INDIVIDUAL PENSION PLANS:

BACK IN THE SPOTLIGHT

This past July, the federal government introduced proposals to overhaul the tax rules affecting active private corporations (including dentistry professional corporations and technical services corporations). Since the summer announcement, the government has faced increasing opposition from farmers, professionals and small business owners across the country. As a result, they have backed away from some of their original submissions. At the time this article was written, we do not know what the final legislation will look like. However, the intent is clear. The federal government has indicated that they will target tax planning options of small business corporations in two major ways:

1. Going forward, it will be more difficult for dentists to remove funds from his/her corporation in a tax efficient manner. If the proposals are passed, income splitting with family members will be severely restricted.

2. Tax wise, it may be prohibitive for dentists to build up retirement savings inside their corporations in any meaningful way.

If the legislation is passed in its present form, an Individual Pension Plan (IPP) may be an attractive option for dentists trying to save for retirement. To better understand an IPP, let's address some common questions.

Dr. Wilson Chen, BSc., DDS, CFP, FMA received his DDS from Western University in 1992 and over the past 23 years, has built a patient-centered, family practice in Hamilton. In 2014, he sold his practice to take a more active financial management and business advisory role for his dental clients and their families. Wilson is the only practicing dentist in Ontario to hold the Certified Financial Planner (CFP) and Financial Management Advisor (FMA) designations. Wilson can be reached at wilson.chen@raymondjames.ca.

WHAT IS AN INDIVIDUAL PENSION PLAN (IPP)

We all know someone who is part of a group defined benefit (DB) pension plan. Government workers, teachers, and employees of large corporations have historically enjoyed a set income at retirement that lasts for life. This provides a high level of comfort and security to retirees, knowing that they will continue to receive a guaranteed "paycheque".

An Individual Pension Plan is very similar. It is a trust, sponsored and funded by your corporation, which provides a steady pre-determined income stream to you at retirement. The difference is that this is set up specifically for you (and possibly your spouse).

- An IPP allows a corporation to contribute funds for a specified employee, to be used by the employee on retirement.
- The contributions are tax deductible to the corporation and grow inside the IPP on a tax-deferred basis. Any IPP income taken out at retirement is taxed as income.
- You must be earning pension eligible T4-employment income to qualify for IPP contributions. Salaries count but dividend income does not.
- It is most suitable for dentists over age 40 and earning a high T4 income. (Presently, $145,000 would be ideal).
- An IPP has been labelled a "Turbo-charged RRSP" since you can potentially shelter a much higher amount of savings for retirement.
- On top of higher annual contributions compared to an RRSP, an IPP may allow for additional deductible contributions for past service, to provide bridging income if you retire before age 65, and to compensate for inflation.

WHAT ARE THE REQUIREMENTS FOR SETTING UP AN IPP

- The IPP sponsor must be a corporation such as a dentistry professional corporation or a hygiene services corporation.
- The IPP member must be an employee of the corporation and receive T4 earnings from the corporation.
- An IPP can have a single member or the plan can be set up with multiple members. There is an opportunity to put spouses on as members, as long as they are also employees of the corporation.
- The Individual Pension Plan must be administered by a qualified actuary or a pension firm that employs a qualified actuary. The actuary uses your personal and corporate information to determine the yearly IPP contributions, your past service contributions, terminal funding, and your monthly pension income upon retirement.

WHO IS THE IDEAL IPP CANDIDATE

- Ideally, any incorporated dentist who is over 40 years of age and earns $145,000+ per year should consider setting up an IPP. An IPP can be set up with lower income ($100,000+) but the benefits are reduced.
- Usually, the longer a dentist has been incorporated and the longer he/she has received T4 income from the corporation, the greater the benefit of an IPP.
- Dentists who are looking for options to shelter a greater amount of savings per year than what an RRSP will allow.
- A dentist who accumulates free cash inside their corporation (cash not needed for office expenses or personal use) and finds it hard to extract the funds out of the corporation without paying high taxes.
- A dentist who will be in a lower tax bracket at retirement or have a spouse (or common-law partner) who will be in a lower tax bracket at retirement.
- A sponsoring corporation that has consistent cash flow in order to make the yearly contributions.
- Someone who likes the comfort of knowing that they will have a predictable pension income that is indexed to inflation. This helps greatly with retirement planning.

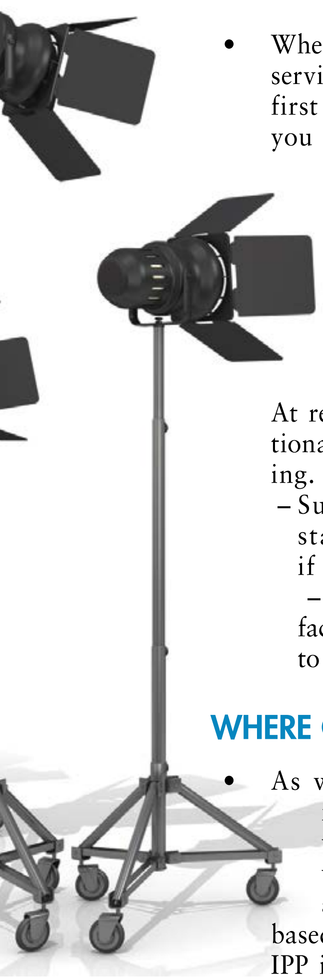
WHEN I START AN IPP, WHAT HAPPENS TO MY EXISTING RRSP

- When an IPP is initially set up, some of your RRSP funds may need to be transferred to the Individual Pension Plan. The actual amount will be determined by the actuary based on your RRSP contribution history and the year your corporation was established. This is called a qualifying transfer. The rest of your RRSP remains intact and will maintain its tax deferred status until withdrawal.
- When an IPP is established, your future RRSP

contribution room will be greatly reduced. In most cases, you will be allowed to contribute $600 per year to your RRSP going forward.

