WOOD GUNDY

INDIVIDUAL PENSION PLANS

Business owners continue to recognize the benefits offered by Individual Pension Plans (IPPs). An IPP may provide higher retirement savings for business owners and their employees who meet specific criteria. For individuals 40 years of age and older, an IPP may be an ideal way to maximize retirement benefits, as the amount that can be accumulated within an IPP is generally greater than the amount that can be accumulated in a RRSP. An IPP allows business owners to make good use of several business tax advantages, allowing more of their business' money to be deemed tax-deductible. This makes an IPP the most tax-efficient retirement savings plan on the market.

An IPP strategy should be considered within the context of a comprehensive financial and estate plan, with all individual circumstances reviewed carefully, and a proper cost/benefit analysis conducted.

What is an IPP?

IPPs are employer-sponsored defined benefit pension plans with typically one or two members. Pension benefits from a defined benefit pension plan are generally calculated according to a formula based on a number of factors, including years of service and salary. The employer makes contributions based upon an actuarial valuation report, which may include funding of any plan deficits. In this case, you know today what the benefits will be at retirement, however, the contribution amounts may vary from year to year.

In contrast, a money purchase or defined contribution pension plan defines the amount of contributions that can be made to the plan. The pension amount received by a plan member is dependent upon the accumulated value of the plan at retirement. These types of plans are similar to a Registered Retirement Savings Plan (RRSP). In other words, you know today what your contribution amounts will be from year to year; however the benefits you will receive at retirement are unknown.

Who can set up an IPP?

IPPs can be established by a corporation for owners/managers, key executives, or professionals, providing that the plan member is an employee of the sponsoring company. The employer can decide which employees will be provided with an IPP, although this type of pension plan is generally offered to connected employees only, since the funding rules are generally less stringent for them. A connected employee is defined as an employee who owns, directly or indirectly, ten percent or more of the sponsoring company's shares or of any other company connected to it.

Self-employed individuals operating an unincorporated business are not eligible for an IPP; however, their employees may be eligible to establish an IPP.

Who can benefit from an IPP?

An IPP can be a valuable retirement savings vehicle if you are:

- 40 years of age or older, and an employee of an incorporated business (as a business owner or professional)
- Receiving T4 income from the sponsoring company (you must be an employee of your corporation)
- Looking for additional retirement income beyond what can be provided for within RRSP limits
- Working for an employer who is willing to set up, administer and fund the IPP

Maximum pension benefits

The maximum pension benefit that an employee can accrue for each year of service is 2 percent of earnings up to a legislated dollar limit. The legislated limit for 2023 is $3,506.67 and indexed thereafter.

Earnings from an employer include salary, wages, commissions, and bonuses, as well as the value of taxable benefits, but dividends are not considered earnings for pension purposes.

A non-connected employee can receive a pension based on the best three years' average income, which can have the effect of mitigating low-earning years or earnings fluctuations. Benefits may also be earned while on disability or leave of absence, based on earnings before the disability or leave.

The pension for connected employees is based on an indexed career earnings benefit formula (actual earnings for the year will determine the benefit earned for each year of service). As a result, connected employees can earn a maximum pension if they draw the maximum earnings required annually ($175,333.50 in 2023).

IPP contributions

As a defined benefit pension plan, an IPP must promise a lifetime retirement pension for the employee. An actuary will determine the contributions required in order to fund the promised pension benefit. The actuarial valuation must be completed at least once every three to four years, depending on provincial legislation. Over time, the IPP fund may be in a surplus or deficit position, as the actual rates of return may differ from the actuarial assumptions prescribed by the Income Tax Act. If the IPP is facing a surplus that exceeds 25% of the value of the pension, contributions may need to be reduced or halted. Conversely, if the IPP is facing a deficit, additional contributions may be required, and would be deductible for tax purposes. Pension regulation currently stipulates that the actuarial assumptions include the following:

- Inflation rate of 4 percent
- Post-retirement pension index rate of 3 percent
- Salary increase rate of 5.5 percent
- Income rate of return of 7.5 percent

At retirement, the IPP may be enhanced with additional benefits and contributions. Depending on the actual retirement age, the funding of these additional benefits may help to reduce any surplus in the IPP or may allow for additional tax-deductible contributions to the pension plan.

