



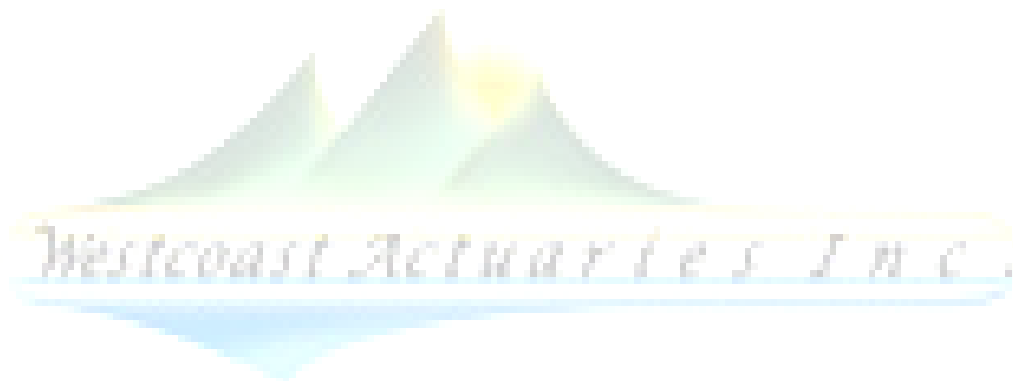
Individual Pension Plan (IPP)

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The Growth in IPP Market

There are currently over 6,000 Individual Pension Plans (IPPs) in Canada and the market is expected to grow significantly in the future. The current tax and regulatory environments are much more favorable and conducive to growth for the IPP market. The major contributing factors are:

- ◆ The age factor - We have an aging population with many baby boomers reaching retirement age in the coming years. Hence more people will benefit from IPPs.
- ◆ The down investment market in the last few years prompted more people to pay closer attention to IPPs. In an IPP, the assets are expected to grow at 7.5% per annum. The plan sponsor (company) can contribute more to the pension plan if the triennial actuarial review identifies investment rates of return of less than 7.5% per year since the previous actuarial review.
- ◆ The increases in the retirement savings limit in recent federal budgets benefited IPPs more than RRSPs.
- ◆ More significant past service funding - For a new IPP implemented in 2006 a shareholder can potentially have contributions made with respect to 15 years (1991 to 2005) of past service. For an IPP that was implemented in the early 90's, for example in 1993, the years of past service funding would have been restricted to 2 years (1991 and 1992). In the future, more and more years of past service funding would be available under an IPP as the current pension tax system matures.
- ◆ Lower fees - actuarial and administration services from some actuarial firms are now available at much more reasonable levels.





What is an IPP?

An IPP is a maximum defined benefit plan which provides contribution amounts in excess of the money purchase pension plan / RRSP contribution limit for people who satisfy certain age and income criteria. It is intended to be a replacement program for RRSP or defined contribution pension plan for employees over a certain age. Some sample maximum 2006 current year IPP contribution amounts (rounded to the nearest \$100) are as follows:

<u>Age</u>	<u>IPP Contribution</u>
40	\$19,600
45	21,500
50	23,700
55	26,000
60	28,500
65	31,800

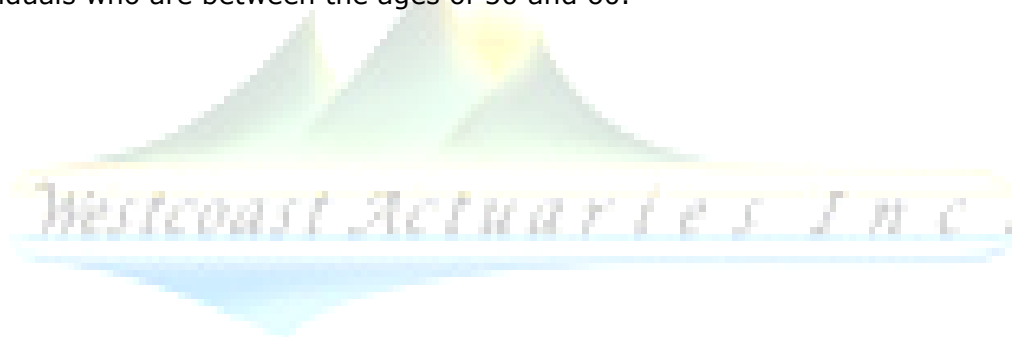
People should consider an IPP as a "**super-sized**" RRSP that requires actuarial and administration services for compliance purposes. Note that the IPP contribution amounts increase with age.

