Individual Pension Plans ("IPPs") & Retirement Compensation Arrangements ("RCAs")

New/Old Tax Strategy in Light of Morneau's Proposed Changes to Private Corporation Taxation

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Morneau has proposed to limit:

- ✓ "Income Sprinkling" amongst family members via T4, T4A income as well as dividend income;
- ✓ "Passive Income" accumulation that is not used for business growth; and
- ✓ Converting "Business Income into capital gains, essentially discouraging the holding of income within a company.

The Problem:

How do you get passive income out of the private corporation/professional corporation and into the hands of the business owner/incorporated professional and family, and not encroach on the 53.5% (Ontario) top marginal personal tax rate or proposed 56% top marginal small business tax rate on passive income?

The Solution:

If the private corporation has been paying T4s to the business owner/incorporated professional and spouse if appropriate:

You could set up an IPP, an RCA, or both for the business owner/incorporated professional and spouse, sponsored by the business or professional corporation ("Plan Sponsor") and make tax deductible contributions to a creditor-proof trust fund that is there for the exclusive use of the plan members and family. Each member will pay tax in the year pension is received (no earlier than age 55 for the IPP) at the average tax rate of the member in that year. Through pension income splitting, it is possible to get average tax rates well below 50%.

If there is still some income in the company exposed to Morneau's new rules after maximum IPP contributions have been made, consider an RCA, where the same opportunity exists to have average tax rates on RCA income well below 50%.

Advantages/Disadvantages of the IPP & RCA (Same old)

IPP & RCA Advantages:

- Make a large tax-deductible past service contribution (past service is years prior to 2017 in which you and your spouse received T4 employment income).
- Make a larger (than the 18% of earnings RRSP contribution) tax-deductible contribution for 2017, 2018 and later (IPP: 25% in 2017, 25.5% in 2018, RCA: 75% of T4 earnings for a 55-year old).

In Addition:

- Assets are creditor proof;
- All investment expenses ("MERs") on assets can be paid by and deducted by the Plan Sponsor;
- Any interest paid on money borrowed to make contributions is deducted by the Plan Sponsor;
- The contributions made by the Plan Sponsor are not subject to payroll taxes;
- Significant added tax-deductible IPP contributions in the year pension commences (referred to as retirement funding);
- Retirement and estate planning is easier;
- If set up properly, assets in the IPP or RCA fund after the last to die of the business owner and their spouse can be passed tax sheltered to the next generation, allowing them to time the asset withdrawal and tax payable; and
- Downside protection: in the event that the plan suffers lower-than-expected returns, the IPP & RCA have the ability to make additional tax-deductible contributions to adequately fund the plan.

Added RCA Advantages:

- No requirement that the RCA ever be fully funded;
- No requirement on when the pension must start. IPPs & RRSPs must start pension by end of the year in which the pensioner turns 71, RCA has no requirement; and
- Participation in the RCA does not generate a pension adjustment nor does it affect or reduce RRSP room.

IPP & RCA Disadvantages:

- RCA - 50% of all contributions and 50% of all realized income has to be remitted to CRA and held in a Refundable Tax Account ("RTA"), to be repaid to the RCA trust when benefits are paid from the trust;
- RCA is not credited with interest; and
- RCA & IPP annual compliance is more onerous than an RRSP.