Pension Adjustment (PA)

Generally, your RRSP contribution limit is 18 percent of your previous year's earned income up to a maximum legislated amount, less any Pension Adjustment (PA). A Pension Adjustment is reported by the employer for members of registered pension plans and has the effect of reducing RRSP contribution room. A PA is essentially a calculated or estimated value of the accrued pension benefit. As an IPP is generally structured to maximize retirement benefits, the PA will fundamentally eliminate new RRSP contribution room, reducing it to $600 per year, after the first year. The client will receive a revised notice of assessment, which will indicate the amount of the RRSP contribution that can be made.

Vesting

When a pension vests, pension benefits generally become locked-in and must be maintained in such a way that they will eventually provide an income stream for your retirement years. If the IPP is terminated, the funds belong to the employee, but cannot be cashed in. If the IPP is terminated before the end of the year in which the client turns 71 years of age, the funds can be transferred to a Locked-In Registered Plan, or, in some cases, to an RRSP. The Income Tax Act limits the amount that can be transferred tax-sheltered from a defined benefit pension plan to a registered plan. Any excess amounts will be paid out in cash, and are subject to withholding taxes.

Key considerations

Advantages	Disadvantages
• As a defined benefit plan, retirement income is defined and predictable. • Higher contribution room for individuals over age 40 when compared to RRSPs. • Can make lump sum contributions for past service back to 1991 (or before if certain circumstances are met). In addition, can make lump sum contribution at retirement to fund certain ancillary benefits. • Contributions are tax-deductible to the corporation; as well, they are not taxable benefits to the employee (beneficiary) of the plan; • All actuarial, accounting and administration fees paid directly by the corporation (not from the IPP fund) are tax-deductible expenses to the corporation. • If the corporation has to borrow funds to fund the IPP, the cost to borrow is also a tax-deductible expense. • Pension income can be split with a spouse as soon as retirement benefits commence to be paid, even before the age of 65.	• Ongoing administrative costs which can be offset by the ability to deduct the IPP fund's investment management fees. • Has the complexity of a pension plan. • Restrictions on withdrawals. • If investment returns exceed the level required to fund benefits, contribution room may be reduced. • If investment returns are insufficient to fund benefits, additional contributions may be required. • New RRSP contribution room is reduced to $600 per year, starting in the second year. • An IPP member cannot contribute to a spousal RRSP.

An IPP strategy versus an RRSP strategy

Employee:

- 55 years of age
- Plans on retiring at age 71
- Earning the maximum annual earnings required to receive maximum pension benefits each year since 1991; $171,000 in 2022

IPP versus RRSP

Using the actuarial assumptions noted earlier in this report:

Description	Without past service	With past service
This person can contribute much more to an IPP rather than an RRSP on a cumulative basis, over the contribution period, for current service.	$448,614	$448,614
The additional contribution to the IPP by the plan sponsor, assuming the employee has 32 years of past service contributions.	$0	$488,810
The employee accumulates this much more in his IPP than his RRSP at age 71, assuming a net return of 7.5 percent.	$886,563	$2,522,717

(Note: By age 71, an additional $1,564,279 would be accumulated in the client's IPP as a direct result of the plan sponsor's past service contribution of $488,810 and all future IPP contributions in excess of the eligible RRSP contributions.)

Upon the employee's retirement, it may be possible to make additional contributions, called terminal funding, to the IPP. This optional contribution can be made at retirement to fund the bridge benefit, subsidized early retirement benefits and/or the indexing that could not be funded in advance.

Description	Without past service	With past service
This additional contribution could be made to the pension plan at retirement.	$202,337	$610,646
Assuming a net return of 7.5%, there would be this much more accumulated within the IPP than would be available in an RRSP.	$1,088,901	$3,133,364

Options at retirement

IPP funds belong to the employee. Unlike an RRSP, IPP funds are typically locked-in, and must be used to provide lifetime retirement income for the plan member.

Receiving pension benefits from an IPP

The IPP can be left intact and the employee can receive pension benefits from the plan. In this case, the employer continues to be responsible for the IPP, including administration of the plan, actuarial valuations and ensuring adequate funding, if required by the legislation.