Requirement of Employment Relationship

Pensions are employment-related benefits provided to employees by employers. There must be an employer/employee relationship with employment income paid in the form of salary and wages, bonus, or amounts paid from an Employee Profit Sharing Plan (EPSP). These are usually amounts reported on T4, T4A or T4PS for tax purposes. Note that dividend income, self-employment or partnership income are not pension eligible.

Who Would Benefit?

Age is the major determining factor. Individuals who are age 40 or over would realize a contribution advantage over RRSP. However, the advantage on a current year basis is relatively small at age 40 so there are not many IPPs set up at that age given the higher maintenance cost for IPP vs. RRSP. Most IPPs are implemented for individuals who are between the ages of 50 and 60.



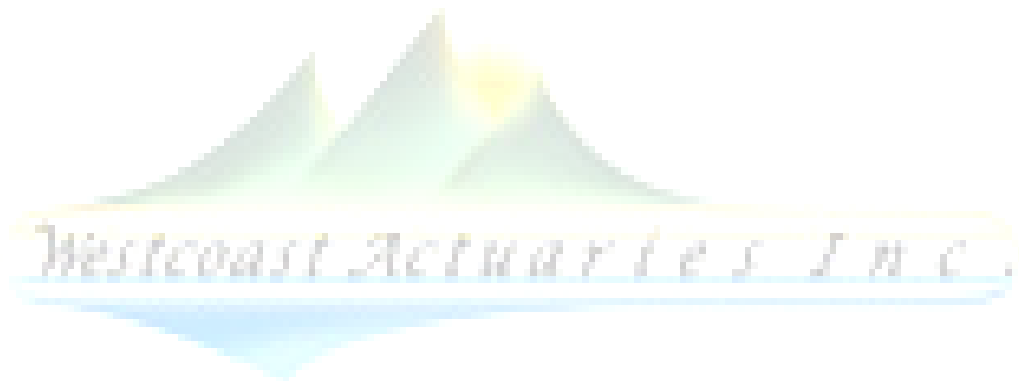


Who Are the Prime IPP Candidates?

IPP is a tax-driven registered pension plan catered to individuals who would like to accomplish more retirement savings than what an RRSP can offer. The prime candidates for IPP are usually profitable corporations that are looking for additional retirement savings opportunities for owners or executives. IPP is an ideal program for business owners, incorporated professionals and highly-paid executives provided that their age is right.

Age is the key criteria for IPP feasibility – the older the IPP member, the higher the contribution amount. Income level is only secondary. While a person needs income level in excess of \$105,000 to qualify for the maximum pension limit under a defined benefit pension plan, many IPPs are set up for shareholders who between \$50,000 and \$100,000 of annual salary. Although they do not realize the maximum contribution advantage over RRSP, they do enjoy a proportionate advantage over RRSP. The table below shows sample contribution rates expressed as a percentage of income for different ages (note that RRSP contribution is limited to 18% of earned income):

<u>Age</u>	<u>IPP Contribution</u>
40	18.6%
45	20.4%
50	22.4%
55	24.6%
60	27.0%
65	30.1%





Advantages & Disadvantages/Restrictions as compared with RRSP

Advantages

- ◆ Higher contribution limits for older people.
- ◆ Ability to top-up past service contribution.
- ◆ More creditor-proof.
- ◆ Ability to make further tax-deductible contributions if there is a deficit.
- ◆ Terminal funding opportunities at retirement.
- ◆ Contributions can be made within 120 days after corporate year-end.
- ◆ Interest on funds borrowed for contributions is tax-deductible.

Disadvantages/Restrictions

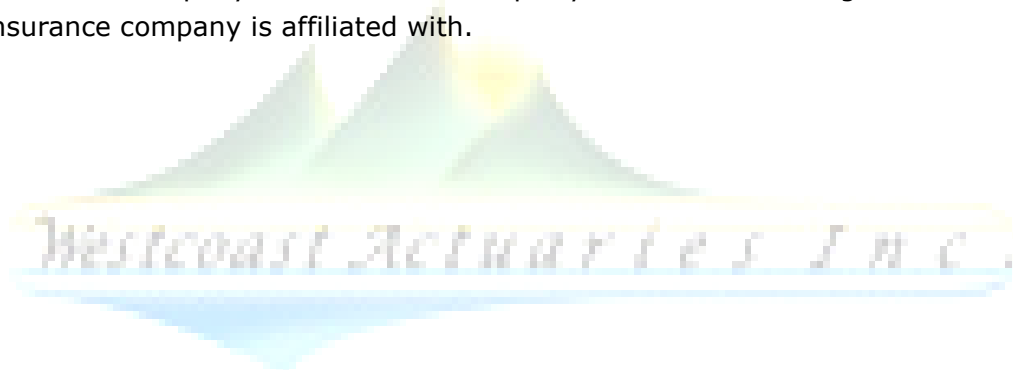
- ◆ Lacks income-splitting like a spousal RRSP.
- ◆ No access to funds while employed.
- ◆ Higher expenses.
- ◆ Excess surplus would reduce the ability for the employer to make on-going contributions.
- ◆ No cash lump sum available. Benefits are locked-in.
- ◆ Mandatory annual minimum contribution except for exempt provinces (BC/MB/PEI/QC).

