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TAXMATTERS

RRSPs, PPPs, IPPs and paying …

Less Tax

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Lower stock markets and higher taxes: it wasn't a good beginning to 2016 to say the least. You may still be a bit queasy from the ups and downs over the past few weeks, but the good news is that there are ways you can protect yourself.

The new year got off to a very shaky start for equity investors as volatile stock markets incurred record losses around the world.

Those sharp declines in the markets hurt many Canadians, as portfolio values plummeted on most mutual funds owned directly by investors or owned indirectly by the Canada Pension Plan and other pension funds.

That just added salt to the wound for high-income earners in Canada who began the year with a new – and higher – tax burden, crossing the threshold into new personal tax territory.

Personal income tax rates for people earning more than $200,000 a year rose by 4 per cent to 33 per cent. Many Canadians who are in the top tax bracket will now give up over half of their incomes to combined federal and provincial taxes.

So the question now becomes how to lessen the impact of these developments by examining alternate tax savings strategies so you can build and protect your personal nest egg.

One way is through Registered Retirement Savings Plan (RRSP) contributions, the basic retirement savings vehicle introduced by the government in 1957 to encourage us to save for retirement. Before RRSPs, only individuals who belonged to employer-sponsored registered pension plans could deduct pension contributions from their taxable income.

RRSPs became extremely popular. According to Statistics Canada, the majority of Canadian families hold RRSPs, totaling in excess of $1 trillion, with more than half in mutual funds. That's where recent drops in the stock market hit most Canadians.

While RRSP contributors receive a tax break on their taxes, many people are unaware that their hard-earned 'sheltered' savings will be fully taxed by as much as 58.75 per cent when they are forced, at age 71, to collapse the account and convert it into a Registered Retirement Income Fund (RRIF) or a registered annuity and begin withdrawals. There is a tax-free rollover to a surviving spouse, but on the second death all RRSP and RRIF money is considered income and gets taxed at the highest rate.

Reducing tax rate to zero

But there are many ways to reduce those ultimate tax liabilities to zero using life insurance.

Life insurance is a no-hassle way to direct your savings to your loved ones or favourite charities without having to go through a will or probate.

Let's take the example of a 70-year-old couple with $1m in registered retirement savings. On the second to die of the spouses, the tax department will take over 50 percent leaving their family much less than they

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expected to receive.

To eliminate that risk, married couples should consider taking out a joint and last-to-die life insurance policy to fund the tax that would be due on the second death. The premiums are very reasonable and represent approximately half the cost of purchasing an equivalent policy on one spouse only. Once you do the math, you will see why it's preferable to pay a small premium for a joint last to die policy in order to guarantee the full amount of your RRSP or RRIF to your family compared to giving half of your savings to the tax department.

If you are charitably inclined, consider funding the insurance premiums by taking money from your RRIF or RRSP and making a charity the owner and beneficiary of the policy. The money used to pay the premiums is considered a charitable donation which will generate a charitable donation receipt which you can use to offset the tax on additional withdrawals from your registered funds. The charity will happily recognize you now for a substantial gift today, even though it will not receive the insurance proceeds until the second to die of you and your spouse.

For the right person, an Individual Pension Plan (IPP) may also be a better option because an IPP can generate significant tax advantages beyond those provided by an RRSP, while producing higher pension benefits.

An IPP is a customized savings vehicle for business owners and incorporated professionals who can save significantly more than allowed under current RRSP rules.

Two important objectives are achieved with an IPP: as a defined benefit pension, it allows greater tax-deferred contributions than an RRSP, and on retirement, it provides annual pension income that takes into account your years of employment and annual T4 income.

A defined benefit pension plan provides the certainty of knowing exactly how much annual income you will receive each year as a pension benefit, in contrast to RRSPs, which are usually invested in mutual funds and stock market portfolios that cannot provide the certainty of future value.

Recently, a more flexible version of IPP has been available in the Canadian marketplace called the Personal Pension Plan or PPP. The PPP has all of the advantages of the IPP listed above, but provides additional benefits, making it more attractive for business owners than the IPP. These include: (1) flexibility in terms of how much to contribute each year when cash-flows are uncertain, (2) the ability to take tax deductions on RRSP assets transferred into the PPP, (3) lower investment management fees, (4) enhanced servicing of the Plan in terms of administrative and compliance matters and (5) greater control over how the assets are invested and withdrawn from the plan.

Objectives and Benefits

PPPs (and IPPs) also lower risk and achieve a steady predictable return of 7.5 percent annually. Added to that is a safety cushion that is built into the IPP that allows a tax-deductible 'top up' if investment returns fall below 7.5 per cent averaged over three years.

Designed for high-income business owners and incorporated professionals (like accountants, lawyers, doctors and dentists who draw T4 income) the PPP is rapidly gaining popularity.

Canada Revenue Agency rules allow you to decide each year whether your PPP pension benefit will be accrued using a defined benefit plan method or the more traditional defined contribution plan method.

Defining 'defined'

Unlike defined benefit plans, defined contribution plans do not provide a fixed amount of funds at retirement; the 'defined' part is simply how much money will be deposited.

The option of having your PPP pension benefits accrue using either a defined benefit or defined contribution method provides great flexibility, especially if your T4 income varies from year to year.

You can switch every year between the two components of the PPP depending on the cash flow needs of your business. So in a year with lower cash flow, choosing the less expensive defined contribution option often makes sense.

Using a PPP, you can save much more than allowed under current RRSP rules, and enjoy the added benefit of creditor protection not available with an RRSP.

As a result, you won't have to rely solely on your RRSP's performance to provide a long and happy retirement. That's because PPPs also offer guaranteed lifetime income. Any surplus in the plan belongs to you. This is an advantage PPPs have over other pension plans where any surplus stays in the fund and is used by

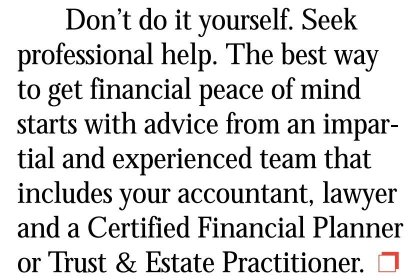
the company to pay for benefits for other members of the plan.

Finally, another way to escape the taxman's bite is to buy exempt permanent life insurance before the end of this year. Right now, when you buy a permanent life insurance policy, income earned within the policy is not taxable. But an update of 35-year-old legislation will lower the maximum cash value accumulations in tax-exempt policies as of January 1, 2017. Because the PPP allows the professional corporation the ability to claim substantially higher corporate tax deductions than what an individual can claim using an RRSP, the corporation will have significant funds now available at its disposal (in the form of tax refunds from CRA or tax savings that no longer need to be remitted) to purchase an exempt permanent life insurance policy. In effect, the CRA is helping you get two for one!

As a practical matter, because it takes about 90 days get an insurance policy in force (complete an application, complete the underwriting process and get a policy issued) the deadline for action is really September of this year.

Policies issued before 2017 will be grandfathered and continue to enjoy the current benefits.

As you can see there are many ways we can help you to keep more of your money. Contact us to determine how any of these strategies can help you, or to get a second opinion on your current planning.



Don't do it yourself. Seek professional help. The best way to get financial peace of mind starts with advice from an impartial and experienced team that includes your accountant, lawyer and a Certified Financial Planner or Trust & Estate Practitioner. ❐

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