

# Individual Pension Plans (IPPs) and Retirement Compensation Arrangements (RCAs)

August 2007

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# Disclaimer

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- ▶ The following information is presented on the understanding that it is for education and information purposes only. Neither RBC nor the presenter has been retained to provide legal, taxation, or accounting advice.
- ▶ Individuals should consult with their own professional advisors to determine the suitability of the information and examples contained in this presentation before acting upon them.

# Agenda

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- ▶ IPP Refresher
- ▶ Introducing RCAs
- ▶ RCA Candidates
- ▶ Numerical Example
- ▶ Contrasting IPPs and RCAs

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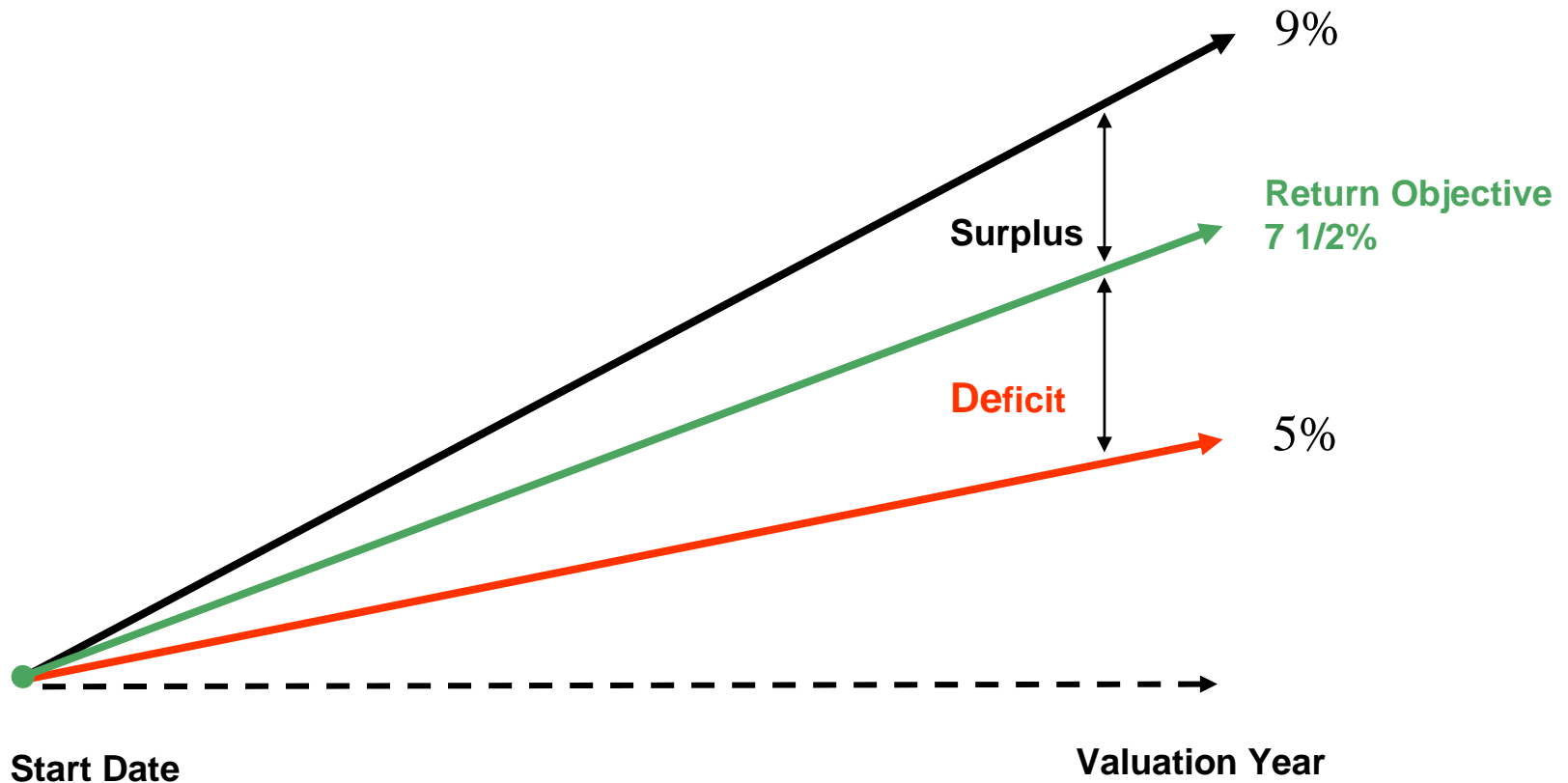
# IPP Refresher