IPP Funding Arrangement

The most common funding arrangements allowed by Canada Revenue Agency (CRA) for purposes of funding an IPP are:

1. A contract with an insurance company

The contract is referred as a Deposit Administration or Investment Management Only (IMO) contract. Most insurance companies have standard IPP products. Available investment options are restricted to the funds managed by the insurance company and certain third-party investment management firms the insurance company is affiliated with.





2. A pension trust with a trust company acting as a corporate trustee.

Most trust companies, in particular the larger firms, may have a significant amount of minimum trust and custodial charges as they specialize in larger pension funds. Depending on the types of investment held in the account, some trust companies offer special products for IPPs ranging from \$300 to \$2,000 per year of trust and custodial charges. The lower fee arrangement usually applies to IPP accounts that only invest in mutual funds that clear electronically.

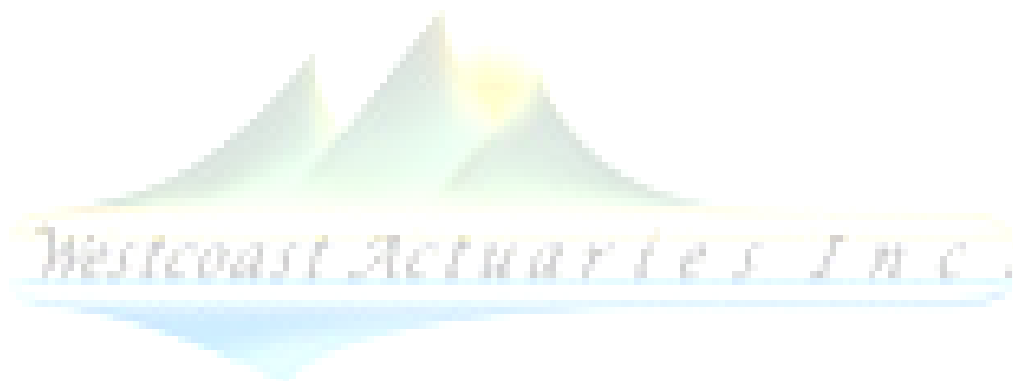
3. A pension trust with three individuals acting as trustees.

A common arrangement would have the IPP member, the spouse and one third-party individual act as trustees. The requirements are:

- ◆ They all must be Canadian residents; and
- ◆ One trustee must be independent (i.e. not a shareholder, partner, employee) of the company that sponsors the pension plan. CRA has removed this requirement for an independent trustee in 2005 but most provincial pension regulators still require that one of the trustees must be independent of the company.

IPP Investments

IPP assets can be invested in any pension eligible investments such as stocks, bonds, mutual funds or pooled funds, T-bills, GIC's etc. The pension fund can have investment flexibility just like a self-directed RRSP. Investment of pension funds follows the "Prudent Man" standard for investment of trust funds - i.e. whether it is prudent to invest funds in such a manner. The key requirements are quality standard and diversification. If pension plan assets are invested in individual securities (e.g. a stock or bond), each security can not be more than 10% of the plan on a book value basis at the time the investment is acquired. There is no longer any foreign content limit after the Federal Budget of February 2005.





