

Federal Budget Update

Changes to Individual Pension Plans (IPPs)

Bill C-13, which contained the proposals in the June 6, 2011 Federal Budget for changes in the Income Tax Act and Regulations which affect IPPs, received Royal Assent on December 15, 2011.

The three amendments to the ITAR which affect IPPs are as follows:

Amendment #1 – Individual Pension Plans defined

Individual Pension Plans (IPPs) are now defined in the legislation. Previously, IPP was the commonly used expression for a designated plan for a small group (usually one or two) of employees who were either connected employees or executives. IPP is now defined as a Pension Plan with three or fewer members, if at least one member is related for tax purposes to an employer that participates under the IPP.

Amendment #2 - Change in Past Service Pension Adjustment (PSPA) rule for Shareholder (connected person) IPPs

Additional conditions must be applied in calculating the PSPA determined when an IPP is implemented, or additional credited service is granted. Due to lobbying efforts in which Westcoast Actuaries played a major role, the legislation which has been enacted significantly reduces the effect this rule change would have had on past service contribution room.

The new regulations specify that the PSPA (and, therefore, the required qualifying transfer to be made to the IPP on plan implementation) shall be based on the greater of:

1. the PSPA calculated under the existing rules
2. the sum of
 - o the individual's accumulated RRSPs (also including RRIFs and Money Purchase Pension Plan account balances) prorated over the period from age 18 to current age up to a maximum of 35 years.
 - o Any unused RRSP contribution room

The legislation defines the individual's accumulated RRSPs, RRIFs and money purchase account balances as the "Designated Savings Arrangement". It is useful to note that the Designated Savings Arrangement does not include contributions made by the individual to a spousal RRSP. It does, however, include death benefits which have been transferred from a spouse's RPP or RRSP and also RRSP amounts transferred as a result of a marital breakdown.

There is confusion at the moment regarding the date on which the Designated Savings Arrangement should be determined. The Explanatory Note to the Budget proposals suggests that the date should be the date on which the adopting resolution for the IPP is signed by the Board of Directors. This conflicts with the effective date set out in the current PSPA rules. We have posed this question to the Department of Finance but have yet to receive a definitive answer. We expect clarification on this and other unresolved issues on the new legislation when the Registered Plans Directorate of CRA issues a bulletin explaining how they intend to administer the changes.

The significant change in the legislation which has been enacted from the original Budget proposal is in respect of the pro-rating formula – the original draft required the PSPA to be based on the greater of the member's RRSP balances and the PSPA determined on the previous basis. It is our understanding that the original proposal had not taken into account such issues as the extent to which an individual's RRSP balance might have included RRSP contribution balances in respect of pre-1990 service under the old tax regime.

This amendment will penalize individuals who have accumulated a significant amount of personal RRSP funds. The available IPP past service funding room under the proposed rules would be reduced by the amount of personal RRSP funds the individual has that are in excess of the required transfer amount to meet past service eligibility.

The new rule will only have an impact for an individual who has a relatively high RRSP balance. For a connected person who has had maximum T4 earnings since 1991 and has 21 years of service credited under an IPP, the past service funding room is shown in the following table.

New Rules - Past Service Contribution Room as at January 1, 2012 for Past Service from 1991 to 2011
Maximum T4 Earnings for all past service years
\$ ACCUMULATED RRSPs
including RRIFs and Money Purchase Pension Plan account balances

	500,000	600,000	700,000	800,000	900,000	1,000,000	1,100,000	1,200,000	1,300,000	1,400,000
AGE										
45	111,628	87,901	10,124	0	0	0	0	0	0	0
46	122,149	115,089	40,089	0	0	0	0	0	0	0
47	132,859	132,859	68,902	0	0	0	0	0	0	0
48	143,758	143,758	96,698	26,698	0	0	0	0	0	0
49	154,888	154,888	123,634	55,893	0	0	0	0	0	0
50	166,228	166,228	149,793	84,168	18,543	0	0	0	0	0
51	177,778	177,778	175,263	111,627	47,991	0	0	0	0	0
52	189,538	189,538	189,538	138,360	76,596	14,831	0	0	0	0
53	201,529	201,529	201,529	164,469	104,469	44,469	0	0	0	0
54	213,751	213,751	213,751	176,691	116,691	56,691	0	0	0	0
55	226,204	226,204	226,204	189,144	129,144	69,144	9,144	0	0	0
56	238,888	238,888	238,888	201,828	141,828	81,828	21,828	0	0	0
57	251,803	251,803	251,803	214,743	154,743	94,743	34,743	0	0	0
58	264,970	264,970	264,970	227,910	167,910	107,910	47,910	0	0	0
59	278,389	278,389	278,389	241,329	181,329	121,329	61,329	1,329	0	0
60	292,081	292,081	292,081	255,021	195,021	135,021	75,021	15,021	0	0
61	306,004	306,004	306,004	268,944	208,944	148,944	88,944	28,944	0	0
62	320,200	320,200	320,200	283,140	223,140	163,140	103,140	43,140	0	0
63	334,669	334,669	334,669	297,609	237,609	177,609	117,609	57,609	0	0
64	349,411	349,411	349,411	312,351	252,351	192,351	132,351	72,351	12,351	0
65	364,426	364,426	364,426	327,366	267,366	207,366	147,366	87,366	27,366	0
66	392,184	392,184	392,184	355,124	295,124	235,124	175,124	115,124	55,124	0
67	429,794	429,794	429,794	392,734	332,734	272,734	212,734	152,734	92,734	32,734
68	468,540	468,540	468,540	431,480	371,480	311,480	251,480	191,480	131,480	71,480
69	484,500	484,500	484,500	447,440	387,440	327,440	267,440	207,440	147,440	87,440
70	496,977	496,977	496,977	459,917	399,917	339,917	279,917	219,917	159,917	99,917
71	505,807	505,807	505,807	468,747	408,747	348,747	288,747	228,747	168,747	108,747

