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CROSS-BORDER WEALTH MANAGEMENT

Pension Options for the **Canadian Business Owner-Managers** Retirement

Strategic Retirement Planning for Owner-Managers of CCPCs: Exploring Pension Options in Canada

Planning for retirement is an important objective for owner-managers operating their business in a Canadian-controlled private corporation ("CCPC"). In this ebook, we discuss three available pension options:

1. Registered Retirement Savings Plans ("RRSPs")
2. Canada Pension Plan ("CPP") or Quebec Pension Plan ("QPP")
3. Individual Pension Plans ("IPPs")

Each option requires a salary or bonus payment as part of the owner-manager annual remuneration strategy. Where corporate profits are retained within the corporation, a different strategy other than pensions must be used to fund retirement.

Understanding Pension Plans: Employer Contributions and Regulatory Framework in Canada

In general, a pension is a plan funded by an employer to provide payments to an employee once they are in retirement. Pension plans can be contributory, where the employee also contributes to the plan, or they may be fully funded by the employer. In Canada, pension plans are defined by provincial legislation and must be registered with the Minister of National Revenue to be deemed a pension plan under the Income Tax Act (ITA). Pension plans also have statutory contribution limits.

RRSPs

RRSPs share similarities with defined contribution pensions in Canada, including annual contribution limits and the tax-deductibility of contributions. Earnings within the plan and amounts contributed are not subject to tax until withdrawal, and the plan must start to distribute funds at retirement or at a specified age. RRSPs have more flexibility than pensions, as withdrawals can be made at the discretion of the RRSP annuitant and can be made at any time – even earlier than the traditional retirement date. The ease of setting up an RRSP and its portability makes it an attractive option. While pensions may only pass in a reduced form to a spouse, RRSPs can pass directly into an estate.

To make an RRSP contribution, the individual must have received in the prior taxation year "earned income," including a salary or bonus as defined under subsection 146(1) of the ITA. The RRSP contribution is limited to the lower of 18% of earned income in that previous year or a legislated annual limit. The maximum amount you could contribute to your RRSP in 2023 was $30,780. For 2024, the maximum contribution limit has increased to $31,560.

Unused contribution room carries forward and adds to the contribution limit calculated for the year before. No contribution can be made to your own RRSP after December 31 of the year you turn 71 years old (at that time, your RRSP must be converted into a Registered Retirement Income Fund or RRIF).

But a contribution to a younger spouse's RRSP can still be made. In addition, contributions do not need to be deducted in the year they are made. They can be carried forward and deducted in a future year, which is helpful if you expect that you will be in a significantly higher marginal tax bracket in the future.

It is important to note that there are penalties for contributing more than your RRSP limit (contribution room), although an over-contribution of $2,000 can sit in the plan without incurring penalties. RRSPs can also be used for income averaging, which is the strategy of reducing income by contributing during high-income years and making withdrawals during low-income years. Finally, once you reach age 65, RRSP income is eligible for pension income splitting with your spouse, to help reduce the overall tax paid on RRSP withdrawals.

CPP

As an owner-manager, making salary payments also includes contributing to the CPP. While regular employees only pay the employee portion of CPP, your corporation – as the employer – will also pay the employer portion of CPP premiums.

Owner-managers of incorporated businesses have the choice to pay either salaries or dividends to extract funds from their companies for personal use. For individuals who have close to the maximum 40 years of contributions to the CPP, paying dividends may be a good option. That can allow them to avoid the expected significantly increased CPP premiums starting in 2024, as the increased premiums will not result in any significant increase in the CPP pension. However, for younger business owners, the choice to pay or not pay salaries to avoid CPP premiums is subject to other considerations. Those include diversifying sources of retirement income, investing the savings for a higher return by not paying CPP premiums, and contributing to an RRSP if no salary is paid.

Note that it is possible to share CPP benefits with your spouse by making an application to Service Canada.

IPPs

IPPs are a form of defined benefit pension plan and can be set up for just one person. An IPP is established by the employer corporation, funded by the corporation, and can be tailored to your individual needs. An IPP is subject to provincial pension rules and administrative requirements.

An IPP is often established in situations where the owner-manager has worked for the corporation for a long period and has not set aside retirement funds outside the company. An actuarial evaluation is required to determine the funding requirements for the pension for current and past service to the company. The most significant initial contribution will be for past service, which requires a history of paying yourself a salary/bonus from the company. Contributions set by the actuarial report are paid by the company and are deductible to the company in the year paid or in the previous tax year if it is paid within 120 days of that tax year-end. Updated actuarial reports will be periodically required to ensure that the plan is adequately funded.

For entrepreneurs over age 50, the initial funding requirement should be significantly higher than for a younger employee and is likely more than can be paid into an RRSP. Note that participation in an IPP will almost eliminate your ability to continue contributing to an RRSP in future years. It is best to catch up on RRSP contributions before instituting an IPP

Please contact Cardinal Point if you are a Canadian business owner-manager and would like to discuss available pension options for funding your retirement as part of your overall financial planning.

Contact Cardinal Point for More Information

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