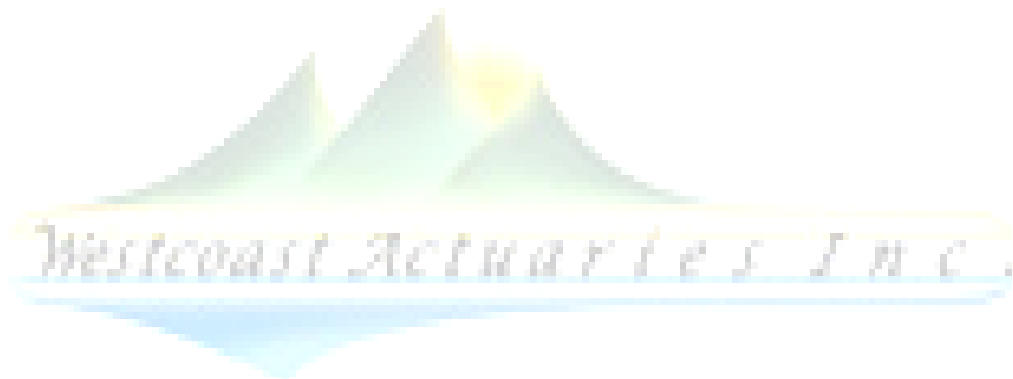
Determination of Pension Benefits

The benefits are based on 2% of indexed earnings for each year of service up to the maximum pension limit for connected persons for years of service after 1990. A connected person is defined in the tax legislation as an individual who own directly or indirectly 10% or more of any class of shares of a company or an individual who does not deal at arm's length with such a person. The arm's length test would make the spouse, parent or child of a connected person also a connected person.

For example, if a member who was paid \$50,000 in 1991 retires on January 1, 2006, his benefits for 1991 would be based on his 1991 earnings (\$50,000) as indexed to increases in the average industrial wage index from 1991 to 2006 (the indexed earnings would be \$69,000, an increase of about 38%). His annual pension benefits attributable to the 1991 year would be \$1,380 (2% of his indexed earnings of \$69,000). His total annual pension benefits will be the aggregate of similarly determined amounts for all years of pensionable service.

At higher employment income, the pension benefits will be restricted to the maximum pension limit. For example, \$80,000 of employment income paid in 1991 would have increased to \$110,400 in 2006 with wage index increases. 2% of indexed earnings of \$110,400 would have resulted in an annual pension benefit of \$2,208 ($\$110,400 \times 2\% = \$2,208$). However, the maximum pension limit for the 2006 year is \$2,111.11 of annual pension for each year of service. For an IPP member who was paid \$80,000 of T4 income in 1991 and retires in 2006, the annual pension benefit for service in 1991 will be limited to \$2,111.11, instead of \$2,208.00 based on the 2% formula.

The maximum pension limit increased from \$1,722.22 for 2003 and prior years to \$1,833.33 for 2004, \$2,000.00 for 2005, \$2,111.11 for 2006, \$2,222.22 for 2007, \$2,333.33 for 2008 and \$2,444.44 for 2009. The maximum pension limit will then increase at the rate of the average industrial wage index growth after 2009. Please note that the maximum pension limit for pre-1990 pensionable service recognized after June 7, 1990 is only 2/3 of the full amount.





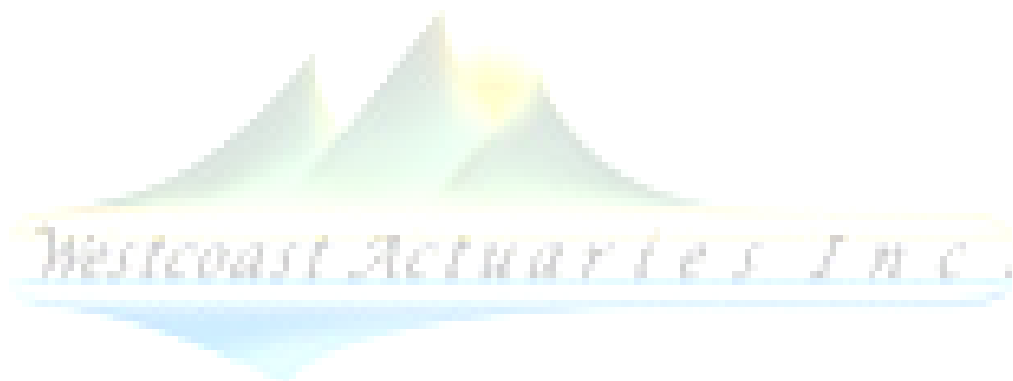
The above determination only applies to **connected persons for years after 1990**. A connected person is defined as an individual who directly or indirectly owns 10% or more of any class of shares of the company or not dealing at arm's length with the company. Annual pension benefits for a non-connected employee or for a connected person for service prior to 1991 can be based on 2% of the best average 3-year indexed earnings for each year of pensionable service subject to the maximum pension limit as stated above.

Settlement of Pension Benefit

Plan benefits can be settled through one or a combination of the following options:

1. pension paid from the plan (pension fund)*.
2. annuity purchased from an insurance company.
3. lump sum payment in:
 - ◆ cash or transfer to a regular RRSP or RRIF if benefits are not locked-in.
 - ◆ transfer to a locked-in RRSP or LIF (Life Income Fund) if benefits are locked-in.