# What is an Individual Pension Plan

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- ▶ Defined Benefit Registered Pension Plan (RPP) typically for one or two members
- ▶ Designed to maximize contributions permitted by the Income Tax Act
  - Maximum pension benefit of \$2,222 per year of service (2007)
  - Maximum benefit achieved with earnings of \$111,111
- ▶ Significantly higher contributions possible than in RSPs
  - Gap increases with age

# Investment Strategy?



- ▶ Additional contributions can be made to shore up any deficit
- ▶ Some measure of surplus can be retained without limiting contributions (generally 2 times annual contribution)

# Eligible Employer Tax Deductions

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- ▶ Current service contributions
- ▶ Past service top up contribution
- ▶ Contributions to shore up any future funding deficits
- ▶ Optional contributions at retirement (“terminal funding”)
- ▶ Interest on loan to make an IPP contribution
- ▶ Actuarial, administration and accounting fees
- ▶ Investment management fees

# Suitable Candidates

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Incorporated Business owners

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Incorporated professionals

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Senior executives

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## Works best for

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- ▶ Individuals between the ages of 40 and 71
- ▶ Individuals earning T4 income of \$111,111 or more
- ▶ Individuals with past service dating back to 1991

# IPPs and RSPs – A comparison

Age in 2007	Maximum 2007 RSP Contribution	Maximum 2007 Current Service IPP Contribution	Maximum Past Service Employer Contribution (*)	Maximum First Year Tax-deductible IPP Contribution
40	\$19,000	\$20,694	\$48,069	\$68,763
45	\$19,000	\$22,730	\$80,659	\$103,389
50	\$19,000	\$24,967	\$116,456	\$141,423
55	\$19,000	\$27,423	\$155,775	\$183,198
60	\$19,000	\$30,128	\$199,058	\$229,186
65	\$19,000	\$45,629	\$517,657	\$563,286
70	\$19,000	\$50,472	\$608,871	\$659,343

\* Assumes past service to 1991 and \$111,111 annual income. RSP transfer of \$273,000 not included.

# Fees for IPP services provided by Buck Consultants

<b>Single member plan</b>	
Documentation:	\$1,500
Initial Actuarial Valuation:	<u>\$1,800</u>
<b><u>Total Year One Cost:</u></b>	<b><u>\$3,300</u></b>
<b>Annual Administration</b>	<b>\$750</b>
( i.e. T3P, PA factor, contribution monitoring, Annual Information Return, IIS)	
<b>Periodic Valuations</b>	
Each 3 <sup>rd</sup> or 4 <sup>th</sup> Year:\$1,500	

<b>Two member plan</b>	
Documentation:	\$1,500
Initial Actuarial Valuation:	<u>\$2,700</u>
<b><u>Total Year One Cost:</u></b>	<b><u>\$4,200</u></b>
<b>Annual Administration</b>	<b>\$750</b>
( i.e. T3P, PA factor, contribution monitoring, Annual Information Return, IIS)	
<b>Periodic Valuations</b>	
Each 3 <sup>rd</sup> or 4 <sup>th</sup> Year:\$2,250	

\* Additional fees may include provincial registration of the plan (where applicable), special services provided by Buck Consultants, and plan termination costs. Quotes for special services and plan termination will be provided to the plan sponsor in advance.

