CIBC PRIVATE WEALTH MANAGEMENT

RETIREMENT COMPENSATION ARRANGEMENTS

As a business owner, you're familiar with making your own rules and setting your own agenda. The freedom to control your future may be one of the reasons you went into business in the first place. But when it comes to funding your own and your key employees' retirement plans, the contributions you can make are limited, as are the tax benefits in traditional plans like a Registered Retirement Savings Plan (RRSP) and an Individual Pension Plan (IPP).

It doesn't have to be this way. By incorporating a Retirement Compensation Arrangement (RCA) into your plans and those of your key employees, you can put your individual mark on things. With an RCA, you can increase your tax-deferred retirement savings so they are in line with your income, while gaining tax benefits for your company. And as a business owner, offering your key employees an RCA can provide a competitive advantage in safeguarding their loyalty, since you can decide on the conditions that they will have to fulfill to be eligible to receive the benefits. Similarly, your employees can benefit from being able to secure their financial futures and maximizing their retirement savings.

RCA BASICS

An RCA provides supplemental pension benefits. The employer makes tax-deductible contributions on behalf of the employee to provide for retirement income. The employee can be the business owner, incorporated professional or other key employee of a corporation. Contributions to an RCA are deductible as a business expense to the corporation, and are not taxed in the employee's hands until benefits are received in retirement.

Benefits of RCAs

Corporation Benefits

- 100 percent tax deductible contributions
- Contributions are not subject to payroll taxes or charges
- Retirement assets may be protected from creditors
- If funded by insurance, an RCA creates potential for accelerated tax-free growth
- RCAs can be used as collateral for loans
- Excellent employee retention tool

Employee Benefits

- Not considered a taxable benefit
- No impact to RRSP or IPP contribution limits
- Retirement assets may be creditor protected
- Taxed when funds are withdrawn at retirement

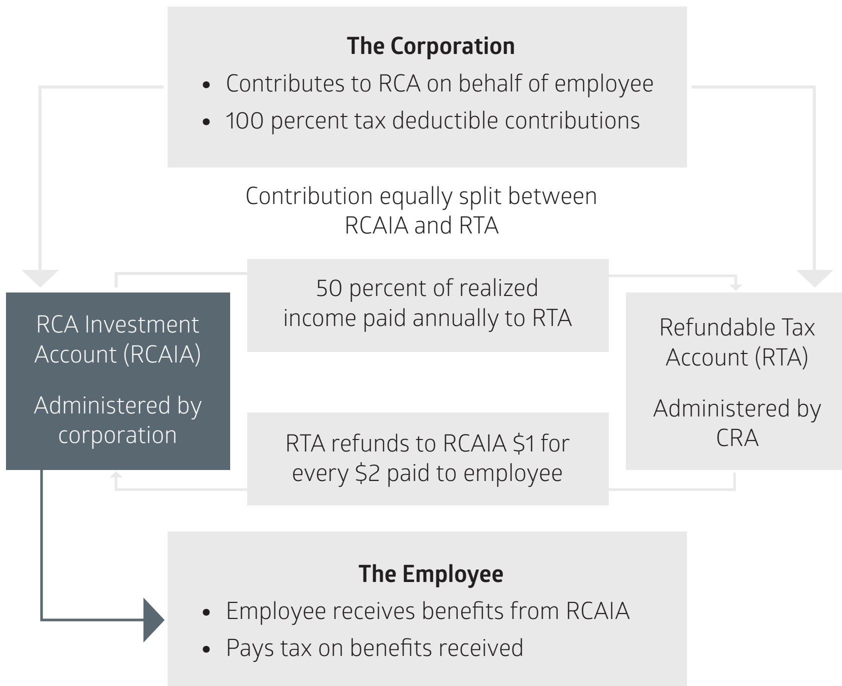
IS AN RCA RIGHT FOR YOU OR YOUR EMPLOYEES?

You should consider an RCA if you:

- Are the owner of a corporation or an incorporated professional
- Have key executives you wish to retain
- Earn significant income (approximately $250,000 per year)
- Want to reward employees above traditional retirement planning methods
- May be a resident of a lower tax jurisdiction in retirement

THE STRUCTURE OF AN RCA

Unlike other pension plan arrangements, the funds contributed by the company to an RCA are split equally into two accounts: the **RCA Investment Account (RCAIA)** and the **Refundable Tax Account (RTA)**.



RCAIA VS. RTA

Within the RCAIA, any investment from equities, mutual funds, fixed income, cash equivalents or even a permanent life insurance policy can be held. The RCAIA is administered by the custodian (one of the trustee's) with 50 percent of the realized investment income sent to the RTA account annually. A buy and hold strategy can be effective in the RCAIA to reduce the amount of realized investment gains thereby reducing the amount being sent to the RTA. The Canada Revenue Agency (CRA) is responsible for the administration of the RTA. No investments are held within the RTA as it earns no investment income.

