

# TAXTALK

## REGISTERED RETIREMENT SAVINGS AND OTHER TAX DEFERRAL PLANS

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Registered Retirement Savings Plans (RRSPs) are an important financial and tax-planning vehicle designed to encourage retirement savings. They provide a tax shelter for those taxpayers earning employment, business and rental income. The contributions to RRSPs are tax deductible and allow for tax-deferred investing until the funds are ultimately required or withdrawn, i.e., in retirement or possibly in low-income years. This TaxTalk discusses RRSPs and alternative planning opportunities that are available to aid individuals in their quest to save for their retirement.

This TaxTalk is based on existing income tax legislation and the current interpretation of the Income Tax Act (the Act) by the Canada Revenue Agency (CRA) and the courts as provided by relevant jurisprudence. In addition, recent proposals to amend the Act have been considered and are referred to below as proposed amendments. Other than these proposed amendments, this TaxTalk does not anticipate any other changes to the Act or its interpretation.

### *Deduction Limits*

For 2005, your RRSP deduction limit equals the lesser of:

- 18% of your 2004 **earned income** (see below) (i.e. the previous year); and
- \$16,500

less:

- your “pension adjustment” for the prior year under a registered pension plan (RPP) for current or past service, and
- your net “past service pension adjustment” for the current year under an RPP

plus:

- any “pension adjustment reversal” for 2005 to restore lost RRSP deduction limit on termination of employment, and
- your unused RRSP deduction limit carried forward since 1991.

CRA provides the “2005 RRSP Deduction Limit Statement” for you as part of your 2004 Notice of Assessment. This Statement indicates (i) your 2005 deduction limit which is the maximum you can deduct on your 2005 tax return. This Statement also indicates (ii) your RRSP contributions made in prior years for which you have not claimed a tax deduction for. These contributions remain available to be deducted in the future. You should verify these two amounts when determining your available RRSP deduction limit for 2005.

**Earned income** includes: employment income, business income, rental income, disability pension income received under the Canada Pension Plan, and taxable support receipts. Earned income does **not** include: business and rental income earned through a limited partnership, interest income, dividends, capital gains, pension benefits, retiring allowances or severance, death benefits and other amounts received from an RRSP or Deferred Profit Sharing Plan (DPSP).

Earned income is **reduced by**: deductible support payments, employment expenses, and business and rental losses. Business and rental losses incurred through a limited partnership do **not** reduce earned income.

Where, in prior years, you deducted less than your RRSP deduction limit, the unused RRSP deduction limit may be carried forward indefinitely, allowing you to contribute to your RRSP in future years when you have more funds available.

On the other hand, a current year contribution does not have to be claimed as a deduction on your current tax return. Instead, you can choose to deduct it in a future year. This strategy will benefit you where, for instance, your marginal tax rate is relatively low this year and you can use the deduction to reduce higher rate income in a later year. Even if you do not deduct the amount this year, your contribution is, in the meantime, earning tax-deferred income within your RRSP.

The 2005 federal budget announced increases in the RRSP deduction limit for 2007 and future years. The limits for 2005 and subsequent years, before any pension adjustments, are as follows:

YEAR	LIMIT
2005	\$ 16,500
2006	18,000
2007	19,000
2008	20,000
2009	21,000
2010	22,000
2011	Indexed for wage growth.

### *Spousal RRSP*

You can contribute all or part of your RRSP deduction limit to an RRSP of which your spouse is the annuitant (spousal RRSP). Your ability to contribute to a spousal RRSP is not limited by your spouse's RRSP deduction limit or their RRSP contributions. The advantages of a spousal RRSP include: splitting income during retirement and, where your spouse is younger than you, a longer tax-deferral period for income earned in the RRSP.

You will lose the benefits of a spousal RRSP if your spouse withdraws funds from the plan too soon. Normally, RRSP withdrawals are taxed in the hands of the recipient spouse; however, if your spouse withdraws funds from a spousal plan in the same calendar year as your contribution or in the subsequent two calendar years following your contribution to any spousal plan, the withdrawal will be taxed in your hands.

For example, for spousal RRSP contributions made in 2005, your spouse will be taxed on withdrawals made on or after January 1, 2008. On the other hand, you would include the withdrawal in your income if the withdrawal happened prior to January 1, 2008. This rule applies whether your spouse has one or many spousal RRSP accounts.

