IPPs: Frequently Asked Questions

General IPP Questions

1 What is an IPP?

2 What is a defined benefit pension plan?

3 Who calculates the amount of contributions to an IPP?

4 Who can establish an IPP?

5 What is special about IPPs?

6 What criteria make an IPP advantageous for an individual?

7 Who is the ideal candidate for an IPP?

8 What is a “connected person”?

9 What are the different types of contributions that can be made to an IPP?

10 Can contributions made to an IPP be withdrawn at any time?

11 Are contributions to an IPP locked-in?

12 Can “past service” be provided when the individual has contributed to a spousal RRSP?

13 What if I have already made my current year’s RRSP contribution?

14 What if I have unused RRSP room at the end of the previous year?

15 What happens if my ability to contribute to the IPP is reduced?

16 Who is the plan administrator and plan sponsor?

17 What is the role of the Trustee?

Questions on the fiscal aspects of IPPs

18 Are IPP contributions tax deductible?

19 Are there other tax deductions related to IPPs?

20 When can you start contributing to an IPP?

21 How much time do you have after the end of the fiscal year to make a contribution to an IPP so that the contribution will be deductible for the fiscal year in question?

22 When does an IPP have to be in place in order for the company to deduct contributions to the IPP for a given fiscal year?

23 What qualifies as T4 income?

Questions on the legal aspects of IPPs

24 Who regulates IPPs?

25 Can the amounts contributed to an IPP be seized by creditors?

26 What happens to an IPP if the company that established it is sold?

Questions on the process of establishing an IPP

27 How can I find out the amount of contributions that can be made into an IPP?

28 What are the steps required to establish an IPP?

29 Why does Buck’s illustration use $100,000 for the 1990 salary?

30 Is there a specific naming convention the IPP must follow?

Questions on the advantages and considerations of IPPs

31 What are the advantages of IPPs versus RRSPs?

32 What are the main considerations for IPPs versus RRSPs?

General Information about Individual Pension Plans

1. What is an IPP?

An IPP is a defined benefit pension plan established by a company for one individual (sometimes two, if the participants are family members). The IPP was developed to offer the maximum benefits permitted by the Canada Revenue Agency.

2. What is a defined benefit pension plan?

As the name indicates, it is a pension plan where the benefits (or the amount of annuities or payments) are defined in advance. The amount of contributions required to fund the promised benefits must therefore be calculated based on a set of assumptions.

3. Who calculates the amount of contributions to an IPP?

An actuary must calculate and certify that the IPP contribution calculation complies with legal requirements.

4. Who can establish an IPP?

Like all pension plans, an IPP must be established by an incorporated company. An individual who wants an IPP must first convince the company that he/she works for to establish the IPP.

5. What is special about IPPs?

For participants meeting certain criteria, IPPs allow for much higher employer tax-deductible contribution amounts than the maximum permitted for RRSPs.

6. What criteria make an IPP advantageous for an individual?

IPPs are most advantageous for an individual who is 40 years of age or older, and who wants to contribute more money on a tax-sheltered basis than the maximum permitted for RRSPs. There's no specific criteria related to the salary of the individual; however, the financial advantages of IPPs increase in relation to the individual's salary up to a maximum.

7. Who is the ideal candidate for an IPP?

Incorporated business owners that meet the criteria outlined above are ideal candidates to establish IPPs for themselves, since a company must establish an IPP and these individuals have the authority to make these types of decisions on behalf of their companies.

8. What is a "connected person"?

A "connected person" is a person who directly or indirectly (spouse, brother, sister, child, grandchild, father, mother) holds at least 10% of a company's shares or the shares of any other corporations linked to the company.

9. What are the different types of contributions that can be made to an IPP?

- Annual contributions: always greater than the maximum permitted by an RRSP for an individual that meets the criteria described above;
- Past service contributions: It is possible to purchase additional years of service in an IPP. It will be necessary to transfer an amount from the participant's RRSP to his/her IPP for the company to contribute the balance of the cost of the past service.
- An additional contribution at retirement: certain benefits cannot be pre-funded due to limitations imposed by the Income Tax Act.
- An additional contribution when terminating the IPP, if annuities are purchased: it is possible to purchase the benefits payable from an IPP from an insurer; in which case, an additional contribution may be required if annuity interest rates are less than 7.5%.