It is important to note that the way the pro-rating formula works provides a different result if all service is credited at plan inauguration compared with crediting part of the eligible service at plan commencement and the rest at some later date.

In the government's view, individuals would have achieved adequate retirement savings if they have already accumulated a significant amount of personal RRSPs. Since connected persons have so much control over the establishment of an IPP, they can implement an IPP and trigger significant past service contributions by the employer even if they already have a huge personal RRSP account. The government therefore introduced this new rule so connected persons with a huge personal RRSP balance will be required to transfer an amount higher than the amount of required transfer computed based on their employment income history.

Amendment #3 – Minimum payments amounts for members over age 71

Starting in 2012 annual minimum amounts will be required to be withdrawn from IPPs, similar to current minimum withdrawal requirements from Registered Retirement Income Funds (RRIFs), once a plan member attains the age of 72. This rule will apply to all IPPs.

This amendment will require the payout of IPP assets that are significantly more than the pension amount as defined under an IPP and may lead to substantial risks of not having adequate benefit security on the promised pension.

It is not at all clear to us how this amendment will be perceived by provincial pension authorities as it clearly contravenes provincial pension legislation in provinces where IPPs are not exempt from the Pension Benefits Act. We have been making inquiries as to how the provinces intend to deal with this issue but have not had any response as yet.

In order to accommodate this change, the plan document will need to be revised. We will be contacting our clients with pensions in payment who are over age 71 to notify them of the amount required to be paid to them in 2012 as soon as possible.

IPPs for connected persons with a significant amount of surplus are only required to pay out the defined benefit pension amount. The surplus can potentially be accumulated tax free and retained in the plan to be used by future generations for their pension. The pension proceeds are, in the government's view, being used for wealth transfer purposes rather than for retirement benefit purposes. The intent of this new rule to impose RRIF minimum payout based on IPP assets after age 71 is to prevent accumulation of significant surplus to facilitate tax-free wealth transfer.

Recommendations from WAI

We expect announcements from the Registered Plans Directorate of CRA as to how they will deal with new IPP submissions in due course. Our recommendations to individuals who wish to establish new IPPs are as follows:

1. If your personal RRSP funds are insufficient to meet the required transfer amount for recognition of your full past service, the proposed IPP past service rule has no impact on your situation. It is recommended that you proceed with plan implementation.
2. If your personal RRSP funds are slightly more than the required transfer amount and less than the past service contribution amount available, then it is recommended that you proceed with plan implementation.
3. If your personal RRSP funds are way more than both the required transfer amount under existing rules and the past service contribution amount available such that there is not a meaningful amount of past service contribution room under the proposed new rule. You may want to consider setting up an IPP with current service only.

Because the new legislation introduces significant changes we are temporarily changing our online quoting system. We will be asking potential IPP clients and their advisors to submit data to us so that we can provide a customized response as we feel it is not possible to provide advice on each individual case on a generic basis. We expect to be able to provide quotations on a "Next day at the latest" response time basis.

IPPs are superior pension schemes for executives, business owners and incorporated professionals that offer greater contributions, deductibility of investment costs, considerable past service contributions at implementation and significant additional contributions after commencement of pension by the employer. While we do not agree with the Finance Department's opinion that the deductions available to IPPs are "excessive" or "unforeseen by the legislation introduced in 1989", the fact that they thought it necessary to restrict IPPs in any way indicates the attractiveness of these programs.

Should you have any questions or require further information or clarification, please contact us at (604) 730-1898 or IPP@WAIInc.ca. Our professional staff would be pleased to assist you.

This content is for general information only. As it is impossible to include all situations, circumstances and exceptions in a commentary such as this, a further review or feasibility study should be undertaken with respect to terminal funding of an IPP and its implications. Every effort has been made to ensure the accuracy of the information contained in this commentary. However, because of the nature of the subject, no person or firm involved in the preparation or distribution of this commentary accepts any liability for its contents or use.