Among the options available, a monthly pension paid from the pension fund (Option 1 above) is usually the preferred option as it does not preclude the pensioner from having a portion of or all of his pension benefits settled through one of the other two options at a later date. Options 2 or 3, once elected by the pensioner, would not be reversible. Please note that for Option 3, there is a maximum amount as to how much a plan member can transfer to RRSP/RRIF (locked-in as required by pension legislation) type vehicle that is based on the annual pension amount earned by the member multiplied by an age-related factor (e.g. 9.0 for ages under 50; 11.5 for age 60 etc.). The excess will have to be paid to the member in cash as a taxable amount. If the member is under age 65, the excess amount can be used to pay for the pre-65 lifetime pension and bridging benefits.





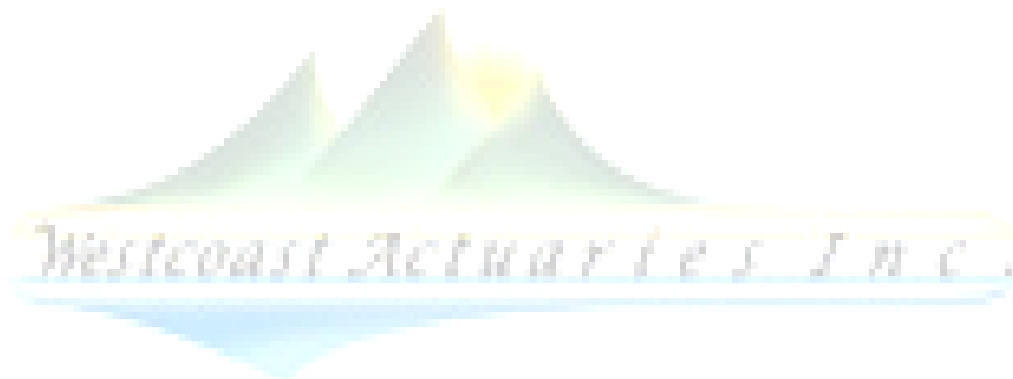
Impact On RRSP

For Past Years

Post-1990 past service benefits can only be provided if the Past Service Pension Adjustment (PSPA) can be satisfied. PSPA represents the RRSP room the member should have lost as a result of the recognition of past service; it is an amount that is calculated based on the IPP member's employment income history for the years past service benefits are being provided under the IPP. The PSPA can be satisfied through:

- 1.** If the member did not make any RRSP for those years, a Form 1004 can be filed with Canada Revenue Agency (CRA) for certification to eliminate the amount equivalent to the PSPA from the member's unused RRSP room carried forward.
- 2.** If the member already made full RRSP contributions for those years
 - a.** An amount equal to the PSPA amount can be transferred on a tax-free basis from the RRSP to the IPP. This is referred to as a "Qualifying Transfer".
 - b.** An amount equal to the PSPA amount can be withdrawn from the RRSP on a taxable basis to create room required for CRA certification process as outlined in **1.** above. This is referred to as a Qualifying Withdrawal.

Most PSPA's are satisfied through Qualifying Transfers from RRSP. If there are not sufficient RRSP funds to satisfy the PSPA through a Qualifying Transfer, either the number of years of past service benefits recognized would have to be reduced or the recognition of past service can be postponed to a future date until the RRSP funds have accumulated to the required PSPA amount. Some individuals may wish to have certain years recognized currently in order to achieve immediate funding for past service purposes while postponing the recognition of other years so that the remaining RRSP funds can accumulate to the required PSPA amount for those years in the future.





For Current Year

When an IPP is implemented for a connected person, that individual's RRSP deduction limit for the year is reduced by a special prescribed amount which is 18% of earned income for RRSP purposes for the year **1990** up to a maximum of \$11,500. For example, if the individual's 1990 earned income was \$50,000, the reduction in RRSP deduction limit would be 18% or \$9,000. If earned income in 1990 was \$100,000, then the reduction is \$11,500 as 18% of \$100,000 or \$18,000 exceeded \$11,500. For 2006, the application of this special rule would result in RRSP deduction limit of \$6,500 for people at maximum earnings level (i.e. \$18,000 less \$11,500 equals \$5,000).