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# Introducing RCAs

# What is an RCA ?

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- ▶ Retirement Compensation Arrangements (RCAs) are non-registered retirement savings plans
- ▶ Purpose must be to eventually provide benefits upon retirement, death or termination of employment
- ▶ Allows for payment of benefits in excess of those payable in registered pension plans
- ▶ As such, they are one form of Supplemental Employee Retirement Plan (SERP)
- ▶ Often layered on top of a registered pension plan / IPP
- ▶ Must be sponsored by a company

# RCA – Reasonableness Test

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- ▶ Applied by the Canada Revenue Agency (CRA)
- ▶ Benefits similar to RPPs are generally acceptable
  - 2% of average of highest 3 years of indexed earnings for each year of service (with no cap on earnings level)
  - Offset by any benefit payable from a registered pension plan
- ▶ CRA may question arrangements where formulas are excessive or where funds are returned to the company
- ▶ May declare the RCA a Salary Deferral Arrangement
  - All RCA funds would become immediately taxable

# RCA – Structure

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- ▶ A trust fund must be established as the RCA Investment Account (RCAIA)
- ▶ A Refundable Tax Account (RTA) must be opened with the Canada Revenue Agency (CRA)
  - Earns no interest or investment income
  - Refunded as benefits are paid
- ▶ Actuarial assumptions determined by actuary
  - Not prescribed as is the case for IPP's
  - Set according to professional standards of practice
- ▶ Employee contributions not permitted
  - Unless required as a condition of employment

