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Increasing retirement income with an Individual Pension Plan

An Individual Pension Plan (IPP) is a defined benefit pension plan that must conform to the Income Tax Act (ITA) 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, giving the individual greater control over the investment of the funds and 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, will have been incorporated since 1991 and has earned T4 income since the date of incorporation. This will create eligible years of past service, beginning in 1991, allowing individuals approaching retirement 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 the more stringent government rules applicable to non-connected individuals create an irrevocable funding commitment for the employer.

The advantages of an IPP versus an RRSP are derived directly from the different federal and provincial regulations governing each plan.

A key advantage of an IPP is the ability to make tax-deductible contributions.

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 age 65 for RRSPs).
- **Greater control of investment returns**. CRA assumes that assets in an IPP will grow at a net annual rate of 7.5%. To the extent the fund does not attain this benchmark in a given period of time, based on the participant's risk profile and portfolio structure, the sponsoring company can make a tax-deductible contribution to "bridge the gap" between the prescribed rate and actual performance. In this manner the individual can accumulate a predictable pool of capital reflecting a net rate of return of 7.5%, on a tax-assisted basis.
- **Security**. The assets held in an IPP may offer potential protection from creditors. It is essential that you speak with a qualified legal advisor regarding any asset protection options available to you.

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.

- **Current service contributions** represent 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.

- **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.

- **Retirement options**. Typically, when the participant retires, either the company becomes inactive or has been sold, in which case there is no longer an active plan sponsor. Although the participant can choose to receive the pension directly from the IPP, it is more common to wind up the IPP at retirement and transfer the value to another registered plan such as a Life Income Fund, Locked-in RRSP or an insured annuity.

Depending on your province, additional 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.

- **Reduced RRSP contribution room**, and restrictions on contributing to a spousal RRSP once your IPP is established.

- **Potential contributions may be required**. Depending on your province, additional funding may be required if your investment returns are too low.

Contributions to an IPP assume a CRA-prescribed 7.5% rate of return.

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

Sample IPP Illustration

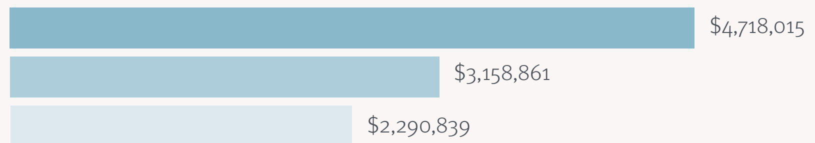
Contributions to an IPP assume a CRA-prescribed 7.5% rate of return. In this example, a 55-year-old business owner, who has 25 years of service with his sponsor company and a salary of $145,000, is saving until age 71. He can compare his projected income from an IPP versus an RRSP at the same or lower rate of return.

Past service with the company can be recognized as long as you transfer a portion of your RRSP into the IPP. If your IPP investment returns fall short of the prescribed rate, your sponsoring company makes an additional tax-deductible contribution to "bridge" the difference.

With an IPP at 7.5%

RRSP alone at 7.5%

RRSP alone at 5%



Required RRSP transfer to recognize past service in the IPP:	$573,810
Tax-deductible corporate contribution relating to past service:	$256,882

Source: Buck Consultants. For illustrative purposes only. Results are not guaranteed.

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