10. Can contributions made to an IPP be withdrawn at any time?

No. Contributions to an IPP cannot be withdrawn for any reason other than for the payment of benefits. When the IPP is terminated, the amount can be transferred to another registered retirement savings product subject to a maximum or used to purchase an annuity.

11. Are contributions to an IPP locked-in?

Yes – generally contributions from an IPP are locked-in on termination. The allowable transfer would be sent to a locked-in registered fund. For connected members, in the Province of Quebec, different rules apply as well as in the Province of Prince Edward Island.

12. Can "past service" be provided when the individual has contributed to a spousal RRSP?

Generally, no. If the individual's contributions in the past have always been to a spousal RRSP, it is unlikely there will be enough room to have the past service certified by CRA. Normally, an individual who has maximized their RRSP contributions can only receive past service benefits by transferring RRSP assets to the IPP or by making a withdrawal. Because the spousal RRSP will not be in the individual's name, a transfer or a withdrawal would not be possible. Any unused RRSP room or personal RRSP funds would need to be used to credit some past service.

13. What if I have already made my current year's RRSP contribution?

You may have to withdraw a part of your RRSP contribution, without penalty or withholding tax.

14. What if I have unused RRSP room at the end of the previous year?

This RRSP room may be used to increase IPP funding for past service.

15. What happens if my ability to contribute to the IPP is reduced?

In certain provinces, once the IPP is established, there is an ongoing obligation to make contributions. However, in the event of cash flow difficulties, it may be possible to suspend contributions. When conditions improve, contributions may be resumed. If necessary, the IPP may be wound up at any time. If the IPP is not required to be registered provincially, there are no minimum funding requirements and therefore contributions do not have to be made.

16. Who is the plan administrator and plan sponsor?

Both the plan administrator and plan sponsor are simply the company that is establishing the IPP.

17. What is the role of the Trustee?

An IPP requires either a corporate trustee or 3 individual trustees to be appointed. The corporate trustee can be very expensive and the assets would most likely have to be held off-book. All 3 trustees must be Canadian Residents. The RBC DS IPP requires 3 individual trustees where one of the trustees must be considered an "independent trustee". An "independent trustee" is one who is not a significant shareholder, partner or employee of the employer or a proprietor of the business of the employer. (for example an accountant, cousin, in-law).

The responsibility of the Trustees is to oversee the Trust. Any one of the Trustees (or all 3 Trustess depending on the terms of the Trust Agreement) has the power and authorization to:

- Delegate custodial responsibility to RBC Dominion Securities
- Satisfy their responsibilities under this trust agreement and exercise all their powers as if they owned the Fund

and by working in concert with the RBC DS Investment Advisor.

- Buy/sell any assets of the fund
- Exercise all voting rights pertaining to equities, bonds or any other instruments of the Fund conferring such voting rights
- Execute any and all transactional documents that may be required to execute the powers conferred by this agreement

It is important to note that individuals acting should have some knowledge regarding pension fund investments and custodial arrangements to act as pension plan trustees. They may have certain liability to act as trustees.

Questions on the fiscal aspects of IPPs

18. Are IPP contributions tax deductible?

Yes, contributions made to an IPP are tax deductible for the employer, or for the participant, if he/she contributes directly to the IPP. In addition, contributions made to an IPP are not subject to payroll taxes.

19. Are there other tax deductions related to IPPs?

In addition to deducting company contributions, an employer can deduct administrative and investment costs related to an IPP, as well as the interest on any amounts that the employer has to borrow to make the company contributions to the IPP.

20. When can you start contributing to an IPP?

Contributions can be made as soon as the documents required to register the IPP with the government authorities have been submitted.

21. How much time do you have after the end of the fiscal year to make a contribution to an IPP so that the contribution will be deductible for the fiscal year in question?

Contributions made during the 120 days after the end of the company's fiscal year end, and which were payable over the course of the fiscal year, can be deducted for this fiscal year.

