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Tax Advisory Bulletin

Date: November, 2007

Re: Individual Pension Plan (IPP) [1]

The Individual Pension Plan is a defined benefit pension plan. Pension plan contributions increase with age. The older you are, the more your company can contribute to the plan. The assets in an IPP are locked-in and, with certain exceptions, may be used for retirement purposes only. This helps protect your retirement benefits. All Individual Pension Plans require an incorporated company or Professional Corporation as plan sponsor.

There are many good reasons for you to consider an IPP:

- Further tax sheltering in excess of RRSP contributions
- Additional tax deductible lump sum contribution at retirement on sale of assets of the company or sale of the company itself
- More prudent investment rules and limitations than RRSPs
- Full creditor protection
- Pre-planned retirement income
- Succession planning within a family business

Your Pension Plan benefits are calculated based on your T4 or equivalent earnings, age and actuarial assumptions. T4 earnings can include T4PS (T4 Profit Sharing) or other forms. However dividends and management fees, where in the latter instance no source deductions were made, may not be included for plan purposes.

The actuary will calculate the sponsoring company's contributions. There is a mandatory actuarial valuation every three years (the triennial actuarial valuation).

When you retire you will have a choice of retirement vehicles. The choices are:

- a monthly pension from the plan,
- an annuity,
- a LIF or an LRIF.

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[1] The contents of this bulletin have been provided by Gordon B. Lang & Associates Inc., an actuarial consulting firm. The company has had considerable experience in forming and administering IPPs.

What is an IPP?

Most people are familiar with RRSPs, which are defined contribution plans. Contribution limits to RRSPs are set by Ottawa (currently 18% of prior year's earnings to a maximum of $20,000 for 2008, and $21,000 for 2009). However, what is not determined is the annual income you may receive from an RRSP on retirement.

An IPP is a defined benefit pension plan. It sets your monthly income at retirement. Covered earnings for pension plan purposes are up to $100,000, in 2005 dollars. An IPP permits the accumulation of greater assets, up to 60% more than an RRSP.

The IPP is similar to an RRSP in that it uses an investment account that accumulates over time to provide retirement benefits. Unlike the RRSP, the IPP provides certain guarantees. The amounts are locked in and may generally be used only for retirement purposes. Plan contributions are determined by a series of Actuarial Valuation Reports in order to provide sufficient assets at retirement.

Key Benefits of the Individual Pension Plan (IPP)

- Allows for larger tax deductions – up to 60% more in contributions into your retirement account
- The IPP is an excellent way to increase retirement assets and have your company make large tax deductible contributions
- Allows a significant tax deductible contribution at retirement
- Safer investment rules and limitations compared to RRSPs
- Allows for additional tax deductible contributions to be made by the company should the rate of return on plan assets be less than 7.5% a year
- Pension plan surpluses belong to the member.
- Provides pre-determined retirement benefits
- Ability to "succession plan" when family members work in the business
- 100% creditor proofing of plan assets
- No deemed disposition of plan assets upon death. Plan assets remain in the plan to provide benefits to surviving members.
- All costs associated with the pension plan are tax deductible to the company.

What you need to know

- Assets are locked-in and may, in most circumstances, only be withdrawn during retirement.
- There is little contribution flexibility – in most circumstances the plan must be funded each year.