For Future Years

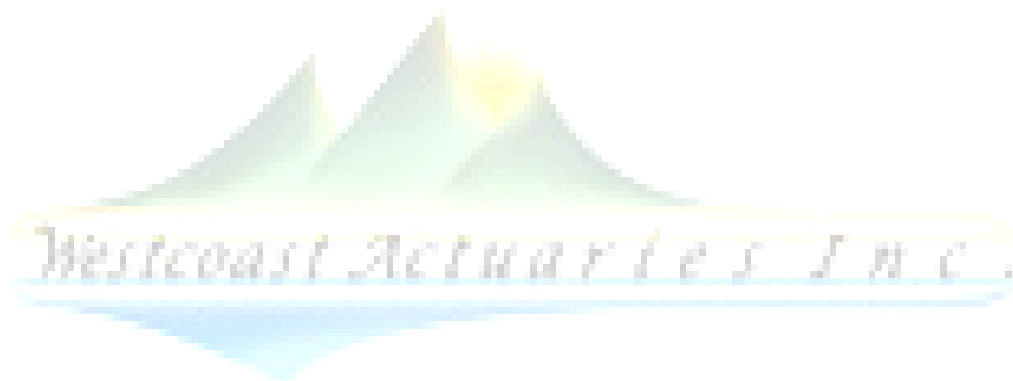
Any pension benefits earned would reduce a member's RRSP contribution room. Each year while the IPP is in effect (i.e. starting with 2005), there will be a Pension Adjustment (PA) reported on the member's T4 that would reduce the member's RRSP deduction limit **for the following year**. A new IPP member in 2006 can expect to have annual RRSP contribution room of \$600 in 2007 and future years.

Past Service Opportunities

Past service benefits for connected persons can be provided without any restriction starting with the 1991 year if the employer was incorporated prior to 1991 and there were T4 earnings paid. For an employer who was incorporated after 1990, past service benefits can only be provided retrospectively to the date of incorporation.

Pre-1990 Past Service Benefits

Pre-1991 benefits can be provided to employees who are connected persons **only if** the same value of benefits is also provided to other non-connected employees through union pension plan contributions, money purchase pension plans or defined benefit pension plans. There are no restrictions on the provision of past service benefits to non-connected employees.





The maximum pension limit for pre-1990 past service benefits is lower and is only 2/3 of the full amount. For example, the maximum pension limit in 2006 for pre-1990 service is \$1,407.41 (2/3 of \$2,111.11) of annual pension for each year of service. Consequently the funding for each year of pre-1990 service is 2/3 of the regular amount. Providing pre-1990 past service benefits does not have any impact on the employee's RRSP. For a long service employee with eligible pre-1990 service, an IPP can serve as a big tax-shelter.

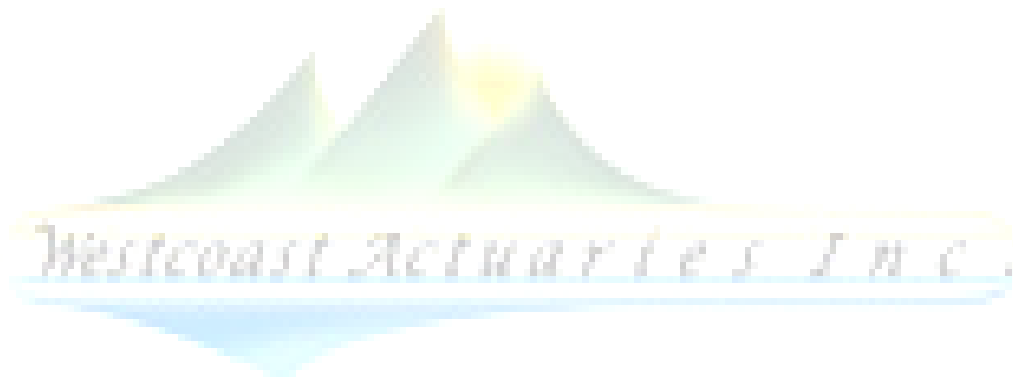
Canada Revenue Agency issued guidelines in 1999 that the present value of pre-1990 past service benefits cannot exceed the present value of post-1989 past service benefits provided for current and future service. This essentially limits the amount of pre-1990 past service contribution to the amount of current service contribution each year until all pre-1990 past service has been fully funded. Income Tax Regulation 8503(15) prohibits a pension plan member from forgoing any taxable payments or benefits the member would otherwise be entitled to in exchange for pre-1990 past service employer contribution.

An IPP Contribution Example

A 60-year old shareholder joins an individual pension plan (IPP) effective January 1, 2006. The shareholder had maximum income for pension purposes for all years.

