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# The RRSPWrap™ for Private Business - Don't Retire Without One

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## The RRSP Myth

While a continuous funded and successfully invested RRSP might provide an adequate pension for those starting businesses, it is unlikely to do so for those who have been in business for 15 to 20 years or more. The reason is simple. RRSP contribution limits were lower and unused contributions could not be carried forward until 1991.

## The Statutory Gap

Let's take two 30 year olds (male or female). One is currently 30 starting in business and the other is 50 and started the business 20 years ago when they were 30. Up to Age 30, neither had made any contributions to an RRSP.

Here's the shocker. The 30 year old starting business today making maximum contributions (under current guidelines) will have an RRSP balance at Age 65 of $2,289,092 (assuming 5.5% earnings net of MERs). However, the 50 year old who started the RRSP 20 years ago at Age 30 will only have 1,481,400. That difference of $807,692 means a pension shortfall of $68,075 for a male (age 82 life expectancy) or $60,042 annually for a female (Age 86 life expectancy).

As can been seen, for those with RRSPs going back more than 20 years, the statutory gap will be much larger.

| Year | Limit | Year | Limit |
|---|---|---|---|
| **1977-1985** | $5,500 | **1996-2002** | $13,500 |
| **1986-1990** | $7,500 | **2003** | $14,500 |
| **1991** | $11,500 | **2004** | $15,500 |
| **1992** | $12,500 | **2005** | $16,500 |
| **1994** | $13,500 | **2006** | $18,000 |
| **1995** | $14,500 | **2007** | $19,000 |

## The RRSP*Wrap*™

Fortunately in 1998 Revenue Canada realized that those in private business were facing serious pension discrimination over those in the public sector. A provision in the *Income Tax Act* being used by Public Corporations to fill the "pension gap" was extended to Private Business if the guidelines for public corporations were followed. The provision (defined under Subsection 248(1) of the *Income Tax Act*) was referred to as a Retirement Compensation Arrangement (RCA) which could be "wrapped" around whatever form of pension the person in private business had. Hence the RRSP***Wrap***™ as R^C^F named it was introduced to private business. An IPP***Wrap***™ and MPPP***Wrap***™ are also now available.

## CRA Guidelines

Here is what Revenue Canada (now CRA) says:

**"A normal level of benefits would be the same benefit provided under a registered pension plan without regard to the Revenue Canada maximum. This would be 2% x years of service x final five-year average earnings or about 70% of pre-retirement income for an employee with 35 years of service." (CRA Roundtable discussion, 1998)**

## Final Average Earnings

What is most important is that CRA has indicated that those in Private Business can have a total pension (RRSP + RCA) based on" average final earnings". The RRSP contribution cap currently discriminates against those earning over $105,555 but 20 years ago it was $37,500.

## *The Benefit*

Our 50 year old started in business 20 years ago and has 15 years to retirement at Age 65. Under CRA rules the entitlement is for a pension of 70% (2% x years of service) of final 5 year average earnings. Let us assume that he/she is currently earning $200,000 of T4 income from the business with indexing at 3%. Projecting forward this results in a pension entitlement of $199,781 (70% of final 5 year average of $285,401).

The RRSP will only provide a pension of $124,859 for the male and $111,591 for the female on a primary basis (would be less for male if joint survivor option elected).

This difference of $74,922 for the male or $88,190 for the female can be covered through the RRSP***Wrap***™.

## *Funding*

RRSP contributions come from personal earnings and are deductible up to 18% or contribution cap. RRSP***Wrap***™ (RCA) contributions are deductible from corporate earnings and are not taxed in the individual's hands until contributions commence at retirement. As well (i) there is no contribution cap on corporate contributions providing CRA funding guidelines have been followed and, (ii) unused contributions can be carried forward just like an RRSP.

## *What Does This Mean?*

**For the Owner** - of a private corporation with taxable profits in excess of what is required to be reinvested in the business, the owner's pension can be enhanced with tax deductible corporate dollars. As well, contributions are held in a Trust and safe from the vagaries of business.

**For Employees** - it can provide long term security and provide initiative to remain with the company. RRSPs alone will not offer sufficient retirement income to most and building extra capital is difficult. Stock option plans are not usually available in private corporations, and do not provide the security of an RCA.

