

PERSONAL PENSION

For older business owners and highly paid executives, an individual pension plan can boost retirement savings.

By Ian E. Baker

They can be great for people over 40, but advisors looking to put clients into an individual pension plan (IPP) need to perform some due diligence to determine whether the product is a good fit.

An IPP is a defined benefit plan that provides members with an annual pension of 2% of employment income, up to a maximum pension limit for all years of service. But there are key conditions that determine whether the plan is viable:

- IPP members and plan sponsors must have a bona fide employee-employer relationship.
- The plan sponsor has to be profitable and be seeking immediate tax deductions without any immediate tax implication for the IPP member.
- The IPP member has employment income (T4, T4A and T4PS earnings are eligible but not dividend income or self-employment earnings).
- The client is seeking long-term retirement planning.

IPPs are subject to registration with the CRA and provincial pension regulators. Income tax laws and regulations limit deductible contributions while provincial pension acts require

minimum contributions to fund the plans. Some provinces grant IPP exemptions from pension registration.

The plans are underutilized because they have been expensive to implement and annual maximum pension limits had been frozen at \$1,722.22 per year of service. But some providers have begun offering more reasonable implementation fees, and the February 2003 federal budget increased maximum pension limits per year of service to \$1,833 in 2004 and \$2,000 in 2005. Increases are indexed thereafter.

So how do IPPs compare with RRSPs? First off, IPP investors can make higher contributions for current and future years of service and contributions for past service are also available. If the annual investment return is less than 7.5%, more contributions can be made. Assets are creditor-proof.

Unlike an RRSP, however, an IPP can't be used to income-split with a spouse, and funds can't be withdrawn while a client is employed. If the plan has an excess actuarial surplus, future contributions are reduced. Contributions cannot be deferred when the plan is subject to provincial pension registration.

Here are some tips for how advisors should use IPPs:

- Base an investment strategy on the fact that the Income Tax Regulation-mandated investment goal is 7.5% per year and

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ASSET MAGNIFICATION

This table shows how quickly assets can add up in an IPP, assuming:

- A one-time transfer during 2004 of up to \$182,300 from the individual pension plan member's RRSP or defined contribution pension plan.
- A one-time company contribution in 2004 of up to \$280,000 in respect of the member's past service liability from 1991 to 2003.
- Annual company contributions in 2004

Age As of Jan. 1, 2004	Past Service Liability	Past Service Pension Adjustment	Maximum Net Past Service Contribution	Maximum Current Service Contribution	Total Maximum 2004 Contribution
40	\$223,900	\$182,300	\$41,600	\$17,900	\$59,500
45	\$245,900	\$182,300	\$63,600	\$19,600	\$83,200
50	\$270,100	\$182,300	\$87,800	\$21,500	\$109,300
55	\$296,700	\$182,300	\$114,400	\$23,700	\$138,100
60	\$325,900	\$182,300	\$143,600	\$26,000	\$169,600
65	\$346,200	\$182,300	\$163,900	\$27,600	\$191,500
69	\$462,300	\$182,300	\$280,000	\$36,900	\$316,900

Figures assume IPP member earns at least \$100,000 per year from 1991 to 2004. Courtesy Westcoast Actuaries Inc.

- of up to \$36,900 in respect of the member's current service liability.
- A potential one-time terminal funding
- company contribution of perhaps \$200,000 or more if the member retires prior to age 65.

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within the scope of the normal know-your-client regulatory requirement.

- Decide whether you want to use an insurance product, a pension trust with a corporate trustee, or a pension trust with three individual trustees. The advantage of using an insurance product or a corporate trustee is that these arrangements remove fiduciary responsibility. A pension trust with three individual trustees offers a wider range of investments, but has the downside of placing fiduciary responsibility on the individual trustees.
- Pick an actuarial firm to implement the IPP with the CRA (and the provincial regulator) and to provide administration.
- Obtain an IPP quotation for all your existing clients. This must include the client's date of birth, T4 earnings history

from 1990 onward, current RRSP/pension plan market value and current RRSP unused contribution room.

- Tell your clients about the product, and schedule meetings to discuss details with those who fit the profile. Proceed with plan implementation if the client is committed to using an IPP for retirement savings.

Although they require some research, IPPs have major advantages. The average initial asset size of an IPP with past service credits since 1991 would be roughly \$200,000. So if an advisor sold 100 IPPs, assets under management would increase by \$20 million. An advisor would need almost 1,300 RRSP clients contributing \$15,500 each to match that. **AE**

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