22. When does an IPP have to be in place in order for the company to deduct contributions to the IPP for a given fiscal year?

In order to deduct contributions for a given fiscal year, all of the documents required to register the IPP with government authorities must be submitted before the end of the 120 days after the fiscal year in question.

23. What qualifies as T4 income?

Although most of the types of income reported on a T4A would not be pensionable for the reason that they are taxable under section 56 rather than under sections 5 or 6 of the ITA, there are some types of income reported on a T4A that are taxed under section 6 as "taxable benefits" provided by an employer, and thus, could be included in pensionable earnings.

By comparing the T4A boxes to section 6 of the ITA, this would include:

- premiums for medicial benefits paid by the employer,
- premiums for a group term life insurance plan paid by the employer
- payments from a wage loss replacement plan (that qualifies as a sickness or accident insurance plan, disabililty insurance plan or income maintenance plan contributed to by the employer)

- lump sum payments from an employee benefit plan (other than death benefits and payments attributable to period when the employee was not resident in Canada)
- and any other type of income reported under box 28 (Other Income) under code 16 (any other amount) that is taxed under section 6 of the ITA.

Questions on the legal aspects of IPPs

24. Who regulates IPPs?

- Canada Revenue Agency: defines the maximum benefit that can be granted within an IPP and, consequently, the maximum contributions that can be made to an IPP;
- Provincial laws on pension plans: define the rules governing minimum funding requirements;
- Regulations on pension plan investments: establish how IPP funds can be invested.

25. Can the amounts contributed to an IPP be seized by creditors?

As long as the amounts are within the IPP, they are generally protected from creditors. However, the benefits payable can be seized.

26. What happens to an IPP if the company that established it is sold?

The new owners have the choice of terminating or continuing the IPP. Determining what to do with the IPP should be discussed during the negotiations surrounding the sale. A transfer of sponsorship may be possible if certain conditions are met.

Questions on the process of establishing an IPP for a prospect

27. How can I find out the amount of contributions that can be made to an IPP?

After completing an IPP client information form provided by your Investment Advisor, WMSS will prepare a personalized illustration. The documents that you will receive will outline the main characteristics of IPPs and show the amount of contributions that could be made in your specific situation.

28. What are the steps required to establish an IPP?

- Provide the necessary information to produce a personalized illustration;
- Review the illustration; in particular the amounts that could be contributed to an IPP;
- Complete an Engagement & Implementation Form to hire Buck Consultants Limited to set-up an IPP;
- Discuss the investment strategy for the IPP funds.

29. Why does Buck's illustration use $100,000 for the 1990 salary?

The maximum RRSP contribution in 1990 (up to a maximum of 11,500$) was based on a maximum salary of 100,000$. CRA needs to use the client's actual 1990 T4 salary (regardless of who he/she was working for at the time) to determine the RRSP deduction limit for the year the IPP is implemented. Buck's illustration simply uses 100,000$ to demonstrate the maximum amount of RRSP contribution that could be available to the client in the year they open the IPP.

30. Is there a specific naming convention the IPP must follow?

Yes, the IPP name on all documents needs to be the same, in order to avoid any confusion from CRA when the actuarial firm requests a registration number for the plan upon set up. At DS, the naming convention is as follows:

IPP of <Company Name> for <Beneficiary Name (s)>
For example: IPP of Widgets Incorporate for Joseph Peter Smith

Questions on the advantages and considerations of IPPs

31. What are the advantages of IPPs versus RRSPs?

The main advantages for individuals meeting the criteria described above are as follows:

- Annual contributions greater than to an RRSP;
- Possible to make contributions for past service;
- Additional contribution at retirement;
- Potential for additional contribution if an annuity is purchased;
- Ability to compensate for investment losses through additional contributions;
- Generally protected against creditors.

32. What are the main considerations for IPPs versus RRSPs?

- Income splitting in the form of a spousal contribution is not allowed with an IPP;
- High levels of surplus in the plan may limit future contributions, while a deficit in the plan may require additional funding;
- IPPs are subject to pension legislation at both the federal and provincial levels, which will result in "locking-in" requirements, except in certain provinces;
- Expenses for the plan set up, administration and wind up are higher than those of an RRSP.

