well. Ken sourced enough professional assistance that Al felt he could trust him to take care of the plan on his behalf. It seemed that this could be the first step to better delegation that Al so desperately needed as a business owner/manager.

Now that Al was ready to talk logistics, Ken provided him two classic case examples to take home. They agreed to meet later in the week to review case specifics.

Case 1: Medical Practitioner & Spouse

A classic IPP in many Provinces is a medical practitioner and spouse. Most provinces in Canada now allow medical professionals to incorporate, and with this opportunity, comes the chance to fund a pension plan for employees of the professional corporation.

In this example, we have two scenarios for a 58-year-old medical professional and spouse. The following assumes an income of over $150,000 since 1991 in the first scenario for the medical professional and $50,000/year for the spouse. In the second scenario, we present just 10 years of past service.

The contribution potential is large from the IPP, and the corporation could take the deductions as generated or amortize them. The contribution schedule for scenario one is as follows:

Corporate IPP Contribution Amounts: Full Past Service		
Contribution Year	**No Amortization**	**Five-Year Amortization**
2019	$722,345	$185,530
2020	$55,175	$210,265
2021	$59,314	$251,981
2022	$63,762	$321,063
2023	$68,544	$437,933

Qualified Transfer	Medical Practitioner	Spouse
2019	$679,320	$224,800

2019 Corporate Deductible Contributions	
Past Service	$679,320
Current Service	$679,320

Senario Two: With 10 Years of Past Service:

Corporate IPP Contribution Amounts: 10 Years Past Service		
Contribution Year	No Amortization	Five-Year Amortization
2019	$245,105	$90,082
2020	$55,175	$99,963
2021	$59,314	$114,953
2022	$63,762	$138,066
2023	$68,544	$175,217

Qualified Transfer	Medical Practitioner	Spouse
2019	$258,300	$76,000

2019 Corporate Deductible Contributions	
Past Service	$193,779
Current Service	$51,126

Note that the qualified transfer is not deductible and therefore shown separate from the corporate contributions.

At plan termination, enhancements may be possible. For this case example, Ken estimates the following potential enhancements:

Terminal Funding			
Medical Practitioner		Spouse	Total
60	$190,632	$84,221	$274,853
61	$199,297	$86,484	$285,781
62	$270,819	$88,651	$296,470
63	$216,151	$90,710	$306,861
64	$224,247	$92,648	$316,895

With only 10 years of past service:

Terminal Funding			
Medical Practitioner		Spouse	Total
60	$76,253	$26,017	$102,270
61	$83,576	$27,598	$111,174
62	$90,921	$29,166	$120,087
63	$98,250	$30,715	$128,965
64	$105,528	$32,236	$137,764

Remember that once these enhancements are made, income will then be required from the trust limiting the tax deferral of the terminal contribution. Should the plan be wound-up, the termination enhancement will generate a large plan surplus, causing many who do this funding to leave the plan active in retirement and take income directly from the pension trust account (as opposed to winding it up and transferring assets to a LIRA).

Case Example 2: Family Business

Another classic IPP is a family business with the parents looking to phase out their involvement in the operation. Tools are desired to strip some of the retained earnings from the business to their benefit. In some instances, the operation is sold and large deductions sought to offset the taxable event.

In this example, we have two 65-year-old professionals with incomes over $145,000, since 1991. The contribution schedule is as follows:

Corporate IPP Contribution Amounts		
Contribution Year	**No Amortization**	**Five-Year Amortization**
2019	$1,929,412	$446,636
2020	-	$428,383
2021	-	$532,179
2022	-	$710,709
2023	-	$1,020,314
Qualified Transfer	**Medical Practitioner**	**Spouse**
2019	$679,320	$224,800

2019 Corporate Deductible Contributions	
Past Service	$1,853,470
Current Service	$75,942

With 10 years of Past Service:

Corporate IPP Contribution Amounts		
Contribution Year	**No Amortization**	**Five-Year Amortization**
2019	$670,146	$194,783
2020	-	$137,335
2021	-	$170,611
2022	-	$227,846
2023	-	$327,103

Qualified Transfer	Medical Practitioner	Spouse
2019	$258,300	$258,300

2019 Corporate Deductible Contributions	
Past Service	$594,204
Current Service	$75,942

The qualified transfer is again not deductible, and therefore, shown separate from the corporate contributions. At plan termination, some enhancements may be possible here. They would, however, be modest in most circumstances in light of past service benefits.

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Al Meets with Himself – Final Thoughts on the IPP

Al thought about all of the various professionals that he had met who were related to the IPP strategy. During his commute, he spent time going over everything he learned.