Calculating Your Retirement Benefit

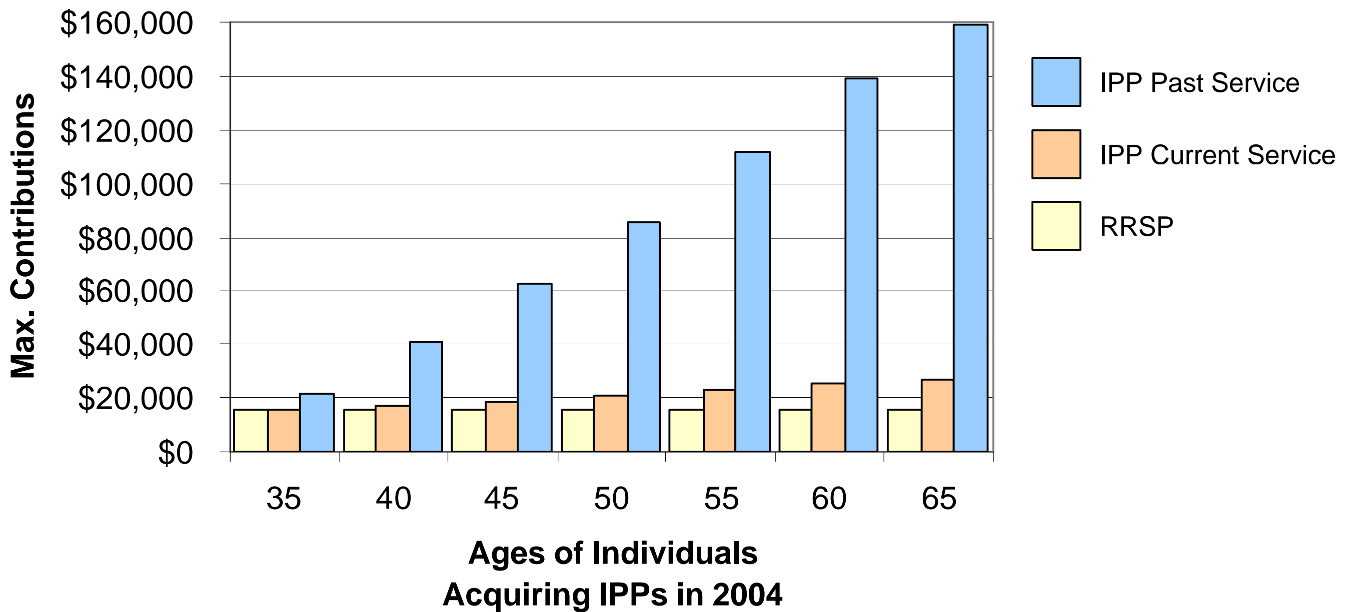
Your annual income at retirement age is calculated using:

- Your career T4 or pensionable earnings
- Your age
- Assumptions determined by the actuary, which are acceptable to CRA

Earnings are used to determine the amount you can contribute

Contributions are also graduated by age. The older you are, the more you can contribute. IPP Contributions first exceed RRSP Contributions around age 35. Above this age your IPP contribution room will be higher than your RRSP contribution room. See chart below.

To fully qualify for maximum IPP benefits, T4 earnings should be larger than $91,667 in 2004 dollars and you should be age 35 years or older.



Funding the Pension Plan

Once the actuary has estimated your retirement benefits, the annual contributions needed to fund those benefits are calculated.

The annual contributions compounded at a 7.5% net annual rate of return will ensure your plan has adequate assets to provide your retirement benefits.

A valuation is completed every 3 years by your actuary to ensure the plan stays on track.

Shortfalls in plan assets normally require further contributions to put the plan back on track. This tax-deductible additional funding can be made over a period of up to 5 years. By the same token, if a surplus is generated in the plan, the sponsoring corporation may be required to take a contribution holiday.

Retirement

Once you retire you will have a choice of retirement vehicles. The choices are a monthly pension from the plan, an annuity, a Life Income Fund (LIF), or a Life Retirement Income Fund (LRIF).

If you decide to purchase an annuity, you should have your financial advisor obtain a market comparison and choose the insurer. The plan will transfer funds to the life insurance company to purchase the annuity.

Annuities can be either single life, covering the life of the plan member only or, if married at date of retirement, a joint & survivor (J&S), with payments generally reducing on the death of the member. The J&S option often includes a minimum guaranteed period of 5 year and subsequent payments to the surviving spouse in full or reduced by a percentage selected at the time of retirement.

Who can take advantage of the IPP?

Key candidates for an IPP are business owners, their families, key executives and professionals with Professional Corporations.

The only stipulation is that the sponsoring company must be incorporated.

Who is the ideal candidate?

An owner, incorporated professional, or executive, age 35 and over, and earning over $100,000, is the ideal candidate.

An Illustration of an IPP with Full Past Service

Maximized Pension Plan Contributions
The service of the member can go back as far as Jan. 1, 1991
for past service purposes.

If the member is already incorporated and has been receiving income from the company, past service benefits may be included as if the member were in the plan. **Past service** is calculated from the later of January 1, 1991 and the date of incorporation of their company, even if they register their IPP in the current year.

This benefit can add up to tens of thousands of dollars in additional tax-free contributions.

To take advantage of this past service opportunity, you must rollover a **qualified transfer** in the form of RRSP assets and/or utilize unused RRSP room. The company would then fund the balance of the past service with tax-deductible contributions.