33. Didn't the government change the rules revolving IPP's making them non-attractive?

Although some significant changes were proposed, for the most part things are back to the way they used to be. Please view this document prepared by Buck Consultants that shows exactly what impact this has had: http://advisornet.fg.rbc.com/individualpensionplans/file-604822.pdf.

Two important points however:

1 – In the first 60 days of the year in which an IPP is established, YOU CAN contribute to your RSP. This amount MUST be deducted for the previous taxation year however, or else the client will need to remove this amount from his/her RRSP.

2 – Generally, you cannot use unused RRSP contribution amounts for future carry forward RRSP deductions. Since the CRA will do a revised notice of assessment for the client only once the IPP is established, the clients MAY be still able to have some contribution amount available for future deductions, (other than the 600$/year) although this would only be applicable if the client had T4 income in 1990, and would be based on 18% of that income, up to a maximum of 11,500$. Until they receive this new assessment, clients should definitely be advised NOT to contribute to their RRSP for current year deductions if they are planning to open an IPP in the same year, as penalties from the CRA will arise.

34. Can money from a LIRA or Locked-in RSP be used for the RSP qualifying transfer?

Yes. Provided there are no legal or investment restrictions on the account, LIRA/LRSP transfers can be used as RRSP qualifying transfers into an IPP to credit past service.

Questions on maturity options of IPPs

35. What happens to the IPP funds if your employment or the plan is terminated?

The IPP funds are transferable to another registered product, but are subject to maximum transfer rules. Generally, any money in excess of the maximum transfer limit will be paid in cash to the member, and will be taxable. If you are eligible for early retirement, the same options are available as outlined below.

36. What are my payment options in retirement?

As a pension plan, the IPP must be used to finance a lifetime pension income. The IPP may be funded until the retirement date, or it may be terminated prior to retirement, in which case the pension payments may be deferred to a later date. At retirement, one of the following three options are available:

- Pension payment from the plan (Company must remain open)
- Transfer the IPP to a registered product
- Purchase of an annuity from an insurance company

37. If I retire before turning 65 will I be able to get my IPP pension right away?

Yes, you can get your pension before you turn 65. An IPP may begin paying a pension as early as age 50, or as late as the year-end in which the individual turns 71.

38. What happens to the IPP funds that remain after my death?

The IPP provides for a survivor pension and for guarantee periods. Should you die before the end of the guarantee period, the full amount of the pension will continue to be paid to your spouse or other designated beneficiary for the remainder of that period. After the guarantee period, the normal form of pension provides for the continuation of the pension payments to an eligible surviving spouse at a rate of 66-2/3% of the IPP participant's pension.

39. What happens on the death of the last person entitled to benefits under the IPP?

Anything left in the IPP fund is surplus that belongs to your estate and would be distributed in accordance with your beneficiary designation or your Will. The fund becomes entirely surplus, because all liabilities end when the last beneficiary of a pension promise under an IPP dies. Your beneficiaries will be subject to income tax when they receive their share of the surplus. Contrast this result with an RRSP or RIF, where your estate is taxed, on your final income tax return, on the residual value, subject to limited deferral provisions. The IPP shifts the income tax burden on the residual funds to your beneficiaries, which may result in a lower level of income tax on those funds.

buckconsultants

RBC Wealth Management
Dominion Securities

The information in this document is based on data that we believe is accurate and complete, but we do not represent or warrant that it is accurate or complete and it should not be relied upon as such. This publication is for information only and should not be construed as offering tax or legal advice. Consult your lawyer, accountant or other professional advisor when planning to implement a strategy. This information is not investment advice and should only be used in conjunction with a discussion with your RBC Dominion Securities Inc. Investment Advisor.

RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. RBC Dominion Securities Inc. is a member company of RBC Wealth Management, a business segment of Royal Bank of Canada. ®Registered trademarks of Royal Bank of Canada. Used under licence. ©2012 Royal Bank of Canada. All rights reserved. (05/2012)