Finally, if you turned 69 prior to 2006, you can no longer contribute to your own RRSP; however, you can contribute to a spousal RRSP, and receive a deduction, provided that your spouse is 69 or younger at the end of 2006.

### *Retiring Allowances and Severance Payments*

You are generally subject to tax on any lump-sum retiring allowance or severance payment you receive. Subject to limitations, you may transfer some or all of these payments to your RRSP. The tax benefit of this planning is a reduction in your taxable income, with no impact on your RRSP contribution limit.

The maximum “eligible” amount that you can transfer to your RRSP is limited to \$2,000 times the number of full or partial years during which you were an employee **before 1996**, plus \$1,500 times the number of full or partial years of service **before 1989** for which your employer did not make vested contributions to an RPP or a DPSP on your behalf.

You must transfer the funds to your RRSP within 60 days following the year you received the eligible receipt. There is no withholding tax on the eligible amount if your employer transfers the funds directly to your RRSP. The transfer cannot be made to a spousal RRSP.

If you receive a retiring allowance in respect of employment that began after 1996, or if you receive a retiring allowance in excess of the eligible amount, these amounts will not be eligible for rollover to your RRSP. However, to the extent that your RRSP deduction limit allows, you may choose to contribute the portion of your retiring allowance ineligible for rollover to your RRSP or a spousal RRSP and claim an RRSP deduction.<sup>1</sup>

The effect of this strategy is to defer income tax on your retiring allowance until such time as you withdraw funds from your RRSP.

### ***Lump Sum Payments***

Lump sum payments from an RPP or a DPSP may be transferred tax free to an RRSP provided the transfer is made directly to your RRSP (i.e. you cannot first receive the funds and then later contribute them to your RRSP). In some cases, the transfer of vested pension benefits must be made to a locked-in retirement account (LIRA) which is subject to withdrawal restrictions under the relevant provincial or federal pension legislation.

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<sup>1</sup> If your former employer has reasonable grounds to conclude that your RRSP deduction limit is sufficient to allow you to deduct the RRSP contribution in the current year, then your employer can contribute the retiring allowance **directly** to your (or a spousal) RRSP and no tax would be withheld.

### ***Borrowing to Contribute***

Interest incurred on funds borrowed to make an RRSP contribution is not tax-deductible. If you want to borrow to contribute, it is generally advisable that the borrowing be for a short-term period (i.e. a few months). In general, it is best to use available cash to make RRSP contributions and borrow to fund other income earning activities (such as acquiring non-RRSP investments) where the interest will be tax-deductible.

### ***Non-Cash Contributions***

Your RRSP contribution need not be limited to cash. You can, if you so choose, contribute certain non-cash property (e.g. publicly traded shares) to an RRSP for you or your spouse.

For tax purposes, when you contribute non-cash property to your RRSP, or to a spousal RRSP, you are deemed to have disposed of the property at its fair market value at the time of the transfer. As a result, the contribution may trigger a capital gain or a capital loss. While only 50% of such a capital gain would be taxable in your hands, you would be denied any benefit should there be a capital loss on the transferred property, as the capital loss is deemed to be nil.

The best approach to take, with property that would create a capital loss, is to sell the property in the open market (i.e. a third party), and then contribute the cash proceeds to your RRSP. In this way, the loss may be recognized, subject to the stop loss rules.<sup>2</sup>

### ***Timing of Contributions***

Subject to your 2005 RRSP deduction limit, RRSP contributions you make by March 1, 2006 will be deductible for 2005.

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<sup>2</sup> The “stop loss” anti-avoidance rules may deny the loss to the extent that the same investment is acquired by you or certain “affiliated” individuals or entities within (i.e. before or after) 30 days of the sale.

If you turned 69 in 2005, your RRSP contribution for 2005 must have been made by December 31, 2005. For further planning, please refer to the discussions on "Spousal RRSP" and "Over-Contribute before Maturity".

Consider making your 2006 RRSP contribution as early as possible in 2006. In doing this, you will benefit from a longer period during which your retirement fund can grow tax deferred.

If you wish to increase your RRSP deduction limit to the maximum of \$19,000 for 2007, you will need earned income of \$105,556 in 2006.

### ***Over-Contribute Before Maturity***

If you have earned income in the current year and you are required to collapse your RRSPs by the end of the year (i.e. if you turn 69 in 2006), you should consider "prepaying" your 2007 RRSP contribution before the end of the current year. The contribution you make in late 2006 will be deductible in 2007 when the new deduction limit (based on your 2006 earned income) becomes available.