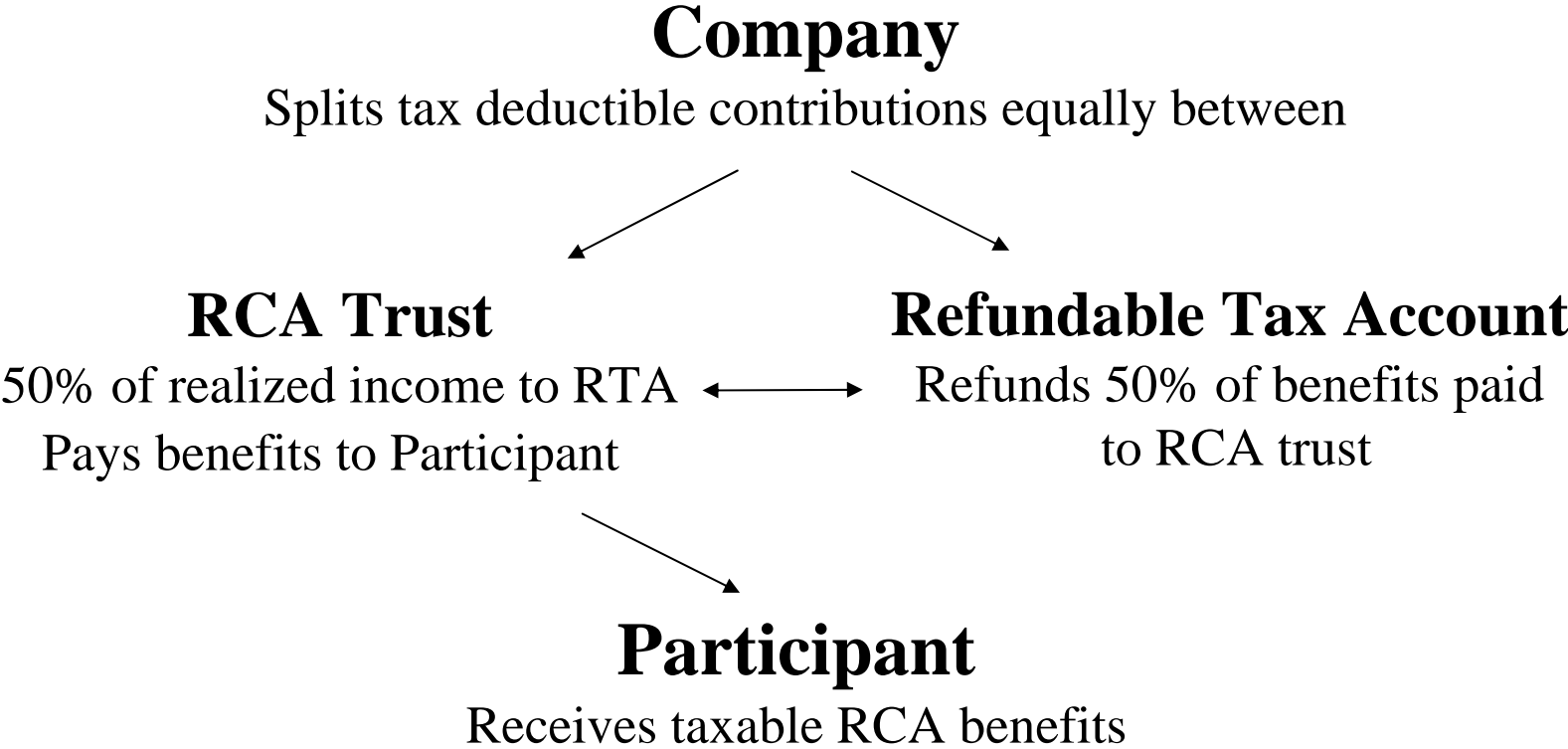
# RCA – Taxation

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- ▶ Contributions to an RCA are
  - 100% deductible to the Company acting as the plan sponsor
  - Not subject to payroll taxes
  - Not taxable to the Participant while in the RCA
  - 50% must be deposited in the RTA
- ▶ 50% of all realized investment income in the RCA Investment Account must be deposited in the RTA
- ▶ Benefits are taxable to the Participant only upon receipt
- ▶ RTA refunds the RCA Investment Account \$1 for every \$2 of benefits paid

# RCA – Flow of money

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# RCA Candidates

# Who is an RCA candidate?

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- ▶ Maximum benefit under most generous registered plans (2% / year of service) reached at earnings level of \$111,111
- ▶ 70% replacement ratio\* achieved with 35 years of service if earnings are below \$111,111
- ▶ Higher earnings are simply not covered by registered plans
- ▶ High income earners are therefore subject to pension discrimination: lower replacement ratio for same service
- ▶ RCAs can bridge the gap

\*Ratio of pension over pre-retirement salary level; 70% is widely believed to be an adequate ratio with which to maintain one's lifestyle

# Who is an RCA candidate?

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- ▶ Incorporated professionals
- ▶ Key employees that companies want to retain
  - Can specify age/service conditions for payment of benefits (“golden handcuffs”)
- ▶ Successful business owners
  - Family members can participate if also employees
- ▶ Participants who will retire in a low-tax jurisdiction
  - Different province
  - Country with favourable tax treaty

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# Numerical Example

# RCA – Characteristics of Participant Illustrated

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## Participant profile

- ▶ Age 55 at 1-1-2007
- ▶ With past service from January 1, 1991
- ▶ Earnings of \$250,000 in 2007
- ▶ Considering retirement at age 71
- ▶ Has an IPP with past service from Jan. 1, 1991

# RCA – Past service

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- ▶ Cost of providing past service: \$1,015,400
- ▶ This amount can be:
  - Contributed in a lump sum
  - Amortized over a period of time (up to retirement)
    - Ex. Payments of \$79,800 per year for 16 years
  - Contributed on an irregular payment schedule, as desired

# RCA – Current Service Contributions

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▶ The following amounts can be contributed in addition to any past service contributions

	<b>Age</b>	<b>Contribution</b>
<b>2007</b>	55	\$ 63,500
<b>2012</b>	60	\$ 74,500
<b>2017</b>	65	\$ 87,400
<b>2022</b>	70	\$ 102,500

## RCA – Participant Age 55 – Accumulation

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- ▶ The RCA balances at the end of the calendar year supposing past service is contributed in a lump sum and that the RCAIA earns 6.5%

	<b>Age</b>	<b>Market Value</b>
<b>2007</b>	55	\$ 1,096,400
<b>2012</b>	60	\$ 1,664,900
<b>2017</b>	65	\$ 2,397,700
<b>2021</b>	70	\$ 3,334,600

