

REGISTERED PENSION PLANS

How they can work for you

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Recent changes introduced by the provincial government allow dentists to incorporate their dental practices, and this could benefit many dentists significantly by opening the door to Registered Pension Plans (RPP).

Dentists who have not yet been able to justify a hygiene corporation or technical services corporation will likely benefit by incorporating their dental practice — especially if they are aggressively saving outside RRSPs (or repaying business debts). This is because the Small Business Deduction can reduce your tax rate by 50 per cent — thus allowing you to accumulate wealth at accelerated rates.

Once your dental practice is incorporated, you will receive T4 income and may be a good candidate for a

Registered Pension Plan (RPP). RPPs are much more sophisticated than RRSPs and can be quite attractive as a conduit for tax deferral and multi-generation wealth transfers. Members of an RPP can include the dentist, spouse and even children and grandchildren.

HIGHER CONTRIBUTIONS THAN RRSP

The Defined Benefit Pension Plan is of particular interest to the mature dentist and can be more advantageous than both RRSPs and Defined Contribution Pension Plans (even after the latest improvements to RRSPs are implemented). This is because annual contributions increase with age, and the cross-over point (where RPP contributions exceed RRSP contributions) is now 37

Table 1

Dr. Tuttle					Mrs. Tuttle					
Age	RRSP Only	RRSP & Pension			Age	Past Service	RRSP Only	RRSP & Pension		
	RRSP	RPP	RRSP	Total			RRSP	RPP	RRSP	Total
46	14,500	18,033	3,000	21,033	45	63,900	12,600	12,709	2,100	78,709
47	15,500	19,385	600	19,985	46		12,600	13,662	0	13,662
48	16,500	20,839	600	21,439	47		12,600	14,687	0	14,687
49	18,000	22,402	600	23,002	48		12,600	15,788	0	15,788
50	18,990	24,083	600	24,683	49		12,600	16,972	0	16,972
51	20,034	25,889	600	26,489	50		12,600	18,245	0	18,245
52	21,136	27,830	600	28,430	51		12,600	19,614	0	19,614
53	22,299	29,918	600	30,518	52		12,600	21,085	0	21,085
54	23,525	32,161	600	32,761	53		12,600	22,666	0	22,666
55	24,819	34,574	600	35,174	54		12,600	24,366	0	24,366
56	26,184	37,167	600	37,767	55		12,600	26,194	0	26,194
57	27,624	39,954	600	40,554	56		12,600	28,158	600	28,758
58	29,144	42,951	600	43,551	57		12,600	30,270	600	30,870
59	30,747	46,172	600	46,772	58		12,600	32,540	600	33,140
60	32,438	49,635	600	50,235	59		12,600	34,981	600	35,581
	341,441			482,392			189,000			400,338

Culture: Dentist age 46, average income \$150,000. Spouse age 45, average income \$70,000.

Table 2

Top-Up Allowed (Jan. 1/00 to Dec. 31/02)				
Portfolio Value @ Dec. 31/1999	\$100,000	\$250,000	\$500,000	
Balanced Portfolio (1.35%)	\$104,105	\$260,262	\$520,525	
Pension Plan Return (7.50%)	\$124,230	\$310,574	\$621,148	
Amount Available for Top-Up	\$20,125	\$50,312	\$100,624	

years old. So, if you are older than 37, you will be able to contribute more to an RPP and the spread will widen with time — as RPP contributions increase by 7.5 per cent per year.

Table 1 illustrates that with an RPP, Dr. Tuttle and his wife could contribute \$352,290 more than they would using RRSPs alone. If you factor in growth at 7.5 per cent per year, it represents additional wealth accumulation of \$617,681 over 15 years. And this is based on the assumption that retirement will occur when Dr. Tuttle is 60. (Note: In the first year, Mrs. Tuttle can contribute \$78,709 — a past service contribution of \$63,900, current service contributions of \$12,709 and an RRSP contribution of \$2,100.)

ABILITY TO TOP-UP

One might question projecting the growth rates at 7.5 per cent per year, but with RPPs, this is the rate dictated by the *Income Tax Act* and used by actuaries when determining the defined retirement benefits.

The 7.5 per cent rate of growth is fixed and the performance is reviewed every three years to ensure the plan is adequately funded. If the average rate of growth is less than 7.5 per cent per year, a top-up can be made to the plan to bring it back to the projected levels. (If your investments average more than 7.5 per cent, your future funding requirements may be reduced accordingly.)

Given the present investment climate, it certainly would have been a nice option to be able to top up your RRSP due to poor results. Table 2 illustrates that if you had \$250,000 invested in your RPP on December 31, 1999, you would have been able to top up the plan by making an additional (tax-deductible) contribution of \$50,312.

EARLY RETIREMENT ENHANCEMENTS

Should you retire before age 65, you can make enhancements to your RPP to fund Bridge Benefits to 65 and to index your pension benefits. These enhancements can be added by making extra contributions (which are tax deductible). According to Brian Jenkins, an actuary with Actuben Consulting, who specializes in Individual Pension Plans, “If you retire before age 65, you can top up your plan by approximately one-third the total value at the time you cease to be employed.”

In the example shown in Table 2, at 60, Dr. and Mrs. Tuttle will be able to contribute as much as \$637,382 to pay for these enhancements. These contributions

would certainly offset any extra income and gains realized from the disposition of his dental practice.

MULTI-GENERATION WEALTH TRANSFERS

The accumulated funds in the pension plan continue to grow tax free, just like an RRSP. Benefits are paid at retirement, according to the formula, and continue as long as the members are alive. When the last member dies, the surplus funds are paid out to the beneficiaries, similar to an RRSP/RRIF — unless your beneficiaries also become employees and members of the plan.

If your children are members, when you and your wife die, the surplus can remain in the plan and continue to grow until the last child dies — or they can receive the surplus at their discretion.

ADMINISTRATIVE AND COSTS

Before setting up a RPP, an actuary should first help you determine how well an RPP suits you. If it makes sense, the set-up costs are between \$5,000 and \$6,000. Each year, your costs will be between \$1,500 and \$2,000 for the reporting and government fees (these fees are tax deductible). The investments have the same rules as RRSPs with respect to foreign content and can be managed through your broker or investment counsellor.

If for some unforeseen reason, an RPP no longer makes sense, you have the option to roll the proceeds over to a locked-in RRSP and close out the plan.

SUMMARY

RPPs are a new concept to dentists. So is being able to incorporate. But individual pension plans and incorporation are not new concepts. They have been operating effectively for many years and the rules are quite clear.

An RPP is a great conduit to defer taxes and accumulate wealth at an accelerated rate — whether or not you already have corporate structures in place. Without considering the extra bonus of topping-up for under-performance or early retirement enhancements, you can accumulate a considerable amount of additional wealth using an RPP. In Dr. Tuttle’s case, he and his wife would add \$617,681 to their net worth by age 60 — over that of RRSPs. I estimated the present value of his total costs to be \$23,650 (after-tax, assuming his plan continues to age 100).

Therefore, if you have the cash flow, this investment has little or no risk, and certainly beats any tax shelter I’ve seen. ♦

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