Demystifying Individual Pension Plans

Getting Serious About Accumulating Retirement

Consider the plight of the typical Canadian business owner trying to accumulate financial security for retirement. The challenges are daunting, including:

- A shortened period to accumulate assets;
- Increased investment volatility; and
- Expected lower investment returns.

Existing programs such as RRSPs are incapable of accumulating the gap in required assets in a relatively short time frame. Fortunately, there is an attractive solution. For business owners, incorporated professionals and executives, the Individual Pension Plan, or IPP, represents a superior vehicle for accumulating retirement assets.

Despite their numerous advantages, IPP's remain one of Canada's best kept secrets. This article will attempt to demystify IPPs.

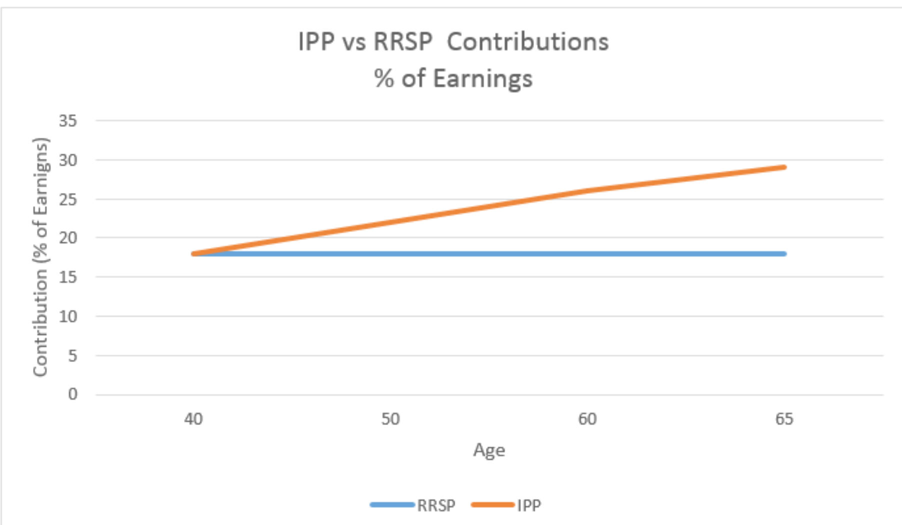
Plan Implementation Considerations

An IPP is a registered defined benefit pension plan designed for 1 or 2 people to provide the maximum pension benefit permitted under the Income Tax Act. A corporation sponsors the IPP and through tax-deductible contributions provides benefits to the IPP member in relation to T-4 earnings.

The amount of tax-deductible contributions is determined primarily through three variables: age, length of service with the corporation, and T-4 earnings.

1. Age

Of the three variables, age is the most important determining factor to maximize contributions. The table below shows the percentage of T-4 earnings for ages 40 through 65 that can be contributed to an IPP versus an RRSP.



LESNIEWSKI MOORE CONSULTING GROUP
FOCUS

Lesniewski Moore Consulting Group is a boutique consulting firm that develops cutting edge solutions that reduces financial risk and achieves security in retirement.

"We offer practical and intelligent consulting solutions."

At age 40, the amount that can be contributed to an RRSP or IPP is about equal but the gap quickly widens. IPP's allow for more generous contributions at older ages, especially at ages 50 and above.

As is the case with RRSPs, there is a specified maximum earnings level upon which contributions are based and it is identical to the RRSP pensionable earnings threshold. The maximum has increased steadily from $86,111 in 1991 to $144,500 for 2016.

2. Length of Service

An IPP can provide for benefits prior to the IPP implementation date, referred to as Past Service. Contributions in respect to Past Service can be made even if all eligible RRSP contributions have been made. To eliminate any doubling of benefits over this same period, a specific amount has to be transferred from the RRSP (referred to as a Qualifying Transfer).

Past Service benefits can be recognized for service going back to 1991. In specialized cases, service prior to 1991 can be recognized. The table below highlights the IPP Advantage for a 60 year old IPP member who has average historical T-4 earnings of $144,500, with various periods of service:

IPP Member, Age 60 Maximum Average Earnings from 1991 to present			
	6 years	15 years	25 years
Total Value Past Service Benefits	$ 229,400	$ 573,500	$ 955,900
Less: Qualifying Transfer	144,500	373,200	573,800
Equals: Net Past Service Contribution	$ 84,900	$ 200,300	$ 382,100
Plus: Current Service Contribution	38,300	38,300	38,300
Equals: Net IPP Contribution	$ 123,200	$ 238,600	$ 420,400
Contrast: Eligible RRSP Contribution	$ 26,010	$ 26,010	$ 26,010

The above table shows that for a high earner with maximum service, first year IPP contributions are significantly higher than the amount that can be contributed to an RRSP.

