

THE INDIVIDUAL PENSION PLAN

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The Individual Pension Plan

Overview

Over the past few years, the regulations governing tax assisted retirement savings have been subject to important modifications, aiming to offer a more uniform access to retirement savings for all Canadian taxpayers. Despite these modifications, a defined benefit pension plan still allows for larger tax-sheltered contributions than an RRSP, particularly for highly paid employees aged 40 or above.

Since January 1, 2001, the rules governing pension plan membership for shareholders and their relatives (connected persons) are much more flexible, as a result of amendments made to the Supplemental Pension Plans Act (SPP Act).

The Individual Pension Plan (IPP) is a defined benefit pension plan for the benefit of a single participant, which provides for all benefits permitted under the provisions of the Income Tax Act (Canada) in order to maximize tax-sheltered retirement savings. The Plan is particularly suited for highly paid employees, whether or not they are connected with the employer.

Permitted Benefits

For Future Service

The IPP allows a participant to accumulate, for each year of service following the implementation of the Plan, an annual pension subject to a maximum of \$3,610.00 for a retirement in 2024 and indexed annually from 2025.

This pension may be paid without reduction as of the age of 60, with the possibility of including a guarantee of continuance to the surviving spouse. Furthermore, the Plan may provide for the payment of bridging benefits between the date of the participant's retirement and the date on which he/she attains 65 years of age.

This pension may also be indexed after the participant's retirement according to a set percentage or according to an inflation-related formula.

For Past Service

Subject to specific conditions, certain periods of service prior to the date of implementation of the Plan may be taken into consideration for the calculation of the pension. Since each situation is different and the conditions are complex, each case must be analysed carefully in order to determine the eligibility of periods of past service.

Tax Advantages

The amount that can be contributed annually to an IPP increases rapidly according to the participant's age. This allows for a significantly larger amount to be accumulated in an IPP in comparison to an RRSP.

Accordingly, for a participant who retires at age 65 or age 60, an IPP, combined with an RRSP for the remaining contribution room, allows for the tax shelter of a larger amount of money than if only an RRSP had been used. The advantage is significant and may be even larger if periods of past service can be recognized.

Effect on RRSP Contribution Limits

Membership in an IPP during one year reduces the RRSP contribution room for the ensuing year. For example, if a person participates in an IPP during a year, his participation to the Plan will reduce the maximum contribution to an RRSP for the following year. During the year of implementation, the RRSP contribution room will be reduced by the amount of the Past Service Pension Adjustment (PSPA). However, for connected persons, the contribution limit for the first year of plan membership is also reduced by an amount generally equal to \$11,500. For the years following the establishment of the Plan, the participant may be allowed to contribute \$600 per year to his RRSP.

Pension Plan Operation

The IPP must be registered with the Canada Revenue Agency (CRA) and Retraite Québec (RQ) and, accordingly, must comply with the applicable provisions of the Income Tax Act (Canada), as well as with the SPP Act. Since January 1, 2001, Plans for connected participants are no longer required to be registered with the RQ, as per the changes brought to SPP Act. Consequently, funds in such plans are not locked-in.

Upon registration and every three years thereafter, an actuarial valuation of the IPP must be performed in order to determine the amount of allowable contributions for the next three-year period. If a surplus develops under the Plan, it can be:

- used to reduce the contribution requirement;
- used to improve benefits under the Plan; or
- left in the Plan, subject to prescribed limitations, until used.

On the other hand, if a deficit is created under the Plan, it can be amortized by way of special, tax-deductible, contributions.

On an annual basis, an information return must be filed with the CRA, as well as RQ if the Plan is subject to such registration. Furthermore, an annual statement of benefits must be remitted to the participant informing the participant of his status in the Plan.

Upon the retirement of the participant, the pension can either be purchased from an insurance company, paid directly from the Plan or transferred to the participant's locked-in retirement account (LIRA) (or RRSP if the IPP is not registered with RQ), whichever is the most advantageous to the participant at that time.

Please note that the amount that may be transferred tax-free upon Plan wind-up could be subject to a maximum.

Terms and Conditions of the Plan

The IPP may be financed completely by way of employer contributions, or may be financed, in part, by employee contributions varying between 1% and 9% of salary.

The age at which an unreduced pension begins can be selected, as well as the possibility of paying bridging benefits. Early retirement benefits, however, cannot be pre-funded. They can either be funded at the time of retirement by way of a special contribution, or by using accumulated surpluses in the Plan.