Past Service Contributions

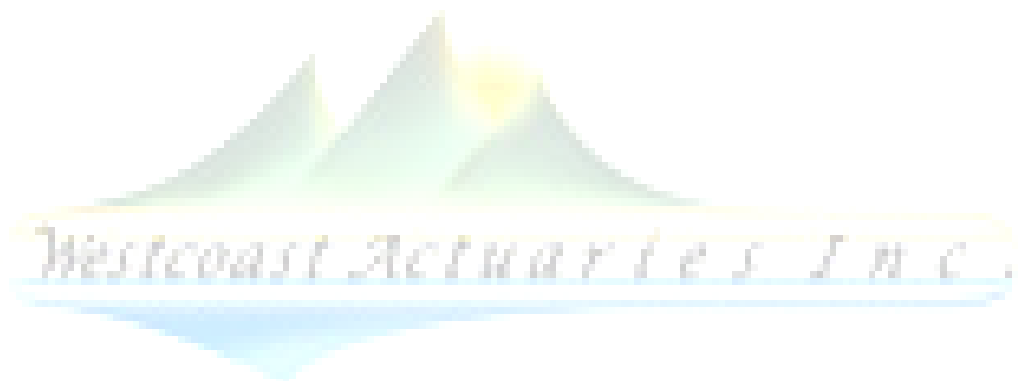
The past service liability for the fifteen-year period (1991 to 2005) is \$412,950 or \$27,530 per year. The reduction in RRSP room as a result of past service benefits being provided (i.e. the Past Service Pension Adjustment or PSPA) would have been \$250,600, determined as follows:





<u>Year</u>	<u>Amount</u>
1991	\$ 11,500
1992	11,500
1993	12,500
1994	13,500
1995	18,000
1996	18,000
1997	18,400
1998	18,400
1999	18,400
2000	18,400
2001	18,400
2002	18,400
2003	18,400
2004	18,400
2005	<u>18,400</u>
Total	<u>\$ 250,600</u>

If the member has \$250,600 of unused RRSP room carried forward available, the full \$412,950 can be contributed by the Company to the IPP as a past service contribution. A prescribed Canada Revenue Agency form will be filed to reduce the unused RRSP room carried forward by the \$250,600 amount. If the member already made full RRSP contributions for prior years and does not have any of unused RRSP room carried forward available, the \$250,600 will have to be transferred from the RRSP to the IPP, resulting in a net past service contribution room of \$162,350 (\$412,950 less \$250,600).





Current Service Contributions

The current service contribution to be made by the Company each year is 27.0% of the member's employment earnings up to the following maximum amounts:

<u>Year</u>	<u>Amount</u>
2006	\$ 28,543
2007	30,684
2008	32,985

Terminal Funding Contributions

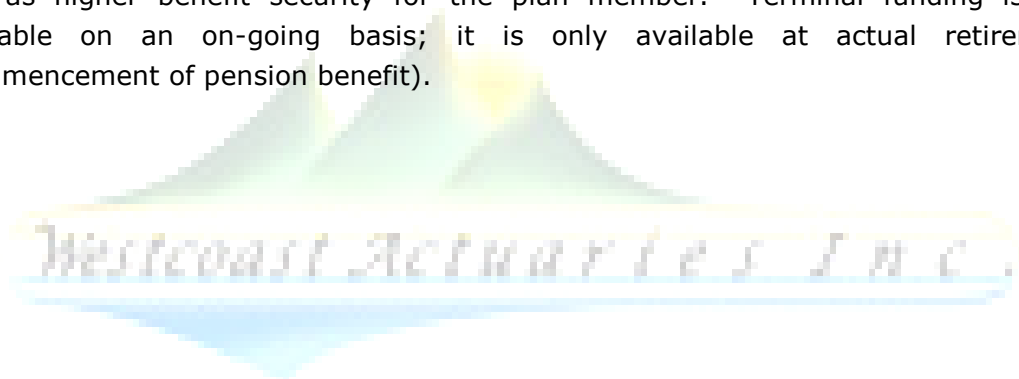
Income Tax Regulations prescribe certain actuarial assumptions to be used in performing actuarial valuation of pension plans for connected persons and highly-paid employees. These prescribed assumptions include:

- ◆ Retirement at age 65.
- ◆ Spouse assumed to be the same age as member.
- ◆ Post-retirement pension increases equal to increases in the Consumer Price Index (CPI) less 1%.
- ◆ Prescribed valuation interest assumption of 7.5% per annum.

This means the pension fund may not have sufficient assets to pay for the following enhanced benefits on early retirement situations:

- ◆ Subsidized early retirement benefits. A pension plan can pay the full pension with no reduction at age 60. The minimum Income Tax Act required reduction is 3% per year prior to age 60 or the earliest unreduced date.
- ◆ The actual age difference between member and spouse.
- ◆ Full CPI for post-retirement pension increases instead of CPI less 1%.
- ◆ Bridging benefits (equivalent of CPP and OAS benefits) prior to age 65.
- ◆ Switching the actuarial assumptions for valuation purposes – in particular the interest assumption from 7.5% per annum to a more reasonable and conservative rate of 5.5% per annum.

