The Stan Clark Financial Team's

PERSPECTIVES

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Financial Planning

Individual Pension Plans

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The 2018 federal budget included tax measures that may impact you as a small business owner or professional. In this issue, we'll focus on the tax measure that affects passive investments within a private corporation and the Individual Pension Plan.

Let's start with the reason for the new tax rules. The government's concern is that under the current rules, a "tax-deferral advantage" exists because the tax rate on active business income (ABI) earned in a corporation is generally much lower than the top marginal tax rate for individuals earning business income or employment income directly, especially if the income is taxed at the lower small business deduction (SBD) rate. If this after-tax corporate business income is not needed for a shareholder's living expenses and is retained in the corporation, there is more after-tax income to be used as capital for investment than there would be if the business income was earned directly by an individual. Over time, this may yield more investment income within the corporation.*

The budget proposed a measure that impacts the eligibility for business income to be taxed at the SBD Rate. The SBD Rate currently applies federally on the first $500,000 of qualifying active business income. Under the new rule, when a corporation earns more than $50,000 of certain types of passive investment income in a year, the amount of active business income that is eligible for the SBD Rate in the following year is gradually reduced. The SBD Rate reduces to zero at the $150,000 threshold of passive income*

What this means is that, going forward in some situations it will take longer to build up retirement savings within a corporation. But, there are alternatives, one being an Individual Pension Plan (IPP), when investment income exceeds $50,000.

An IPP is a defined benefit pension plan, generally for individuals 40 plus and earning in excess of $147,000 annually in T4 income**. It is similar to an RRSP in that it uses an investment account to accumulate assets over time as retirement benefits. However, unlike the RRSP, an IPP allows for accumulation of greater assets and allows owners to make contributions for service prior to the set-up of the plan. No other plan or individual investment can offer this benefit.

Other key benefits include:

- Tax-deductible contributions to the plan for the corporation, along with all associated costs.
- Predictable retirement income.
- Creditor protection for assets held in the IPP on condition that the pension plan was set up in good faith (e.g. not due to a looming bankruptcy).
- Ability for succession planning when family members work for the corporation.
- The possibility of terminal funding, which could allow for large contributions at retirement. While, the CRA restricts the benefits that can be pre-funded, at retirement, the pension plan can be amended to include full indexing, an early retirement pension with no reduction, as well as bridge benefits.
- Income earning in the IPP will not be included in the investment income that could reduce the SBD.

When you retire or sell your business, you can either receive a monthly pension plan from the IPP, buy an annuity or transfer the commuted value to a registered account. The rules are similar to RRSP's in that you must begin taking income by the end of the year you turn 71.

You should also consider some of the potential negatives. There's the paperwork and cost to create and maintain an IPP and your funds are locked-in, allowing less flexibility.

If you are interested in obtaining a personalized quote to see if an IPP can benefit you or would to learn more, please let us know. We'll be happy to help.

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