

THE IPP ADVANTAGE

By Peter Watson

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The Individual Pension Plan (IPP) is perhaps the least known, yet most effective tax reduction strategy available in Canada. Start your own IPP, magnify your retirement income and save thousands of dollars in tax—what could be better?

IPPs allow for increased contributions versus an RRSP

The January / February 2004 issue of CA Magazine refers to an IPP as “an RRSP upgrade.” In our opinion, the word “upgrade” is an understatement. Consider the numbers. In 2004, a 50 year old who commences an IPP could have a maximum contribution of \$113,300 compared to a maximum RRSP contribution of \$15,500. Therefore the IPP has a tax deductible advantage of \$97,800. (Schedule 1)

Higher contribution rates also continue in subsequent years. The 50 year old can contribute \$23,700 next year versus \$16,500 to an RRSP. The annual contribution limit increases with age as can be seen in Schedule 2.

IPP Creates Larger Nest Egg

The real benefit for our 50 year old using an IPP is a significantly larger retirement nest egg. The value of the IPP at age 65 is \$1,935,300 versus \$1,268,300 with the RRSP only option. (Schedule 3) The higher value of the IPP nest egg could generate an additional \$46,000 of annual retirement income over and above your RRSP.

Who Should Start an IPP?

If you are at least 40 years of age and earn \$100,000 as an owner manager, executive or incorporated professional you should seriously consider an IPP. The IPP is best suited for individuals with steady incomes who have a history of maximizing their RRSPs.

Age is an important consideration. While a 40 year old should consider an IPP, a 45 year old should seriously consider it and if you're above 50 then you should be alarmed at the magnitude of tax savings you are squandering if you do not use an IPP.

How Does An IPP Work?

As BDO Dunwoody states, “the rules are complicated, the concept is simple” (First Quarter 2004 Tax Factors). The Pension Act allows a corporation to set up an IPP for an owner or key employees. Funds are contributed to the IPP by the corporation from income or retained earnings. Those payments are a tax deduction for the corporation and roll tax-free into the IPP. The individual will eventually pay taxes when the funds are drawn out of the IPP during retirement, similar to an RRSP.

Advantages and Disadvantages

An IPP has both advantages and disadvantages when compared to an RRSP.

Advantages:

1. Higher annual tax-deductible contributions
2. Contributions for past service back to 1991
3. Excess contributions when investment returns are lower
4. Contributions for termination or early retirement
5. Creditor proof

Disadvantages

1. Costs
2. Loss of ability to contribute to a spousal RRSP
3. No lump sum cash option

Schedule 4 provides a comprehensive summary of the advantages and disadvantages.

Our Solution

Peter Watson Investments has developed “THE IPP ADVANTAGE PROGRAM”, a unique five step process that takes you from start to finish. We combine our skills and over 40 years of experience in Wealth Management, including tax planning, retirement and estate planning, investments and portfolio design.

The steps include:

1. Discovery: We ask a series of questions about age, income, your business, financial objectives etc. in an effort to get a clear picture of your situation.
2. Architecture: After analyzing your situation we design a customized strategy which includes an actuarial calculation of benefits as well as an investment policy statement.
3. Communication: We will provide a direct comparison of IPP versus RRSP numbers including; tax deductible contributions, ultimate dollar value at retirement and pension income. All costs will be discussed as

well as any advantages or disadvantages particular to you. We will then include your accountant in the discussion to ensure that all necessary issues have been addressed.

4. Implementation: This will include preparation, delivery and assistance with the completion of all required documents to establish the IPP and implement the investment strategy.
 5. Ongoing Monitoring: PWI will coordinate the administration of the pension requirements as well as provide ongoing advice on the management of the pension assets.
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Technical Editorial Review:

Ian Baker, FCIA, FSA & Stephen Cheng, FCIA, FSA
Principals & Consulting Actuaries
Westcoast Actuaries Inc.