A terminal funding contribution is then required to fund for these enhancements. This terminal funding can be viewed as the mechanism to convert a large lump sum deduction for the employer into pre-65 pension benefits, better indexing benefit as well as higher benefit security for the plan member. Terminal funding is not available on an on-going basis; it is only available at actual retirement (commencement of pension benefit).





Terminal funding is often tied to the retirement of the IPP member and sale of the business where some of the taxable gain from the sale is offset by the deduction for the terminal funding contribution to the IPP.

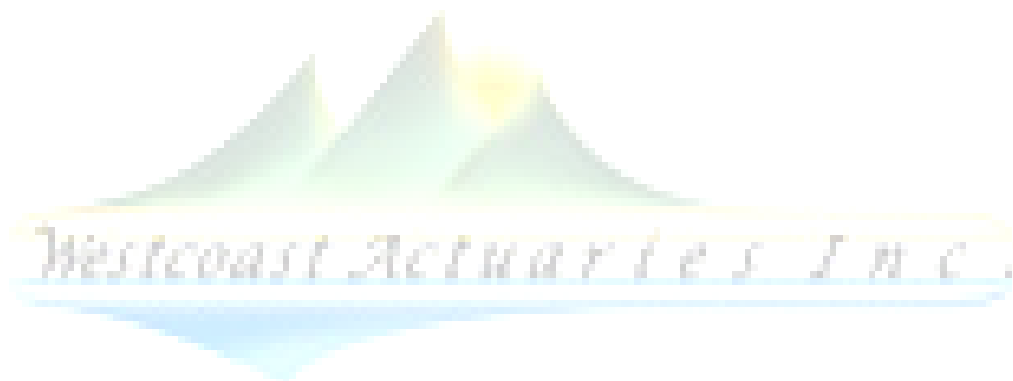
What Are the IPP Contribution Advantages Coming From?

In the pension world, the defined contribution design favors the younger members while the defined benefit design favors the older members. The critical factor that determines who would be better off under a particular design is "AGE". The "AGE" factor controls the length of the pre-retirement asset accumulation period and hence how much an individual can benefit from the magic of "Compound Interest".

Consider two individuals who both earn \$100,000 of annual income; one is 30 year-old and the other one 60 year-old. The defined contribution formula (e.g. 18% of earned income for RRSP) provides RRSP contribution of \$18,000 for both. Assuming that both will retire at age 65, the 30 year-old can grow the \$18,000 for 35 years to provide a reasonable amount of pension but the 60 year-old can only grow the \$18,000 for 5 years before converting that to pension. The magic of compound interest can only work if the pre-retirement asset accumulation period is sufficiently long. The following table illustrates the magic of compound interest based on an investment return of 7.5% per annum.

<u>Age</u>	<u>Amount Contributed</u>	<u>Accumulated Amount @ Age 65</u>
30	\$18,000	\$226,240
40	\$18,000	\$109,770
50	\$18,000	\$53,260
60	\$18,000	\$25,841

For an individual who is close to retirement, the relatively short pre-retirement asset accumulation period does not allow compound interest to work its magic. A defined benefit type of plan such as an IPP would be needed to provide a contribution advantage versus RRSP as the increasing cost of pension with age is reflected in the contribution amount which is actuarially determined; i.e. \$21,500 for a 45 year-old, \$23,700 for a 50 year-old, \$26,000 for a 55 year-old, etc. These contribution amounts assume that the individual earns annual salary in excess of \$106,000.





Under the current tax legislation, an individual would lose \$9 of RRSP room for every \$1 of annual pension earned. For the younger ages (under age 40), the present value of \$1 annual pension payable at age 65 is less than \$9 so the individual is better off by staying with RRSP. At the older ages that are close to retirement, the present value of \$1 annual pension is certainly worth more than \$9. For example, \$1 of annual pension at age 65 has a present value of approximately \$14.50 based on the assumptions prescribed in the income tax regulation for IPP valuation purposes. Once the IPP provides sufficient contribution advantage on a past service and current service basis to justify the additional costs involved, that will be the right time to switch to the IPP type of plan

An IPP is certainly not a program for everyone. It only benefits people with the right age profile under the right circumstances. People who may potentially benefit from such program as well as their investment advisors should try to acquire the basic product knowledge to identify whether an IPP is the proper retirement savings vehicle to replace RRSP.

