Are you familiar with the Individual Pension Plan?

For owners of SMBs, an individual pension plan can be a way of maximizing retirement capital while providing advantages similar to those of a defined benefit pension plan.

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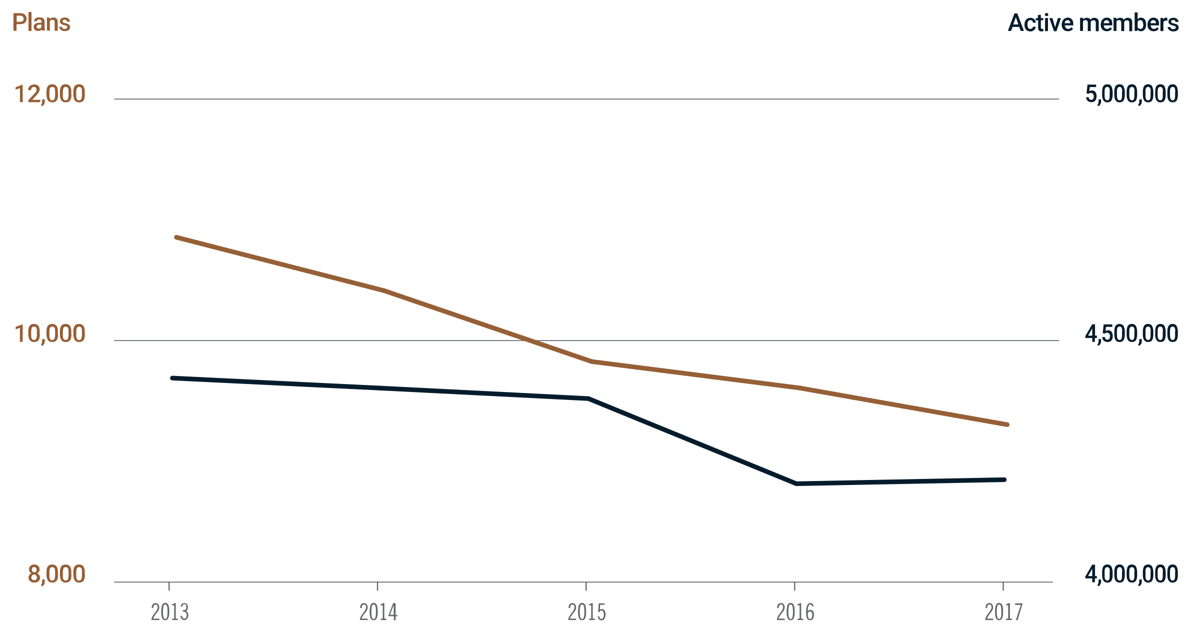
People who work for a large employer with a defined benefit pension plan have a distinct advantage: they can predict the income they will draw from their pension fund each year... for the rest of their lives.

This is clearly not the case for a great number of workers. As shown in the following graph, the number of defined benefit pension plans in Canada is gradually dropping, as is the number of plan members.

Registered Pension Plans in Canada

A downward trend



Source: Statistics Canada / Graphics: Actualis.

Special situation for entrepreneurs

This situation is even trickier for entrepreneurs, who can't count on anyone but themselves to build up the assets that will fund their pension income.

If you are the owner of a small or medium-sized business, however, you might want to look into a financial vehicle designed for individuals in your position: the Individual Pension Plan (IPP).

What is an Individual Pension Plan?

An IPP is a registered pension plan that a company can establish for its sole owner, shareholders or key employees, in the same way that large employers do for their employees. This allows small-business owners to benefit from advantages similar to those of a defined benefit pension plan, notably guaranteed pension benefits.

Maximize tax-sheltered savings

The IPP generally allows higher contributions than the limits that apply to RRSPs, which makes it an interesting option for entrepreneurs who have maxed out their RRSP and TFSA room. Note that, as for the RRSP, IPP contribution room is based on earned income: the portion of income that a small-business owner pays him- or herself in dividends is not included.

It's the employer who contributes

With an IPP, the employer makes the contributions, and these are tax deductible. In some cases, this deductibility could even help the business to maintain profits below the small business deduction threshold, providing a dual advantage.

It's the employer who is responsible for returns

The employer must also fund the plan, so as to fulfil the commitment of paying defined benefits throughout retirement. This means that if the financial markets underperform, the employer must make additional contributions to maintain the plan's funding level. These additional contributions are also tax-deductible. In an RRSP, it is the individual who assumes all of the market-related performance risk.

Savings exempt from seizure

Unlike an RRSP, an IPP is considered to be very well protected against creditors.

For high-income individuals of a certain age

The IPP is generally regarded as being intended for business owners who pay themselves a salary of at least $70,000, or even at least $100,000 a year. As well, the individual should ideally be at least 40 years old. Often, it is after age 50 that the IPP proves most beneficial in terms of maximizing pension contributions.

A complex product

Since it is a registered pension plan, the IPP is a complex product that should be set up by an actuary in accordance with Canada Revenue Agency standards. It can also be relatively costly. Good research and good advice are therefore highly recommended.

In this respect, a first step could be to consult your mutual fund representative or financial security advisor, who can draw on a broad network of specialists to provide guidance for entrepreneurs.

Sources

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