

# The benefits of individual pension plans

By PETER MERRICK  
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Canadian entrepreneurs are embracing Individual Pension Plans (IPP) largely because of the sizable initial contributions, and as such, large corporate deductions associated with plan set up. The tax relief is quite superior in most cases to what is offered through personal investment in RRSPs.

However, there are several other additional benefits to IPPs which often go overlooked. Most significant among these are: additional funding on retirement, investment expense deductibility, Employer Health Tax savings, and creditor protection.

The additional funding on retirement allows the company to make one large, final payment into the IPP. This amount varies by retirement age and length of service, but is frequently a large six figures, and can grow to over one million dollars. This funding provides two significant benefit enhancements to the plan. The first is additional indexing. Many plans have a built-in indexing provision, something

not available in the standard RRSP.

Additional funding enhances this indexing level. Over the length of a plan member's retirement, this can have a significant impact on the total amount of pension received. The second benefit applies only to those plan members who retire prior to age 65. The additional funding provides a benefit bridging provision for those who retire early. Enhancing both the reduced pension and CPP benefits is a distinct advantage for the early retiree.

In order to take advantage of the additional funding, the IPP must either be maintained on in retirement or the assets can be used to purchase an annuity.

Rolling the assets into a locked-in retirement account (LIRA) or locked-in retirement income fund (LRIF), will result in a surplus which will cause the assets to be taxable in the participant's hands in the retirement year. Even though the individual will have substantially more retirement assets available than by using an RRSP, the taxable liability associated with the LIRA/LRIF option could be determining.



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The deductibility of investment expenses can provide a significant benefit to a business owner setting up an IPP for themselves. At age 69, an IPP participant could find himself with well in excess of \$1 million dollars in the plan. With a two-per-cent investment management fee quite common, that would translate in a taxable deduction to the sponsoring company of \$20,000.

For a company that establishes a plan for its owner manager aged 45 at the time of plan set up, the company could expect to deduct in excess of \$330,000 in investment expenses over the life of the plan.

In Ontario, Quebec, Manitoba and Newfoundland the provincial governments levy a payroll tax for health. Contributions made to an IPP are not subject to this tax. This means the savings in payroll taxes will in many cases offset the cost of establishing and administering the IPP.

Many business owners find themselves in need of greater protection for their assets than are pro-

vided by an RRSP. IPPs, by nature of the trust structure, provide a much greater level of creditor protection for the assets. Although not protected against divorce or fraud, IPPs will otherwise secure the participant's assets for their retirement.

## Retirement Options

On retirement, an IPP participant has three options on how to handle the assets in his plan, rolling the funds into an LRIF, purchasing an annuity, or drawing a pension directly from the IPP.

Rolling the funds into a LIRA discharges any further obligations to the plan. A wind-up is performed and any surplus or deficit is calculated. Once any deficit is funded, the company no longer has any responsibilities to the pension.

The subsequent pension will be based on the performance of the assets inside the plan and standard maximum/minimum withdrawal calculations for LIRAs. The additional funding on retirement is not available under this option.

Purchasing an annuity will also relieve the sponsoring company of any further obligations. The pension will be based on the annuity rates at the time the annuity is purchased. This option will allow for an additional funding payment to be made on retirement.

The final retirement option is to leave the plan intact and begin withdrawing a pension from it no later than the end of the plan members 69<sup>th</sup> year. This optional still requires triennial valuations and the sponsoring company is still responsible for funding any

deficits. This plan allows for the additional funding on retirement, as well as an indexed pension with known annual payments. If the company is willing to maintain sponsorship, this is usually the preferred option for pension payouts. Where the business is going to survive the retirement of the plan member this is often the recommended option.

IPP require specialties in areas such as accounting, actuarial evaluation, investment management, pension legislation, employment law and employee benefit plan construction.

Many employers and their accounting professionals will need to seek educational services to aid them in the IPP set up maintenance and wind-up stages. Therefore, it is worth the time and money to hire a skilled IPP consultant to assist in the design, implementation, maintenance and wind-up stages of an IPP solution.

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## Investing in personal development

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(held in Coventry, England) one of the attendees told a group that her investment in professional development over the past five years had been one of the very best investments she'd made since starting her own firm.

She went on to say that in 2000, she was running a firm that had revenue of about £250,000 and could hardly keep up.

Out of some desperation she read the book *The E-Myth Revisited* by Michael Gerber and learned for the first time about working "on", not just "in" her business.

She realized that technical competence alone was not enough to succeed in the CA business, or any business for that matter.

Once this penny dropped she began to invest her PD time and

money where it would have the best chance of payback. She went on to explain that her return on the PD investment was a firm now doing £1,000,000 with the same staff (because she was outsourcing most of the work to India), a Porsche in her driveway, and most importantly, her life under control!

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## Gold is a safe haven in times of crisis

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exceeds forecasts, should not be regarded as a universal solution to the gyrations of central banks' monetary policy.

It should not be considered a recession hedge but, rather, an asset that can be sold to raise funds in a crisis. Gold is sold in recessions because people want to raise cash. It is not under any safety umbrella.

### A new era

A fresh generation of investors has arrived who have forgotten or never been part of the lessons of the last gold experience. They fail to fully understand why they bought gold in the first place. They just recognize that their investment's market value has risen. Remember: "Genius is a rising market".

Investors currently buying gold are tempted to regard themselves as experts, and abandon their sound investment plans. They may start to open discount accounts and trade themselves into poverty! Does this strategy work? Ask those traders that got "Nortelled".

If the economy enters a recession over the next 12 months, precious metals are unlikely to continue their upward move. The

pressure on asset-holders to sell in order to gain cash is always difficult for those who choose not to sell. They see the value of their holdings fall. Yet prices in general continue to rise.

The fall should not be comparable to what happened to gold and silver after January, 1980. That was a historically unique period in the post-World War II era. The rate of price inflation under President Carter soared. This, coupled with Nelson Bunker Hunt's silver play, created panic in this market.

After the Soviet Union invaded Afghanistan in December, 1979 the metals mania exploded for one month: January, 1980. It then declined overnight.

In a recession, asset values tend to fall as people become desperate for cash. Fear is a great motivator. And so are margin calls. The marginal sellers of assets are more active than the marginal buyers of assets.

Nevertheless, most recent first-time buyers of gold and silver often overlook the obvious: that the moves of both metals over the last four years are anomalies. There is low inflation, and foreign governments, especially the emerging markets India and China, have

never been astute in their investment decisions regarding gold and the U.S. dollar. They sold gold at the bottom, because it was not doing well, and they're now buying gold at the top—the classic mistake of buying high and selling low.

### So what should you do?

We have repeatedly emphasized that some basic principles apply to all successful investment portfolios:

- diversification of portfolio to reduce risk;
- balance value and growth positions;
- choose excellence in investment management;
- winners take years to develop, so think long term;

If you can discipline yourself to stay with these timeless principles over a long period of time, investing becomes much easier.

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