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THE IPP CONUNDRUM

Michelle Dickinson / November 17, 2011

Individual Pension Plans (IPPs) don't enjoy high brand recognition, nor are they all that generally well known or understood by the investing public.

But savvy advisors have taken the time to understand the product for two reasons: IPPs can be a value-added service for existing and prospective clients; and IPPs may be the new frontier in the asset accumulation cycle. As mutual funds were to the 1990s and ETFs were to the early 2000s, so IPPs may be to this decade: an unprecedented pool of growing client assets in need of management, support and advice.

Investor psychology

You know your clients and you know any investment idea you suggest is only as good as the client's psychological comfort level. Writing options on bank or telco shares may be a great idea, but not if the client is married to their stock and can't make the leap that it's possible to buy the stock back if it's called away. With IPPs, there's nothing really different. Understanding the psychology of your clients helps you serve that client better and anticipate their needs sooner and more intuitively. So that begs the questions: what's really important to a business owner or entrepreneur in finally deciding to go ahead and set up an IPP?

Despite the recent rule changes which have put a cap on the way past service contributions are funded, IPPs remain Canada's least known, yet most effective tax- reduction strategy that enables entrepreneurs to secure a reasonable level of retirement income and in the process save thousands of dollars in tax.

But what factors really come into play when an entrepreneur takes the plunge and decides to set up an IPP? The reality is that it's not one—but many—factors that help them make their ultimate decision.

1) Client focus: it's the numbers that matter.

The key actuarial assumption allowed by the Canadian Revenue Agency (CRA) is that money in an IPP will grow at a 7.5% rate annually. If, over the course of each three-year valuation period, assets in the plan have grown at less than the 7.5% rate, the planholder's company can contribute funds necessary for a top up. There is an implicit guarantee built into this assumption: it's really an investment return guarantee which, when compounded out over time, will help provide consistent performance to help offset the volatility implicit in investing in any or all asset classes.

2) Client focus: it's tax strategy that matters.

IPPs are highly tax-efficient, enabling entrepreneurs to take money out of their company tax-free, to grow on a tax-deferred basis for their exclusive use in retirement. In other words, the planholder's company contributions are a tax-deductible business expense and accumulate tax-free inside the pension trust established for the IPP. What's more, past service may be calculated back as far as 1991, similar to unused RSP contribution room. Further, depending on the planholder's age and income level, contributions to an IPP can be anywhere from 15% to 65% greater than the personal RSP contribution limit.

3) Client focus: it's creditor proofing that matters.

For these clients, IPPs are more highly protected than just about any other plan, including seg funds and RSPs. By law, ongoing, regularly scheduled payments to the planholder's IPP may still proceed even when the business is under creditor protection. In addition, such payments may proceed ahead of payments to secured lenders and other creditors. Also, individuals' IPP assets are even protected if they don't declare bankruptcy, which is not the case with RSPs.

4) Client focus: it's the fees and costs that matter.

Unlike RSPs, management fees charged for an IPP are deductible, as are plan set-up and administration fees. What's more, if the IPP planholder's company borrows money to top up his or her plan on each three-year actuarial evaluation date, the interest paid is deductible to the company. Basically, all costs associated with an IPP are tax deductible.

5) Client focus: it's client peace of mind that really matters.

IPPs offer a baseline income in retirement, a benefit currently enjoyed by only about 30% of Canadian retirees.

As an advisor, you can't manage or control the actuarial assumptions of an IPP or the complex requirements of *The Income Tax Act*, but you can help manage the process by which your clients deal with the more personal aspects of every investment decision they make. The goal after all is to balance the hard number calculations with more personal considerations in order to help clients achieve peace of mind.

The IPP target market is very specific and the benefits apply differently to different age and wealthcycle groups. So take the time to understand the key benefits as they apply to your clients and segment your market as reflected in your book of business.

Who is your potential market for an IPP?

Entrepreneurs (business owners). A client must own their own business to qualify.

Incorporated professionals (dentists, doctors, veterinarians, etc.) The practice must be incorporated.

Michelle Dickinson is CEO of DickinsonCarr Inc.

Filed by Michelle Dickinson, editor@Advisor.ca
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