Suggested References:

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www.peterwatsoninvestments.com

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**THE IPP
ADVANTAGE
COMPARED TO AN
RRSP
FOR AN INDIVIDUAL AGE 40-69
FOR THE YEAR 2004**

Schedule 1

Age on Jan 1/04	IPP Maximum Past Service Contribution	IPP Maximum Current Service Contribution	IPP One-time Allowable RRSP Contribution	IPP/RRSP Total Maximum 2004 Contribution	RRSP Only Contribution Limit 2004	The IPP Advantage
40	\$41,600	\$17,900	\$4,000	\$63,500	\$15,500	\$48,000
41	45,800	18,200	4,000	68,000	15,500	52,500
42	50,100	18,500	4,000	72,600	15,500	57,100
43	54,500	18,900	4,000	77,400	15,500	61,900
44	59,000	19,200	4,000	82,200	15,500	66,700
45	63,600	19,600	4,000	87,200	15,500	71,700
46	68,300	20,000	4,000	92,300	15,500	76,800
47	73,000	20,400	4,000	97,400	15,500	81,900
48	77,900	20,800	4,000	102,700	15,500	87,200
49	82,800	21,100	4,000	107,900	15,500	92,400
50	87,800	21,500	4,000	113,300	15,500	97,800
51	92,900	22,000	4,000	118,900	15,500	103,400
52	98,200	22,400	4,000	124,600	15,500	109,100
53	103,500	22,800	4,000	130,300	15,500	114,800
54	108,800	23,200	4,000	136,000	15,500	120,500
55	114,400	23,700	4,000	142,100	15,500	126,600
56	120,000	24,100	4,000	148,100	15,500	132,600
57	125,700	24,600	4,000	154,300	15,500	138,800
58	131,600	25,000	4,000	160,600	15,500	145,100
59	137,600	25,500	4,000	167,100	15,500	151,600
60	143,600	26,000	4,000	173,600	15,500	158,100
61	149,800	26,500	4,000	180,300	15,500	164,800
62	156,100	27,000	4,000	187,100	15,500	171,600
63	162,500	27,500	4,000	194,000	15,500	178,500
64	169,000	28,000	4,000	201,000	15,500	185,500
65	163,900	27,600	4,000	195,500	15,500	180,000
66	189,900	29,700	4,000	223,600	15,500	208,100
67	217,800	31,900	4,000	253,700	15,500	238,200
68	247,800	34,300	4,000	286,100	15,500	270,600
69	280,000	36,900	4,000	320,900	15,500	305,400

Note: All figures rounded down to nearest hundred.

Source: Peter Watson Investments
Actuarial figures provided by Westcoast Actuaries Inc.

**THE IPP CUMULATIVE ADVANTAGE
 COMPARED TO AN RRSP
 FOR AN INDIVIDUAL AGE 50
 FROM AGE 50 TO 69.**

Schedule 2

Year	Age on Jan 1/04	IPP/RRSP Total Maximum Contribution	RRSP Only Maximum Contribution	IPP Annual Advantage	IPP Cumulative Advantage
2004	50	\$113,300	\$15,500	\$97,800	\$97,800
2005	51	23,700	16,500	7,200	105,000
2006	52	25,400	18,000	7,400	112,400
2007	53	27,300	18,990	8,300	121,000
2008	54	29,300	20,000	9,300	130,300
2009	55	31,500	21,100	10,300	140,700
2010	56	33,800	22,200	11,500	152,300
2011	57	36,300	23,500	12,800	165,100
2012	58	39,000	24,800	14,200	179,300
2013	59	41,900	26,100	15,700	195,000
2014	60	45,000	27,600	17,300	212,400
2015	61	48,300	29,100	19,100	231,600
2016	62	51,900	30,700	21,100	252,700
2017	63	55,700	32,400	23,300	276,100
2018	64	59,900	34,200	25,600	301,700
2019	65	64,300	36,100	28,200	330,000
2020	66	69,100	38,000	31,000	361,000
2021	67	74,200	40,100	34,000	395,100
2022	68	79,700	42,300	37,400	432,500
2023	69	85,700	44,700	41,000	473,500

Actuarial assumptions as per Income Tax Act regulation 8515 (7).

All figures rounded down to nearest hundred.

Source: Peter Watson Investments
 Actuarial figures provided by Westcoast Actuaries Inc.