- ▶ Amounts include both the RCAIA and RTA accounts

# RCA – Pension Options

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- ▶ At retirement, the RCA can either pay an indexed lifetime pension or be liquidated over a certain number of years
- ▶ In our example, the annual pension would start at \$183,700 from age 71 and be indexed to full cost-of-living each year
- ▶ If liquidated instead, annual payments would be:

<b>Period</b>	<b>Annual amount</b>
5 years	\$ 710,200 /yr
10 years	\$ 383,500 /yr
20 years	\$ 222,100 /yr

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# Advantages and Considerations

# Advantages of an RCA

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- ▶ Replacement to “bonus-down” strategy to reach small business corporate taxation levels
- ▶ Better income replacement at retirement
- ▶ Great to attract and retain key employees
- ▶ Contributions 100% deductible and no payroll taxes apply
- ▶ No impact on the participant’s RRSP contributions
- ▶ Offer maximum payout flexibility
- ▶ Not subject to probate fees after death
- ▶ Generally creditor protected

# Considerations

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- ▶ RTA earns no investment income
- ▶ Less tax-efficient than a registered pension plan (RPP)
- ▶ Requires annual regulatory filings

# RCA – Highlights

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- ▶ Retirement benefits on earnings above maximum pensionable
- ▶ Set up by a company for an employee
- ▶ Contributions are deductible to the Company
  - 50% of all contributions and realized investment income must be deposited in a Refundable Tax Account
- ▶ Funded with traditional investments or a life insurance policy
- ▶ Not subject to provincial pension legislation
- ▶ Funds are generally creditor protected

# Fees for RCA services provided by Buck Consultants

<b>Single member plan</b>	
Documentation:	\$1,500
Initial Actuarial Valuation:	<u>\$3,500</u>
<b><i>Total Year One Cost:</i></b>	<b><u>\$5,000</u></b>
<b>Annual Administration</b>	<b>\$500</b>
( i.e.T3-RCA, Annual RTA remittance, T737-RCA, Contribution Monitoring)	
<b>Periodic Valuations</b>	
Each 3 <sup>rd</sup> or 4 <sup>th</sup> Year:	\$1,500

<b>Two member plan</b>	
Documentation:	\$1,500
Initial Actuarial Valuation:	<u>\$5,250</u>
<b><i>Total Year One Cost:</i></b>	<b><u>\$6,750</u></b>
<b>Annual Administration</b>	<b>\$500</b>
( i.e. T3-RCA, Annual RTA remittance, T737-RCA, Contribution Monitoring)	
<b>Periodic Valuations</b>	
Each 3 <sup>rd</sup> or 4 <sup>th</sup> Year:	\$2,250

\* Additional fees apply for additional benefit/contribution processing and for special services provided by Buck Consultants, including plan termination costs. Quotes for special services and plan termination will be provided to the plan sponsor in advance.

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# Contrasting IPPs and RCAs

# Contrasting IPPs and RCAs

IPP	RCA
<b>Most tax efficient</b>	<b>Tax efficiency varies</b>
<b>All contributions invested in IPP investment account</b>	<b>50% of contributions must go to CRA in Refundable Tax Account</b>
<b>For connected members*, past service often eligible only from 1991</b>	<b>Past service eligible for all years from date of hire, without restriction</b>
<b>IPP benefit maximized at \$111,111 earnings level (\$2,222 / yr of service)</b>	<b>RCA benefit is 2% / year of service, with no limitation on earnings level (less any RPP benefit)</b>
<b>At retirement, lifetime pension payable or plan wind-up and funds transferred (all or part of which may be locked-in)</b>	<b>At retirement, lifetime pension payable or RCA liquidated over shorter period of time (e.g. 5 years, 10 years, etc.)</b>
<b>Latest retirement at end of calendar year where participant reaches age 71</b>	<b>No fixed limit on allowable retirement age</b>
<b>Investments subject to diversification and “prudent person” approach</b>	<b>No investment restrictions. Seek to minimize realized investment income</b>

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Thank you!