This additional funding makes the IPP an incredible tax sheltering advantage over the RRSP.

Compare the chart below to the contributions you can make to an RRSP ($15,500 annual maximum in 2004)

Individual Pension Plan Contributions Example

Age in 2004	Past Service Contribution (from January 1, 1991)	2004 Current Service Contributions	Maximum First Year Contribution
35	$21,900	$15,700	$37,600
40	$41,200	$17,200	$58,400
45	$62,400	$18,900	$81,300
50	$85,700	$20,800	$106,500
55	$111,300	$22,800	$134,100
60	$139,500	$25,000	$164,500
65	$159,000	$26,600	$185,600

Assumptions: maximum earnings of $100,000 and full past service (Jan. 1, 1991 or earlier)
Note: The past service contribution does not have to be made in one year. It can be funded over a period of 15 years, but must be fully funded by age 65

Please note:

This example includes an RRSP transfer of $174,300
Contributions are determined by the actuary
Based on maximum earnings updated to 2005 of $100,000 per annum

Frequently Asked Questions

1. Who determines when the member can collect?

CRA allows retirement income to commence as early as age 50.

2. What are the maximum allowable benefits available to the member?

Pension discrimination occurs at 2005 earning levels of $100,000. If the member earns over this amount, CRA does not permit the excess to be factored into the calculations of the benefits and contributions.

3. Who owns the pension plan?

The company or Professional Corporation sponsors the plan. The trustees hold the assets on behalf of the members and their beneficiaries.

4. What if the plan does not earn a 7.5% rate of return?

Every three years there is a valuation completed by the actuary. This analysis of the plan will indicate its funded status. In the event a 7.5% per annum compound rate of return was not earned by the assets of the fund, the sponsoring company must make additional tax-deductible contributions to bring the fund back on track. This is not a penalty.

It is simply to ensure that the pension plan is properly funded. In fact, this gives a distinct advantage over defined contribution pension plans and RRSPs. These contributions can be amortized over a period, generally, of up to 5 years.

If the fund earns more than 7.5%, the surplus can be retained in the pension plan to grow or be used to create contribution holidays.

5. What happens to my RRSP room?

Your RRSP room will be adjusted once you set up a pension plan. This adjustment is called a Pension Adjustment or (PA).

6. Can the plan be indexed to cost of living increases?

A lump sum additional contribution can be made at the time of retirement to increase the indexation of the pension by an additional 1% per annum compound over that previously assumed by the actuary.

7. What are the restrictions on investments held in an IPP; are they the same as RRSPs?

In an IPP, no more than 10% of the portfolio can be held in any one stock. The same foreign content rule of 30% applies as in the case of RRSPs. The Department of Finance has also recently added restrictions on Income Fund Investment options.

8. What happens if the sponsoring company cannot afford to make the minimum annual contributions to the IPP?

Pension contributions must normally be made each year unless pensionable service is suspended. The plan sponsor may borrow to fund the plan. If this is not an option the plan sponsor can elect to wind up the plan and turn it into a Locked-in Retirement Account (LIRA) or purchase an annuity from the assets of the fund.

9. What happens to the IPP in the event of a marital breakdown?

Provincial laws require pension plan assets to be treated in a manner similar to RRSP assets, as matrimonial assets to be divided between the member and spouse.

10. What is past service?

CRA allows pension plans registered today to capture past service as if the member was in the pension plan as far back as January 1, 1991. Past service can only be captured for service when the company was incorporated and the member was an employee receiving income from that incorporated company.

In addition, the member will be required to rollover a specified portion of RRSP assets. The plan sponsor will be permitted to make past service contributions to the IPP in addition to current service contributions.

11. What is "projected additional funding" that the plan sponsor can make upon retirement?

Upon retirement, plan sponsors are permitted to make a tax-deductible lump sum payment into the pension plan. This amount is calculated by the actuary to create the additional benefits available at retirement which would include unreduced early retirement benefits, bridging benefits (replacement for OAS and CPP to age 65) and full CPI indexing.

12. Why the need for incorporation?

CRA regulations for Individual Pension Plans require a corporate plan sponsor. Professionals may create a Professional Corporation (PC) to act as plan sponsor however past service benefits do not apply prior to the establishment of the PC.

13. Who is responsible for the investment of the IPP assets?

The investments are the responsibility of the member (who is generally appointed Investment Manager) who in turn arranges for his financial advisor to place the plan assets into suitable investments.