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PERSONAL PENSION PLANS: A POWERFUL SOLUTION FOR HIGHLY TAXED BUSINESS OWNERS AND INCORPORATED PROFESSIONALS

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Many business owners and professionals have used their corporations as a vehicle for saving for their retirement. However, the new tax measures proposed by the Minister of Finance in July 2017 and revised in December 2017, that target income sprinkling, holding a passive corporate investment portfolio and converting a private corporation's regular income into capital gains, boil down to higher taxes for business owners and incorporated professionals and their families and less money for retirement savings.

Best Kept Secret

One extremely tax-effective solution that is still available to business owners and incorporated professionals is the Personal Pension Plan or PPP. The PPP is a "three-accounts-in-one combination registered pension plan governed by the same rules as other tax-assisted retirement plans and has been available since 2012 but is extremely underutilized. It was developed by pension lawyer, Jean-Pierre Laporte of Integris Pension Management Corp.

According to Laporte, "The PPP is the most tax effective retirement savings program in Canada and is superior to IPPs and RRSPs."

By combining elements of Defined-Contribution (DC) and Defined-Benefit (DB) rules, the PPP gives business owners and incorporated professionals more flexibility, allowing them to take a break from contributing to the plan when cash is tight, and it has higher limits than RRSPs that are capped at 18% of income to a maximum of $26,230 for 2018. Depending on the age of the pension plan member, annual contributions to a PPP can be as high as $43,500 per year.

According to Integris, "The key advantage of the PPP design is that it provides flexibility with respect to the amount of contributions made each year. In good years, a business owner might utilize the DB component of the PPP to tax-deduct as much as possible. In lean years, the same business owner may elect to save under the DC component and reduce contributions to a mere 1% of salary. When business subsequently picks up again, the member could look back to the years where contributions were small and retroactively effect a 'buy back of past service", thus creating additional contribution room."

A third account, the ‘additional voluntary contribution” (AVC) subaccount forms the third component of the PPP plan design. This AVC account allows for the tax-deferred transfer of RRSP assets and is not permanently ‘locked-in’ by pension legislation, making the funds in it accessible at any time to the business owner. If and when the member chooses to use the DC account in a particular year instead of the DB account, contributions can be made on a voluntary basis to the AVC account as well during the year, triggering a personal tax deduction for the plan member of up to 17% of their T4 income in that year.

The PPP includes the following additional tax deductions and advantages that are not available to business owners and incorporated professionals who save through their corporation or via RRSPs:

1 – Past service purchases – the ability to buy back past service allows you to earn a pension for the years where you had T4 income from the corporation before the plan was set up. Typical amount of deduction can vary between $30,000 and over $500,000.

2 – Special payments – these can be made if the return on the assets in the DB component of the PPP are less than the prescribed 7.5 per cent per year rate of return expectation or if there is a deficit/liability in the plan due to poor performance of the portfolio.

3 – Terminal funding – if early retirement in elected, terminal funding can enable the purchase of an enhanced pension that is indexed to inflation. Typical amount of this tax deduction can range between $55,000 to over $1 million.

4 – RRSP double dips – In the year the plan is set up, the member can claim a personal tax deduction by contributing to his or her RRSP, in addition to the annual pension plan deduction claimed by the corporation for its contribution.

5 – Investment management fee deductions – under the Income Tax Act the investment fees for managing the pension money are tax deductible whereas the management fees for managing RRSP and other registered assets are not.

6 – Interest deductions – if the corporation borrows money to contribute to the PPP the interest on the borrowed funds will be tax deductible, whereas interest on money borrowed to contribute to an RRSP is not tax deductible.

7 – Higher annual contribution limits compared to RRSPs -Contribution limit to a PPP can be $270 to $17,300 more than the allowable maximum RRSP contribution.

8 – GST/HST Pension Entity Rebate – This rebate applies to PPPs that use the trust platform and gives the corporation a rebate of 33% of all HST paid in connection with the PPP. On the insurance platform the PPP is HST-free to the company.

9 – Lifetime Capital Gains Exemption – Terminal Funding and Buy Back of Past Service can be used to “purify” the corporation of non-active business income assets, so it can qualify for the Lifetime Capital Gains Exemption of $848,252 in 2018. This type of purification needs to be done when a corporation is sold through a share transaction.