The Basic Strategy

Al learned that the last major pension reform legislation was, in part, intended to equalize the tax-sheltering available to all Canadians independent of whether their company offered a pension plan or use of the RSP facility. In each, the taxpayer starts and stays in one program for the rest of their career. For example, the RSP program allows a level deposit each year. The amount of the deposit (18% of earned income) represents the amount required (basically) to replace around 60% of the pre-retirement earnings.

A Defined Benefit Pension plan allows an increasing deposit each year based on age. The amount of the deposit (9-25% of earned income) also represents the amount required to replace around 60% of the pre-retirement earnings. The difference being that in the beginning, the deposit amount is much lower than an RSP but then grows to an amount much higher later. To play the advantage, one has to have control over corporate governance and hold off on having the company finance the IPP strategy until after age 40. The only taxpayers able to "play" the strategy are owner/managers of small businesses and/or executives with influence.

The Initial Deposit

Another thing that Al learned was that most of the tax advantage comes in the first year of the program, due to the ability to back-date benefits as far as 1991.

As the member of a pension plan would have made deposits to an RSP or Defined Contribution program, a qualified transfer would be needed to roughly equal the deposits made into these accounts, during these years.

Once the qualified transfer is accounted for, an actuary determines how much should be in the pension trust based on the number of years that the plan was back-dated. The difference between the amount required and the qualified transfer becomes the deductible contribution from the sponsoring company of the plan.

After this initial deposit, which can be amortized over a number of years, there are annual deposits that can be made to a plan. These are larger than what could go into an RSP. One can make a final deposit (severance payment), as well. After factoring these deposits, the initial deposit remains the most significant for most people interested in an IPP.

The Pension Trust

The pension trust holds the assets of the pension plan. The Canada Revenue Agency requires that trust assets grow at 7.5% measured (no less frequent than every three years). Both federal and provincial legislation exists that regulate what a pension trust can invest its asset into. A rule of thumb is that what goes into an RSP account could probably go into a pension trust account, as well. Further, a pension trust account cannot invest in speculative investments, concentrate its investments beyond 10% in any one choice (except for investment funds) or invest assets in non-income producing investments. Basically, guaranteed investment certificates (GICs) and investment funds work very well for most pension trust accounts.

The Exit Strategy

Finally, if most of the benefit comes from the initial deposit, it is not unreasonable to begin looking at an exit strategy as early as the first valuation report (3 years). Under the current conditions, an exit should be contemplated sometime between ages 65 and 71.

While some investors will keep the pension trust in place and draw income directly from the trust, many will want to wind it up and transfer as much as possible (maximum transfer value) to a LIRA account. For those fortunate enough to live in Saskatchewan, they can transfer their assets to a regular RSP account.

At age 71, the LIRA can convert to a LIF or annuity and in many jurisdictions 50% into an unlocked RRIF. The LIRA is simple and works very similar to an RSP account. The difference being it is locked-in and cannot be liquidated like an RSP can. The investments available are identical to an RSP program. When the LIRA converts to a LIF/RRIF, income can be drawn each year subject to required minimums and maximums.

The end result of most IPP programs is a very large LIF/RRIF account. The LIF/RRIF continues to tax shelter investments while offering annual income. The substantive difference to this and an RSP approach is the LIF cannot be liquidated in whole but must convert to income during retirement.

Al's Decision

Al realized that the IPP would provide him far greater tax-sheltering than his current RSP program. If he delegated much of the work to professionals in this area, his only downside was the exit strategy left him money that was less liquid than RSP money. This, however, did not bother him because he was going to need income during retirement.

The process of professional delegation would be Al's first step to regaining balance in his workplace and personal life. Al planned to make changes that would allow him more time to do the really important things: spend time with his family.

Al felt comfortable that should he pass away prematurely, the estate planning available with the money in an IPP was similar and possibly better than an RSP account. Al decided to view this strategy as an intelligent way to strip some of the profits from his company in a tax-efficient manner, a strategy that would greatly increase his tax-sheltered investing and would create a creditor-proof safety net for his finances.

Al agreed that if there was one thing he should be able to count on after all of these years as an entrepreneur, it was a solid stream of retirement income.

Your Next Steps

Investment counselors at Qube are happy to assess your situation for the feasibility of an IPP. With some basic information, we can provide a potential deposit schedule and management plan to help determine the viability of an IPP for your situation.

Do you already have an IPP?

There are a number of exit strategies to consider beyond the scope of this overview discussion. For example, some may decide to "hibernate" their pension plan to return to an RSP program in the final years of employment. This strategy can defer inclusion of deemed plan surplus until a lower tax environment often achieved in retirement while maximizing the total retirement deposits. Contact our staff for an assessment of your potential exit strategy!

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