If the IPP is wound-up, options include:

- The purchase of a guaranteed life annuity to provide the pension benefit
- The transfer of funds to an RRSP, except for Saskatchewan, Newfoundland and federally regulated IPP for which the funds must be transferred in an income-paying locked-in retirement plan

Any excess funds over the allowable limits are paid out in cash and subject to tax.

IPPS at death

Pre-Retirement

If the plan member dies before retirement, the surviving spouse must be given the option of purchasing a deferred annuity or transferring the commuted value of the IPP to another locked-in registered plan or, in some cases, to an RRSP. If there is no surviving spouse, the IPP funds can be distributed to other beneficiaries or to the estate of the plan member, subject to tax, but preferential tax treatment may be available.

Post-Retirement

Upon the death of the plan member after retirement, funds will be distributed based on whether the pension was being paid to the plan member from the IPP, or if the IPP was transferred to another registered plan.

Pension benefits from the IPP

If the plan member dies after retirement and is receiving pension benefits from the plan, the surviving spouse will continue to receive a pension as a survivor benefit (100% during any guarantee period, usually 66.66% thereafter). If the pension benefits were used to purchase a joint life annuity, the surviving spouse will continue to receive lifetime annuity income, in accordance with the terms of the annuity contract. If you are receiving income from a joint life annuity, there will be no estate value upon the second death, subject to any guarantee periods that may have been purchased.

If there is no surviving spouse, or upon the death of the surviving spouse, any remaining value within the IPP can be distributed to other beneficiaries or to the plan member's or spouse's estate, subject to tax, but preferential tax treatment may be available. Again, if you are receiving income from a life annuity, there will generally be no estate value upon death, subject to any guarantee periods that may have been purchased.

Pension benefits from another registered plan

If the plan member dies after retirement and the IPP funds were transferred to another approved registered plan, the surviving spouse can roll the full value to his or her own registered plan. Depending on the pension legislation regulating the plan, a locked-in registered plan may or may not be unlocked. The spouse, as beneficiary, may roll the proceeds to an RRSP or to a LIRA (if under age 71), or to another approved registered plan, depending on legislation. It is important to remember that in some provinces, the only option may be a life annuity if death occurred after age 80 (usually this would be a joint life annuity if there is a spouse), and, subject to guarantee terms. There would be no further proceeds upon the death of the surviving spouse.

If there is no surviving spouse or, upon the death of the surviving spouse, any remaining value within the registered plan can be distributed to other beneficiaries or to the plan member's or spouse's estate, subject to tax, but preferential tax treatment may be available. It should be noted that in all cases, a surviving spouse must be the beneficiary of any pension benefit.

Additional voluntary contributions

After transferring amounts from your RRSP to fund past service in your IPP, you may have funds remaining in your RRSP. With an Additional Voluntary Contribution (AVC), you may extend the benefits of your IPP to your retirement savings held outside the plan. This is inclusive of any RRSP amounts remaining after past service transfers. This also allows you to reduce the number of accounts to manage, in turn lowering potential annual administration costs, and potentially deducting the investment management fees on this portion of your retirement savings as well.

An AVC is an amount contributed to an IPP above and beyond any required contributions. You can transfer funds accumulated in other pension plans, such as an RRSP, a company pension plan or a Deferred Profit Sharing Plan (DPSP), as an AVC to your existing IPP. The funds transferred as an AVC are held in a separate account under the IPP umbrella and are subject to pension legislation. AVC funds are invested in accordance with your existing IPP Statement of Investment Policies and Procedures and can only be invested in IPP-eligible investments.

Advantages of additional voluntary contributions

- Fees associated with the IPP may be lower than those charged on retirement savings accounts.
- In certain provinces, funds held within an IPP may be protected from creditors.
- Unlike IPP assets, Additional Voluntary Contributions are not locked-in and may be transferred back to an RRSP at any time. This does not apply if the funds were transferred from a locked-in plan.
- Investment management fees may be deductible to the corporation.

We're here to help

Together with your advisor, you can create a retirement plan to help you make the transition from work to a worry-free retirement. To find out how you can gain the unique advantages of an IPP, contact your advisor.

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01/23