## *RCA Structure*

As mentioned, an RRSP***Wrap***™ is a Retirement Compensation Arrangement (RCA) "wrapped" around the RRSP to provide a level of benefits following CRA guidelines. The RCA has two components. (1) The RCA Investment Account (RCAIA) and (2) the Refundable Tax Account (RTA). There is also a Trustee that administers the Trust.

## *The Trustee*

Given the long term nature of an RCA, only a Corporate Trustee should be used. RcF has special arrangements with BMO Trust Company at reduced fees for private businesses. Although RCAs provide wonderful benefits to owners and employees of private businesses, they must be properly administered. Failure to do so can result in substantial penalties. A professional Corporate Trustee eliminates those concerns.

## *The Refundable Tax Account (RTA)*

A unique feature of an RCA is the RTA. This is effectively a pre-paid tax account. 50% of each contribution made by the corporation to the RCA goes to this account. Although this is currently slightly higher than personal tax rates (but not subject to payroll taxes), the advantage is that when funds come out at retirement, actual tax paid is at then at personal rates including treaty rates for non-residents. All RTAs are held in a special division of CRA in Winnipeg. RTAs earn no interest and some consider this unfair but, in reality it is not. To personally build a capital pool to provide additional retirement income, personal tax would be paid "as-you-go" and, perhaps at higher rates than at retirement.

## *The RCA Investment Account (RCAIA)*

Through a special PENSION***Plus***™ contract designed by RcF for use in RCAs, there are countless investment options available in the RRSP***Wrap***™ offered by Canada's insurance companies.

They can be portfolio managed (the insurance company does it for you) or self-administered (you or your investment advisor decide). Using PENSION***Plus***™ all insurance companies receive equal funds and pay the required benefits. It is a level playing field. All earnings in the RCAIA using PENSION***Plus***™ are also tax-sheltered unlike a Conventional Funded RCA where ½ of realized investment earnings go to the RTA.

How does PENSION***Plus***™ tax-shelter earnings? PENSION***Plus***™ is configured taking advantage of deferred taxation offered to Canada's insurance companies relative to accrual income. These are commonly called the "exempt" rules. A medical is required to determine longevity of the Plan Member and/or survivor. The advantage is that survivor benefits can be adequately dealt with, particularly in second marriages or where the spouse is significantly younger than the Plan Member.

## *The Tax Trap*

The focus on current taxation vs. long term planning is a dangerous "trap" that snares many business owners. To save immediate tax, there is the danger of having all one's eggs in the same basket. Not only is this fool hardy, but we live in an increasingly litigious climate. Bad things can happen. The long term security of the RRSP and the RRSP***Wrap***™ should be a "must have" for all business owners. To keep profits invested in securities within the corporation or holding company does not offer the same level of protection as an RRSP or RCA(RRSP***Wrap***™). As well, the short term savings of the small business rate will be lost to investment income tax over the long term and do not qualify for the new eligible dividend taxation. Although, Corporate Insured Retirement Plans established in holding companies provide tax-sheltered investment income, loans are required to successfully withdraw funds, which few people want at retirement. The RRSP***Wrap***™ helps "bullet proof" your long term security which can be more important than current tax savings.

## *Compliance*

As with every good thing, there are those that try to push the envelop. The RRSP***Wrap***™ using the RCA is designed to provide security at retirement. CRA frowns on those what would leverage the RCA investment and lend back to their company or split the ownership of an "exempt" insurance contract between the RCA and a Corporation they control. CRA could deem such schemes to be a Salary Deferral Arrangement with substantial penalties, or treat the life insurance proceeds as a taxable distribution from the RCA.

## *Who is RCF?*

RCF is Canada's leading full service RCA provider and the creator of the RRSP***Wrap***™ and PENSION***Plus***™. We provide third party services to financial advisors. Our specialist team provides all entitlement and funding calculations for your accountant following CRA guidelines.

Our in-house legal counsel establishes the RCA, including the Refundable Tax Account, and provides your lawyer drafts of all documentation which is completed relative to your circumstances. Our PENSION***Plus***™ funding illustrations are compared to conventional funding on an apple-to-apple basis. You decide which insurance company you wish to deal with.

## *Know Your Options*

Every business owner earning over $125,000 annually should know their options under the Income Tax Act for supplemental pension funding. Talk to your Financial Advisor to receive your entitlement and funding numbers or visit RCF***Direct*** at **www.rcf.ca/rcfdirect**. You can complete the request form on-line or download / fax to us.

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