**THE IPP PENSION INCOME
ADVANTAGE
COMPARED TO AN
RRSP
FOR AN INDIVIDUAL AGED 50
FROM AGE 50 TO 69**

Schedule 3

Year	Age Jan 1/04	RRSP Only		IPP/RRSP	
		Ending Balance	Estimated Annual Pension	Ending Balance	Estimated Annual Pension
2004	50	\$212,000	\$11,500	\$313,500	\$17,000
2005	51	245,000	13,400	361,600	19,900
2006	52	282,000	15,700	415,200	23,100
2007	53	322,900	18,200	474,700	26,700
2008	54	367,900	21,000	540,800	30,800
2009	55	417,400	24,100	614,000	35,500
2010	56	417,800	27,600	695,200	40,700
2011	57	531,600	31,600	785,000	46,700
2012	58	597,200	36,100	884,300	53,400
2013	59	669,200	41,100	994,100	61,000
2014	60	748,000	46,700	1,115,300	69,600
2015	61	834,300	53,000	1,249,100	79,400
2016	62	928,800	60,100	1,396,600	90,400
2017	63	1,032,100	68,100	1,559,200	102,900
2018	64	1,144,900	77,100	1,738,200	117,100
2019	65	1,268,300	87,200	1,935,300	133,100
2020	66	1,402,900	98,700	2,152,200	151,400
2021	67	1,549,700	111,500	2,390,600	172,100
2022	68	1,709,900	126,100	2,652,600	195,600
2023	69	1,884,600	142,400	2,940,500	222,200

All figures rounded down to nearest hundred.

Source: Peter Watson Investments
Actuarial figures provided by West Coast Actuaries Inc.

Advantages**1. Contributions are tax deductible**

All contributions are tax deductible to the corporation. The money is received by the individual tax free within the IPP. Taxes are eventually paid as the funds are withdrawn from the IPP as income during retirement.

2. Higher Annual Contributions

The IPP allows for significantly higher tax deductible contribution versus an RRSP. As Schedule 1 indicates, the advantages start at age 40 and increase yearly until age 69, which is the final year you can contribute to an IPP.

3. Contributions for past service

A past service contribution amount can be calculated for employment back to and including the year 1991. This contribution amount can be paid upfront or phased in annually over several years.

4. Higher contributions when investment returns are lower

The actuarial assumption is that assets within the IPP will grow at 7.5% annually. If the actual results are less, then additional tax-deductible contributions are made to the IPP to make up any deficit.

5. Contributions for early retirement

The actuarial assumption is that the individual will retire at age 65. If retirement is earlier, then a one time "termination contribution" will be permitted to accommodate the early retirement.

6. Expenses are tax deductible

Both the initial set up and ongoing maintenance costs of the IPP are tax deductible to the corporation. Expenses can be paid from the assets of the IPP or separately by the corporation.

7. Borrowing costs are tax deductible

The corporation can borrow funds to make IPP contributions and the interest on the loan is tax deductible. This is not the case if the individual took out an RRSP contribution loan.

8. Surplus remains with the individual

Unlike a conventional company pension, the IPP is the property of the individual. The assets stay with the individual after termination or retirement. The full value of the IPP is passed to the stated beneficiary at death or forms part of the estate if no beneficiary is named.

9. Creditor proof

According to BDO Dunwoody, “IPP assets are better protected from future business risks when compared to RRSPs”.

10. Termination

The IPP can be terminated for any reason. Subject to the maximums allowed under the Income Tax Act section 8517, the majority of the funds may be transferred to a locked-in RRSP. There will likely be a portion which would be taxable in the year of termination.

11. Contributions tied to earnings

If earnings decline below a minimum threshold the maximum contribution amount declines too. When earnings increase then so do the contributions.

Disadvantages

1. Costs

There are initial set up costs and ongoing annual maintenance costs.

2. Loss of Spousal RRSP Contributions

The IPP does not allow for spousal RRSP contributions that can be a successful income splitting strategy. The small ongoing RRSP contribution that is allowed by the IPP can be contributed to a spousal plan. If the spouse is also an employee of the firm, they can potentially have their own IPP.

3. No Lump Sum Cash Option

Unlike an RRSP where any amount of assets can be withdrawn at any time, these assets are for your pension and can only be withdrawn beyond specified limits in very limited circumstances such as serious illness or financial hardship. Look to other areas of your portfolio for liquidity.

4. Regular Contributions Required

The corporation will be required to make the annual contributions even through financially difficult years. BDO Dunwoody suggests that “IPPs are best suited for employers with relatively stable levels of business income”.