For a participant without a spouse, the pension benefits are guaranteed for a fifteen-year period, whereas for a participant with a spouse, the pension benefits provide for a survivor pension equal to two thirds of the participant's pension.

After retirement, the Plan can provide for the indexation of the pension in accordance with a set percentage or according to a formula related to the evolution of the Consumer Price Index. Any surplus that exists at the time of Plan termination is paid out to the participant.

Past Service Benefits

1. Service on or after January 1, 1991

Periods of service prior to the inception of the Plan and after 1990 can be recognized under the Plan to the extent the participant has unused RRSP contributions. If the participant does not have unused RRSP contribution room, those periods of service can only be recognized if the participant agrees to withdraw or transfer previous contributions. The maximum annual benefit for years of past service is the same as that for future service, i.e. the previously mentioned limit.

2. Service before January 1, 1990

Periods of service prior to 1990 can also be recognized, subject to the rules below.

For a participant that is neither a significant shareholder nor a connected person, the years of service can be recognized without any impact on the RRSP. However, the limit applicable to the pension is reduced to 2/3 of that applicable for future service.

For a participant that is a significant shareholder or a connected person, years of service can generally be recognized if the following conditions are met:

- The significant shareholder or connected person did not participate in another pension plan or deferred profit sharing plan of the employer, or of a related corporation, during those years.
- The employees other than the significant shareholders and connected persons participated in another pension plan, and the value of the benefits accruing to the significant shareholders and related persons for those years does not exceed 50% of the value of the benefits accumulated by all participants under all plans for those years.
- For 1981 and subsequent years, the compensation of the significant shareholder or connected person must be at least \$65,000 or 75% of his average compensation over the three consecutive years, in the past, during which the compensation was highest.

In addition to the above rules, the CRA ruled on March 31, 1999 that service before January 1, 1990 can only be recognized if the present value of such past service is not greater than the present value of benefits earned after the effective date of the Plan. As a result, for each dollar of current service, one dollar can be contributed for service prior to January 1, 1990.

3. Service during 1990

Periods of service during 1990 can also be recognized, subject to the following restrictions:

- The participant must have unused RRSP contribution room or be prepared to make a contribution withdrawal or transfer; and
- The pension for that year of service is capped at the limit applicable to the pension for future service; and
- For significant shareholders and connected persons, the restrictions imposed on the recognition of service prior to January 1, 1990 must be respected.

Overview of Advantages

- ✓ Annual contributions greater than an RRSP
- ✓ Employer's contribution exempted from payroll taxes (such as the contribution to Health Services Fund)
- ✓ Possibility of additional contributions if investment returns are less than expected (7.5%)
- ✓ Possibility of making additional contributions
 - For past service
 - For early retirement
- ✓ Better protection from creditors

Actuarial Services

The following actuarial services are included in the Plan implementation fees:

1. Initial analysis to determine the relevance of establishing a pension plan for a designated person
2. Illustrations and projections to assist the market intermediary
3. Issue of Form T2033 "Direct Transfer under Paragraph 146(16)(a) or 146.3(2)(e)" and/or Form T2151 "Direct Transfer of a Single Amount under Subsection 147(19) or Section 147.3"
4. Issue of Form T1004 "Applying for the Certification of a Provisional PSPA"
5. Issue of form T1007 "Connected Person Information Return"
6. Preparation of Form T510 "Application to Register a Pension Plan"
7. Company's resolution for adoption of the Plan
8. Maintenance of the Plan Text specimen with the Canada Revenue Agency (CRA)
9. Establishment of an investment policy for the pension plan
10. Initial actuarial valuation
11. Preparation of a letter to the CRA requesting approval of Plan contributions
12. Documentation for the creation of an individual trust agreement (financing vehicle)
13. Supervision of Plan operations
14. Supervision of changes in legal requirements
15. All correspondence with the CRA
16. Summary of the Plan for the employer; general and specific conditions

For an additional cost of \$575 per year (\$810 if the plan is registered with the RQ), the following services are also offered:

- Calculation of the Pension Adjustment (PA);
- Preparation of the Annual Information Return for the CRA;
- Preparation of the Income Tax Return of the Trust (T3P form);
- Preparation of an annual statement (RQ registered plans only).