Individual Pension Plans Uncovered

By Gordon B. Clarke, CPP, CIM, OLS (Retired)

The February 2003 budget announced long awaited increases in RRSP contribution limits. These have been proposed for many years and are welcomed by Canadians who are saving for retirement. But for many it still falls short of the mark. That is because for anyone currently making over $80,500, the limits that the government puts on his or her contributions are such that the RRSP's may not be sufficient to adequately fund a retirement. However there is another option called an Individual Pension Plan (IPP) that may be of interest to certain individuals.

An IPP is a defined benefit pension plan established for one or more members of an incorporated business. It is a relatively new concept, having been permitted by Federal law since 1991 with the intention of providing senior executives and business owners with the opportunity to achieve maximum tax relief combined with an indexed retirement pension. It offers many advantages over a traditional RRSP.

- Generally larger tax deferred contributions are permitted than with a RRSP;
- Contributions increase with age;
- Past service contributions may be possible;
- Unlike most RRSP's, an IPP is creditor proof;
- Additional contributions may be made to an IPP to make up for poor investment returns;
- Upon death, transfers of the IPP to a spouse may occur on a tax free, rollover basis;
- Beneficiaries beyond the spouse, as opposed to the RRSP/RRIF, are taxed in the hands of the beneficiaries;
- Contributions to pre-2003 employment years may be paid immediately in a lump sum or amortized over 15 years;
- An IPP may be implemented for ages up to age 69; and
- When the funds within the IPP are surplus to the pension needs, the surplus may be accessed.

The disadvantages are as follows:

- Once an IPP is established, there is an ongoing obligation to make

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contributions. However in the event of cash flow difficulties, contributions may be suspended or the plan may be wound up;

- As a registered pension plan, an IPP must adhere to Federal and Provincial regulations, which means that there are setup and administration fees including actuarial evaluations;
- Funds are locked in and cannot be used before retirement;
- There is a loss of income splitting opportunities since, unlike a spousal RRSP, an individual cannot contribute on behalf of a spouse. The spouse may, however, also be a plan member if he or she receives T4 remuneration from the sponsoring employer; and
- Unplanned contributions may be required if the plan's investments do not do as well as expected.

As you can see, an IPP is more complex than an RRSP but for anyone in their late 40's or older with an income of close to $90,000 or more, there is a potential for significant tax savings and also an opportunity to establish a defined benefit pension plan.

Recent legislation has now made it possible for many self-regulated professions to incorporate. Doctors, pharmacists, veterinarians and others who were previously restricted from becoming incorporated may now establish professional corporations. This gives them the opportunity to consider the tax saving potential of an IPP.

An IPP may also be available to anyone in a defined benefit pension plan who, upon retirement, establishes an incorporated business. For example, a police officer with 30 years of service who was planning on retiring and starting another career could have a pension within OMERS or PSPP with a value of well over $600,000. This pension could be transferred tax free into an IPP. This would create an inheritable estate that would not have been possible if a normal service pension option had been selected.

Individual Pension Plans are not well known but do deserve a look by anyone who meets the basic criteria of being a business owner and wouldn't mind saving taxes while funding his or her retirement.

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