This strategy will allow you to transfer a higher amount to your Registered Retirement Income Fund (RRIF). Although this "premature" contribution is an over-contribution subject to a 1% penalty for each month that it is in the RRSP in 2006 (subject to the \$2,000 over-contribution that is allowable - see below), your ultimate future after-tax income on this over-contribution may outweigh the penalty.

You will benefit the most from this strategy where your marginal tax rate in 2007 is expected to exceed your marginal tax rate(s) in the year(s) that the RRSP contribution is to be ultimately withdrawn.

### ***\$2,000 Over-Contribution***

You could consider making a lifetime (not annual), non-deductible over-contribution of \$2,000 to your RRSP. Since the over-contribution is not deductible, the amount contributed is from your after-tax dollars.

Unless you limit your RRSP contributions before the last year in which you are eligible to contribute to an RRSP, the \$2,000 over-contribution will be subject to double taxation. Double taxation would occur since the initial \$2,000 came from after-tax dollars and will be taxed again when you withdraw it from your plan. However, even if you are subject to double taxation you may realize a benefit if the funds are allowed to grow tax free in your RRSP for a considerable period of time.

You could also consider making a \$2,000 over-contribution for any of your children who are 18 or older. This over-contribution will be deductible by your child in a future year when your child has earned income, creating an RRSP deduction limit.

### ***Building Unused RRSP Deduction Limit for Children***

If you have a child who has earned income in a particular year, your child should file a personal tax return and report his or her earned income, even if your child is not required to file a return because his or her income is too low. In this way, with each year's tax return filed, your child will build up his or her unused RRSP deduction limit. The end result of this strategy is that your child will have a larger RRSP deduction limit available for future years.

### ***Equity Investments in RRSPs***

Although income and capital gains earned within your RRSP accumulate tax free, the income will eventually be taxed at your full marginal tax rate in the year you withdraw funds from your RRSP.

While you only pay tax on 50% of your capital gains on property you hold *outside* your RRSP: if you earn capital gains *inside* your RRSP, you will be taxed on 100% of the gain in the year of withdrawal. As a result, from a tax standpoint, it may be better to hold growth equity shares outside of your RRSP.

### *RRSP Investments in Small Businesses*

Your RRSP may, subject to certain restrictions, invest in shares of **private companies**.<sup>3</sup> Some of the specific rules and restrictions that apply are summarized below:

- Your RRSP cannot own shares of any corporation<sup>4</sup> that you control. In addition, anybody who is related to you (i.e. spouse, children, siblings or parents) is also precluded from owning shares in their RRSP of a company that you control.
- Where you own, together with a related group, 10% or more of the issued shares of a private company,<sup>3</sup> inside and outside RRSPs, and you deal at arm's length with the company, your (combined) cost of the investment in the company must be less than \$25,000.
- Where you, together with a related group, own less than 10% of the shares of any class of a private company,<sup>3</sup> you may invest RRSP funds in this private company, **without limit**, provided that the shares held, inside or outside of the RRSP, after the investment, do not cause you, and the related group together, to own 10% or more of the issued shares of any class of the company.

### *Foreign Content*

For 2004, the foreign property content of your RRSP was limited to 30% of the cost amount of its qualified investments. Effective January 1, 2005, there is no longer a restriction on the foreign property content in an RRSP.

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<sup>3</sup> The company must either be an “**eligible corporation**” or a “**small business corporation**”. While the definitions for these terms are not the same, in general, the company must be a Canadian controlled private corporation that carries on an active business in Canada.

<sup>4</sup> Including shares of related companies.

### *Early Withdrawals*

If your income for 2006 is unusually low, consider making a withdrawal from your RRSP in 2006 in order to raise your taxable income to \$36,378. This income amount is the maximum for the lowest federal tax bracket. Please keep in mind, however, that RRSP withdrawals do not re-generate your deduction limit. You may only “re-contribute” to an RRSP to the extent your “earned income” has created additional RRSP deduction limit.

### *Using the Pension Income Credit*

You are entitled to claim a non-refundable tax credit on the first \$1,000 of qualifying pension income. Qualifying pension income would include most types of retirement income received on a periodic basis, such as:

- life annuity payments out of a superannuation or pension plan, regardless of your age,
- if you are 65 years or older, annuity payments from an RRSP or DPSP and payments from a RRIF, or
- if you are under 65 years of age, annuity payments from an RRSP or DPSP and payments from a RRIF, if these payments are received by virtue of the death of your spouse.