WHAT IS A PAST SERVICE CONTRIBUTION AND TERMINAL FUNDING

Past service contribution and terminal funding are two opportunities to put additional funds into an IPP. Contributions are made by the corporation and tax deductible to the corporation.



- When setting up an IPP, you can make a past service contribution depending on when you first started the corporation, the years that you received T4 income from the corporation, and the amount of RRSP contributions you made during that time. In many cases, past service contributions will allow you to shelter a significant amount, over and above your annual IPP contributions. The actual amount of past service contribution will be determined by the actuarial assessment. At retirement, IPP rules may allow for additional contributions through terminal funding. This additional funding will help to:
  - Supplement your income before you start to receive government benefits, if you choose to retire before age 65.
  - Keep up with the effects of inflation by factoring in a full cost of living adjustment to your retirement pension.

WHERE CAN I INVEST MY IPP FUNDS

- As with an RRSP, your IPP funds can be invested in a wide range of investment vehicles. Your financial advisor can work with you in order to design a portfolio and formulate an asset allocation mix based on your individual investment goals. An IPP is a self-directed plan. You decide where and how to invest the funds.
- Your actuary and your financial advisor will play separate roles. The actuarial firm will administer the plan and your financial advisor can help you invest the funds.
- Since an IPP is meant to provide a secure retirement benefit, the investment guidelines for an IPP are more conservative than for an RRSP. For example, within an IPP, a maximum of 10% of the funds can be invested in a single security. Talk to your financial advisor regarding the specific investment rules governing an IPP.

WHAT HAPPENS IF THE INVESTMENT RETURNS IN MY IPP FLUCTUATE

We all know that most investment portfolios are not static. Returns tend to be variable, especially in the short term. To ensure that your pension is well funded for retirement, the actuarial firm responsible for your IPP will perform a review of the plan every three years (triennial review).

- If the rate of return of the plan assets is below 7.5% per year, the administrator may allow for additional tax-deductible IPP contributions from the corporation.
- If the returns are significantly above expectations, you may have to suspend contributions (take a contribution holiday) until the funds are back in line with the calculated pension goals.
- The purpose of the triennial review is to ensure that the plan is adequately funded to meet future retirement pension payments.

WHAT ARE SOME ADVANTAGES OF AN IPP

- With the new corporate tax proposals, there may be less avenues to take money out of your corporation without paying high taxes. IPPs can help this situation since contributions are paid by the corporation (not from personal cash flow like an RRSP) and are tax deductible to the corporation. Therefore, it removes accumulating funds from your corp in a tax efficient manner.
- With higher contribution limits than an RRSP, it allows for a larger pool of funds to grow and compound for your retirement. Just like an RRSP, any IPP savings grow tax deferred until income is withdrawn. The contribution limits are age related, so dentists who are over age 40 will see a larger contribution room difference.
- Since an IPP is a true pension, any proceeds you receive in retirement can be split with a

lower income spouse for tax purposes under pension splitting rules. This can reduce your overall tax bill and help minimize clawback of government retirement benefits.

- Most fees associated with an IPP are tax deductible by your corporation. Investment management fees, which are not tax deductible in an RRSP, can also be deductible for an IPP.
- You are still in control of your investments inside an IPP.
- Actuarial monitoring increases the chance that your retirement will be adequately funded. Unlike an RRSP, IPP shortfalls can be made up by additional contributions
- You have a pre-determined income stream upon retirement.
- Funds sheltered in an IPP are creditor proof.
- Unlike a group pension plan which is lost once the member and spouse passes away, IPP surpluses belong to the member and can be passed to your children or estate upon death.
- There are some flexible options to receive the money when you retire 1) Can be kept in the IPP and pension income distributed annually 2) Can be used to buy an annuity 3) Can be transferred to a LIRA or a LIF.

WHAT ARE SOME DISADVANTAGES OF AN IPP

- There are costs to set up an IPP and to maintain the plan. Initial implementation costs, annual tax filing costs and triennial actuarial review fees should all be considered. These costs are tax deductible to the corporation. Recently, some actuarial firms have introduced an annual set fee system, which is simpler and cost-effective.
- Withdrawal of IPP funds are less flexible than RRSPs. IPP funds are locked in and only accessible upon retirement. Funds cannot be accessed until age 55 at the earliest.
- There are more stringent contribution rules for the corporation. Since it is a pension, the company is obligated to fund the IPP annually. This can be a problem for businesses with fluctuating cash flows but is generally not a concern for stable dental practices. There is some flexibility if the corporation does not have enough cash to fund IPP obligations. It can borrow money to contribute to the IPP or there are options to fund any shortfalls over several years.
- To satisfy past service requirements, existing RRSP funds may have to be transferred into the IPP. Once an IPP is set up, RRSP contributions are generally limited to $600 per year.
- There are stricter investment rules that govern an IPP. Although this provides less flexibility in investment choices, it does help to decrease volatility in the portfolio. After all, a big part of an IPP is to accumulate and grow your funds conservatively.

HOW DO I START THE PROCESS

If you are in the right demographic to take advantage of an IPP, speak with your financial advisor to set up an actuarial review. This will detail how much you can save inside an IPP, any past service contributions you are entitled to, and the costs to run the plan. The personalized actuarial projection will help you, your tax professional and your financial advisor to weigh the cost/benefit and make an informed decision.

People are living longer and, in some cases, must fund a retirement that spans 30+ years. Without a public sector or corporate pension, dentists must rely on their own savings and careful tax and retirement planning to achieve financial freedom. To this end, an Individual Pension Plan may benefit those saving for retirement under a new proposed tax regime. ✧

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