Taxation of RCAs

All contributions made to an RCA on behalf of specific business owners and employees enrolled in the program are 100 percent tax deductible to the corporation. CRA requires that these contributions must be reasonable. That's where the advice of an actuary is essential to provide an actuarial certificate showing that contributions are not excessive.

Regardless of the type of income earned in the RCAIA, half the investment income realized by the trust must be remitted to CRA. No matter what investments are held, RCAs are exempt from preferred tax treatment such as capital gains or dividends. Upon withdrawal of funds, payments made from the RCAIA to the employee are treated as pension income and subject to tax at the employee's tax rate. In cases where the recipient resides outside of Canada or a lower tax jurisdiction in retirement, a lower tax rate may apply.

"Advantage" Rules and Penalties

If an advantage occurs in an RCA, a penalty tax will be imposed by CRA, payable by the annuitant, equal to 100 percent of the benefit.

PROHIBITED INVESTMENTS

An investment may fall into a category of investments that are not permitted within an RCA without resulting in penalty taxes. A prohibited investment generally includes:

- Debt of the annuitant;
- Investments in which you have a significant interest (you own ten percent or more of the issuing company, either individually or as a member of a related group), or where you do not deal at arm's length*.

*A non-arm's length transaction is one where parties are related in some capacity, or the parties do not deal at arm's length for another reason such as they acted in concert without separate interests.

If your RCA acquires a prohibited investment, a tax equal to 50% of the fair market value of the investment will apply as at the date of acquisition (or the date it becomes a prohibited investment). The tax will generally be refunded if the investment is removed from the RCA by the end of the year following the year in which the tax was applied.

Any investment income earned on a prohibited investment, while held in the RCA, will be treated as an "advantage" and may be subject to a 100 percent penalty tax.

Transitional rules may apply to such income realized until the end of 2021. The "transitional prohibited investment benefit" must be removed from your RCA within 90 days after the end of the tax year. If applicable, the investment income earned on the prohibited investment will not be considered an "advantage" and instead will be included in the income of the annuitant.

The "transitional prohibited investment benefit" is the total income earned and capital gains realized less any capital losses realized on these prohibited investments in the tax year.

The annuitant of the RCA is required to report the acquisition of prohibited investments directly to CRA.

Income at Retirement

At retirement, benefit payments to the employee are paid from the RCAIA to the employee. During the annual administration process that takes place at the beginning of the next calendar year, RTA funds are also transferred to the RCAIA at a ratio of $1 for every $2 of benefits paid out of the RCAIA.

Harness the Power of Life Insurance

Using tax-exempt life insurance to fund an RCA adds a degree of tax efficiency to the process, provided the insurance policy stays within prescribed limits set out by the government. A Universal Life policy, for example, allows an investment to grow tax free until retirement as all earned income is put back to work as long as the policy is held to maturity. Any investment income stays within the insurance policy and is not considered income realized by the RCAIA. Therefore, a Universal Life policy ensures that 100 percent of income earned in the policy stays in the RCAIA, minimizing required remittances to the RTA. Universal Life insurance combines life insurance with tax-sheltered investment options in one policy. You can benefit from considerable choice and flexibility in investment selection, premium amount and death benefit options.

RCAS IN ACTION*

John Smith, a 45 year old business owner, currently earns $200,000 per year. He started his company 15 years ago and plans to work until age 65 and he will have 35 years of service at retirement. He would like to have an annual pension income equal to 70 percent of the average of his three highest indexed salaries earned during his career. Assuming his salary increased at five percent per year in the future, John should have a total annual pension of $371,469. Also, John can make withdrawals on an annual basis. This amount will simply be added to his income. RCA provides maximum flexibility when it comes to withdrawals. Any withdrawals could reduce the the annual pension amount.

The corporation can make annual contributions to an RCA in order to fund the pension in excess of what can be provided under a registered pension plan, such as an Individual Pension Plan (IPP). These contributions are tax-deductible to the corporation and are not taxable in the employee's hands until benefits are paid in retirement.

Annual contributions (all or in part) not made in a given year can be carried forward to a year when the corporation has higher profits. An employee's or plan holder's past service can also be funded at any time, providing the contribution is reasonable under the circumstances.

Your advisor can provide you with a complimentary RCA illustration that will show the exact amounts your company could contribute to an RCA on your behalf. Our customized illustrations take into account your age, earnings history and retirement plans.

*All numbers and calculations provided by Buck.

RCAS AT DEATH

The death benefit paid by the RCA upon the death of the annuitant is dependant on the terms of the RCA when it was first established. Certain conditions can be imposed by the sponsoring company and will vary by plan.

LET'S TALK ABOUT THE POSSIBILITIES

Not only can an RCA help you be competitive and meet the needs of your corporation and your key employees, it also benefits your corporation. Your advisor can provide you with access to the possibilities offered by RCAs and help you sort through all the choices to ensure you select the most appropriate strategy.