10 – Inter-generational Tax-Deferred Wealth Transfer – In a family business where several family members participate in a single family PPP, upon the death of retired family members, PPP assets earmarked to fund the stream of pension benefits become surplus. The plan provisions can stipulate that any surplus in the pension plan belongs to the surviving plan members to fund their own pension benefits. This will eliminate the problem of “deemed disposition” of RRSPs on death and will allow for the transfer of wealth from one generation to another without triggering any immedi-

ate taxation. Taxes of course will eventually be payable when pension income is taxed in the hands of retiring plan members.

11 – Commuted Value Transfers – When an individual who is a member of a Defined Benefit (DB) pension leaves their employer, a portion of the commuted value of the DB pension is subjected to an excess amount calculation under ITR 8517, and is taxed in the hands of the member in the year of the transfer. If the individual joins their family business or sets up a new corporation, all of the DB assets can flow on a tax-deferred basis into the DB component of a PPP without triggering any taxation.

12 – Superior Creditor Protection Features – Whereas RRSPs at banks and financial institutions are only creditor protected in the event of bankruptcy, the PPP is provided with the highest level of creditor protection in Canada that applies to all formal registered pension plans. The assets of the pension plan cannot be seized by creditors of the plan member (except spousal creditors under Family Law legislation) nor of the corporation that sponsors the pension plan. Moreover, pursuant to recent changes that were made in 2008 to the federal Bankruptcy and Insolvency Act, the annual contributions required of the company to the pension plan receive 'super priority' in the event of the insolvency of the corporate sponsor and rank above the claims of the secured creditors such as major commercial lenders.

Considering all the above advantages, a business owner, or incorporated doctor, dentist, lawyer or accountant, can tax-shelter hundreds of thousands of extra dollars in a PPP due to the more generous tax treatment of registered pension plans by the Income Tax Act (Canada).

The only legal stipulation for a business owner or incorporated professional to be able to benefit from a PPP is that he/she and any family members who receive a salary from the corporation for work done, is receiving T4 income from the corporation since dividend income does not qualify as "pensionable".

Membership in the PPP can be restricted to the business owner and one or more key employees (who can be family members).

For example, a 45-year old business owner who incorporated in 2008 and had a T4 eligible income of $100,000 per year (opting to take the rest of his income in dividends), would be able to claim the following corporate deductions – assuming a 5% per year growth rate for invested assets:

a) Past service of $56,227
b) Special Payments of $72,434 (assuming assets grow at 5% annually vs 7.5%)
c) Terminal funding (age 57) of $625,344 (further discussed below).
d) Deduction for payment of fees (assuming 1% fee per year on assets) of approx. $4,000 in 2018 assuming $400,000 in the plan. Each year as the assets grow this annual deduction will be higher e.g. in 2028 when there is over $1 million in the plan the deduction will be approximately $10,000.
e) Extra contributions in excess of RRSP limits over 20 years: $360,651

Therefore, this business owner can significantly exceed the tax savings that RRSPs offer. For example, at age 57, the company will have accumulated an extra $ 926,673 in registered dollars over and above what the RRSP can provide (including Terminal Funding).

If the business owner decides to retire early, a tax-deductible terminal funding amount can be paid by the corporation to pay for an unreduced early retirement pension. Assuming the business owner in the above example elects to retire at age 57 (which he could do by simply shifting his compensation from salary to dividends and continuing to work as before), he could receive a $96,323 a year pension and trigger a supplemental corporate tax deduction of $625,344 in the form of terminal funding. Higher pensions would be payable in proportion to the salary received by the business owner from the corporation.

It is important to note that the $96,323 pension in this example is also eligible for “pension income splitting” with a spouse as early as age 55, whereas RRIF income can only be income split starting at age 65. The business owner and his wife can each claim a $2,000 per person pension income credit. Therefore, the taxable pension income of the business owner in this case would be only $48,161.

While the intention of the Department of Finance is to restrict the ability of business owners and incorporated professionals to treat their corporations as a retirement savings vehicle, the PPP can help them absorb the effects of the new tax hikes and create a substantially larger retirement nest egg at the same time.

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