3. T-4 Earnings

The third variable for determining tax deductible contributions to an IPP is the level of T-4 earnings paid to the IPP member. It is important to note that because IPP benefits are paid in relation to T-4 earnings, dividends and other forms of income do not qualify. Higher T-4 earnings will result in larger Past Service benefits, however, even relatively modest T-4 earnings can result in meaningful contributions. This is shown in the preceding table which is based on a member who is age 60, with 25 years of Past Service, with varying T-4 earnings levels:

IPP Member, Age 60 Various Average Earnings from 1991 to present			
	$50,000	$75,000	$144,500
Total Value Past Service Benefits	$ 452,900	$ 674,200	$ 955,900
Less: Qualifying Transfer	199,600	310,100	573,800
Equals: Net Past Service Contribution	$ 253,300	$ 364,100	$ 382,100
Plus: Current Service Contribution	13,300	19,900	38,300
Equals: Net IPP Contribution	$ 266,600	$ 384,000	$ 420,400
Contrast: Eligible RRSP Contribution	$ 9,000	$ 13,500	$ 26,010

Additional Special Features of IPPs

- Predictable income at retirement
- Higher contribution limits
- Effective tax reduction strategy
- Tax deductible contributions and expenses
- Protection from market risk
- Creditor proof
- Systematic savings
- Time to plan - 120 days after corporate year end to make contribution
- Ability to top-up past RRSP contributions
- Multiple retirement income options

Ideal IPP Candidates

- Business owner, incorporated professional or executive;
- Age 40 or older;
- T-4 earnnings

The IPP in Operation

Upon establishing an IPP, the IPP behaves quite similarly to an RRSP. Once the contribution amounts are calculated by the actuary, they are contributed to a trust and invested in a similar manner to an RRSP. Like an RRSP, the investment returns accumulate tax-free while in the IPP which allows for greater compounding of assets.

The table below shows asset accumulation at age 65 (from age 55) in an IPP versus an RRSP; assuming the same investment:

Accumulated Assets at Retirement Age 65 Various Average and Initial Earnings from age 55			
	$50,000	$75,000	$144,500
IPP Accumulation	$ 1,211,900	$1,802,700	$2,754,700
RRSP Accumulation	$ 568,400	$ 874,600	$1,635,100
IPP Advantage	$ 643,500	$ 928,100	$1,119,600

Table Assumptions

- Maximum contributions to IPP and RRSP, respectively
- Past Service from 1991 to present
- Current Service from age 55 to 65, for given initial earnings at age 55
- Future earnings assumed to increase at 5.5% per annum
- Investment earnings 7.5% per annum.

An IPP will result in significantly greater accumulation of assets using a vehicle that is similar in risk profile to an RRSP.

Investments

Generally stated, any investment that is available to an RRSP is permitted in an IPP. There are two notable exceptions. First, investment in one's own corporate stock, mortgage or debit is not permitted. Second, assets have to be invested in a diversified portfolio which generally limits investments to no more than 10% of the portfolio book value in any single security.

IPP Plan Wind-Up

While the IPP is in operation, no assets can be withdrawn. However, assets can be obtained from the IPP in one of three ways.

1. Transfer the IPP assets to an insurance company to purchase an annuity which will provide income for as long as you live (and which may include survivorship benefits to the spouse).

2. Wind-up the IPP and transfer the assets to a locked-in RRSP. Transferred assets can continue to accumulate tax free until the end of the year the former IPP member turns age 71.

3. Continue the IPP and pay a monthly pension from the IPP trust. The underlying corporation must continue to sponsor the IPP.

Summary

IPPs are retirement accumulation vehicles and replace the basic RRSP vehicle for business owners, incorporated professionals and executives. IPPs offer a number of significant advantages over RRSPs and also provide a tax efficient method of transferring corporate assets to personal holdings.

For more information or to arrange a meeting please contact Lesniewski Moore Consulting Group Inc.

Mark Lesniewski
President & CEO
Calgary/Toronto

Dianne Verschuere
Executive Vice President
Calgary/Toronto

Lindsey McKinnon
Regional Vice President
Manitoba/Saskatchewan

1-888-228-9024
www.LMCGroup.ca