IPPs for Small Business Succession Planning

Individual Pension Plans (IPPs) were introduced in 1991 to help business owners, incorporated professionals and key employees save for their retirement. An IPP is a defined benefit pension plan that is designed to accumulate retirement assets. IPPs are often referred to as supersized RRSPs. Depending on your circumstances, annual contributions can be substantially higher than annual RRSP contribution limits. The IPP must fund a guaranteed retirement benefit based on the member's employment earnings.

Generally, by age 38, the annual IPP contribution limits equal those of RRSPs and then continue to increase in subsequent years. The IPP is designed to provide a predictable income and employer contributions can be topped up when investment returns are less than 7.5% over a 3 year period. As well, the IPP can be an effective method of having your company fund your retirement benefits while possibly reducing corporate taxes. Once a business owner is ready to retire, which can be as early as age 50, the IPP's assets can be used to pay a guaranteed benefit amount or transferred to a locked-in plan to provide future pension benefits.

IPPs are ideally suited for employees between the ages of 38 and 71 who earn (T4 income) over $132,000 per year including key employees, incorporated professionals (such as doctors, dentists and accountants) and small business owners. With potentially higher contribution limits than RRSPs, IPPs offer other advantages including:

- greater certainty of retirement benefits
- allows your business to deduct initial contribution for past service when the IPP is established
- allows your business to deduct ongoing eligible IPP contributions
- investments accumulate in a tax-sheltered registered account
- investment growth of the plan's assets is actuarially determined at a rate of return of 7.5% annually
- provides pre-determined retirement benefits (additional IPP tax deductible contributions can be made when the realized investment returns are less than 7.5%)
- any IPP surpluses belong to the member(s)
- all costs and reasonable expenses related to the maintenance of an IPP are tax deductible to the company

IPPs and Succession Planning

Parents often establish a family business with the hopes of someday leaving the business to their adult children. One often overlooked strategy is to use an IPP for succession planning and multi-generational wealth transfer between family members.

How it Works

Consider the case of a successful business owner who has decided to establish an IPP to supplement retirement savings. Since the owner's spouse is an employee of the business (i.e. earning T4 income), the owner decides to add the spouse as a member of the IPP.

Assuming their children are actively involved in the family business and receiving employment earnings from the company, they are added to the parents' IPP as additional plan members when they reach age 38.

By setting up an IPP, the parents increase the certainty of their retirement future as they will each receive a guaranteed pension at retirement. By adding their adult children as IPP plan members, the parents have in essence established a multi-generational IPP that can defer taxable distributions of the balance in the IPP to the subsequent generation.

In our example the children take over running the family business after the parents retire and start to collect retirement pensions from the IPP with a guaranteed period for any surviving spouse. After the parents pass away, any remaining IPP assets stay in the plan for the benefit of the adult children as they are the surviving IPP plan members. There is no deemed disposition and no tax consequences to the successive generation on these assets. However the assets could create a surplus position within the IPP, meaning the business can take a contribution holiday by using the surplus to fund the adult children's annual IPP contributions.

Had the parents chosen not to include their adult children on the plan, there would have been a deemed disposition of the IPP assets on the death of the surviving parent, leaving behind a potentially large tax liability for their estate.

Conclusion

Setting up an IPP for multi-generation wealth transfer purposes works best in bona-fide family businesses where the adult children intend to carry-on the operation of the business.

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