



Wealth
Management

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Using Individual Pension Plans to increase retirement income

An Individual Pension Plan (IPP) is a defined benefit pension plan that must conform to the Income Tax Act as well as the requirements of the Canada Revenue Agency (CRA), and is typically established by a company for a single person. By providing the maximum benefits permitted under the Income Tax Act, an IPP generally allows higher tax-deductible contribution amounts than those permitted under an RRSP. For individuals who wish to maintain their pre-retirement lifestyle when retired, IPPs are an effective way to accumulate tax-sheltered funds.

Under a defined benefit pension plan, the annual retirement benefit is determined in advance, based on T4 income and eligible years of service with the employer. The required employer contributions to fund the pension benefit are calculated using prescribed rules and actuarial assumptions resulting in a greater, more predictable accumulation of retirement capital.

Who can open an IPP?

IPPs are designed for incorporated business owners and incorporated professionals, deemed to be “connected” members who directly or indirectly (through a spouse or family member) own 10% or more of the company shares.

Ideally the candidate will be between the ages of 40 and 71, operates an incorporated business and has earned T4 income since the date of incorporation. This will create eligible years of past service allowing individuals to compensate for the years when corporate revenue was largely reinvested in the establishment and growth of the business.

“Non-connected” members, such as key employees of the sponsoring company, can also be considered for an IPP, however there are more stringent government rules applicable to non-connected individuals.



All IPP contributions, actuarial and investment management fees paid on a member's behalf are fully tax-deductible corporately.

Beyond RRSPs: The benefits of an IPP

The significant advantages of an IPP versus a registered retirement savings plan (RRSP) are derived directly from the different federal and provincial regulations governing each plan. The key benefits arising from these differences are:

- **Greater accumulation of capital.** IPP contributions for individuals 40 and over will be greater than the maximum allowable RRSP contributions.
- **Predictability.** Unlike the RRSP, because the contributions made to the IPP represent the increasing actuarial cost of the defined benefit accumulating with each additional year of service, the projected assets in the IPP can be more predictable.
- **Tax efficiency.** All IPP contributions, actuarial and investment management fees paid on a member's behalf are fully tax-deductible corporately. For the individual, IPP contributions are a non-taxable benefit and investment growth is tax deferred until withdrawn at retirement.

Pension income can be split with a member's spouse as soon as payments begin (as opposed to the age of 65 for RRSP assets that are converted to registered retirement income funds (RRIFs)).

- **Greater control of investment returns.** The contributions required to fund the IPP are calculated by an actuary using various assumptions prescribed by the Income Tax Act. If a deficit exists, the plan sponsor can make additional contributions to make up for the shortfall, translating into yet another important tax deduction.

Contributing to an IPP

An actuarial valuation determines all admissible contributions to an IPP.

- **Past service contributions.** A key advantage of an IPP is the ability to make tax-deductible contributions in respect of the member's service with the company prior to implementation of the IPP, dating as far back as 1991 or the member's date of hire.



When an IPP investment return falls short of the prescribed rate, the sponsoring company can make an additional tax-deductible contribution.¹

- **Current service contributions.**

This represents the employer cost of the defined benefit accrued in the current year. The employer has 120 days following the fiscal year-end to make the contribution and deduct it as an expense for the year in question.

- **Contributions to make up the gap between CRA-prescribed return and actual portfolio return.** When IPP investment returns fall short of the prescribed rate, the sponsoring company can make an additional tax-deductible contribution to “bridge” the difference.

- **Deductions.** The company has up to 120 days following the fiscal year-end to make a contribution for service before the end of the year and deduct it as an expense for the year in question.

- **Additional contributions at retirement.** Should the member elect to draw the pension benefit from the IPP, an optional contribution may be made by the employer to fund ancillary benefits which can only be funded at retirement.

3 retirement options

- **If the sponsor company remains active or becomes inactive,** a member can start receiving the pension benefits at any age before the end of the calendar year in which age 71 is attained. The normal form of this payment is a fully indexed pension that continues at 2/3 to any surviving spouse with a guarantee of at least five years of full payments.
- **If the sponsor company is sold** or the business owner does not receive pension benefits, the IPP winds-up with the commuted value transferred out to another registered plan such as an RRSP, RRIF, Life Income Fund, or a Locked-in RRSP. Any excess of funds are payable as a cash payment and subject to taxes.
- **If a member wants their benefit to last their lifetime,** an annuity can be purchased from an insurance company.



Depending on your province, mandatory funding may be required if your investment returns are too low.

Considerations before establishing an IPP

While an IPP offers several important advantages, there are some additional considerations to take into account, including:

- **Complexity of the plan.** An actuarial valuation is required at the time the IPP is set up, and every three to four years thereafter, depending on the province.
- **Ongoing fees and costs.** Annual IPP administration fees are higher than the fees to administer an RRSP.
- **Contribution room.** Your RRSP contribution room is reduced by contributions made.

To learn more about IPPs, and to have a personalized IPP illustration created for you, please contact us today.



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1. The actual surplus/deficit of the plan will be calculated by the actuary and involves taking into account other economic factors, such as inflation and indexing, to determine the required rate of return.

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