If your income will be taxed above the lowest tax bracket, you will have some net tax payable on the first \$1,000 of pension income since the \$1,000 non-refundable tax credit is computed at the lowest tax rate.

### *RRSP Home Buyers' Plan*

If you are a “**first-time**” home buyer, consider using the RRSP Home Buyers' Plan (HBP). The HBP allows you and, if applicable, your spouse to withdraw up to \$20,000 each from your existing RRSPs tax-free, to purchase a home.

For a more detailed discussion of this topic, please refer to TaxTalk 2005 Issue 3, *Year End Tax Planning - 2005*.

### *Lifelong Learning Plan (LLP)*

Under an LLP, you can withdraw funds from your RRSP tax free, if the funds are used to finance full-time (or part-time if the student has a mental or physical impairment) post-secondary education for you or your spouse. Certain other rules and restrictions may apply.

For a more detailed discussion of this topic, please refer to TaxTalk 2005 Issue 3, *Year End Tax Planning - 2005*.

### *Transferring Out of an RRSP by Age 69*

If you were older than 69 at the start of 2006, you can no longer contribute to your RRSP. **If you turn 69 this year, you must mature (i.e. collapse) your RRSP accounts by December 31, 2006.**<sup>5</sup>

In collapsing your RRSPs, your choices are to:

- convert your RRSP into a fixed term or a life annuity (a tax deferred transaction),
- convert your RRSP to a RRIF (a tax deferred transaction), and/or
- be taxed on the value of your RRSP (a taxable event).

A RRIF allows you to manage your investments in much the same manner as a self-directed RRSP. You must make annual minimum withdrawals from your RRIF. These withdrawals are included in income in the year withdrawn.

The minimum annual withdrawal is not subject to withholding tax and may be based on your age or your spouse's age. If you wish to minimize your annual withdrawal (perhaps to defer tax) you should use the younger spouse's age. If you would rather maximize your minimum annual withdrawal you should use the older spouse's age. You can increase the withdrawals from your RRIF over the annual minimum required amount to perhaps meet cash requirements; however, withholding tax will apply to the excess amount withdrawn.

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<sup>5</sup> You do not have to wait until you are 69 to collapse the plan.

### *Source Deductions on RRSP Contributions*

If you are an employee or owner-manager who receives a salary/annual bonus,<sup>6</sup> you can choose to contribute all or a portion of your remuneration (subject to your RRSP deduction limit) directly to your RRSP provided your employer agrees to the direct transfer.

Your employer is not required to withhold income tax provided they make the contribution directly to your RRSP and the amount contributed does not exceed your RRSP deduction limit for the current year. Furthermore, you are not required to obtain a letter of authority from CRA to do this.

Subject to your RRSP deduction limit, this rule may enable you to immediately contribute 100% of your salary/bonus into an RRSP instead of a tax reduced salary/bonus contribution (i.e. gross versus net). However, your gross salary/bonus will still be subject to CPP and EI premiums, if you have not reached the maximum contributions required for the year.

With this strategy, you will benefit from the fact that more of your money will be invested in your RRSP earlier; thereby creating a longer period for tax deferred compounded growth.

### *Reduction in Source Deductions*

You may ask CRA for authorization to have withholding tax on your salary reduced based on your own RRSP contribution(s). Once your employer receives the authorization, the amount of income tax your employer will deduct from your pay cheque will be reduced. Evidence of the RRSP contribution must be provided to CRA (i.e. the RRSP contribution receipts) before they will allow your employer to reduce the tax withholdings.

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<sup>6</sup> This would include bonuses paid to owner/managers by companies who "bonus down" to the income level eligible for the special low rate of tax available to small businesses.

CRA will generally provide advance authorizations to allow reduced withholdings if you are making monthly pre-authorized RRSP contributions, and you provide them with suitable documentation (e.g. a copy of the pre-authorized RRSP contribution contract).

### ***Rollover of RRSP and RRIF upon Death***

In general, when a taxpayer dies, the fair market value of his or her RRSPs and RRIFs is included in their final income tax return (i.e. terminal return) and is subject to tax.

There are exceptions to this rule. In general, where the RRSP/RRIF funds are transferred to a spousal RRSP/RRIF or to an RRSP for the benefit of financially dependent children or grandchildren, the funds will not be taxed on the terminal return.

The mechanics to obtain a rollover can be complex and will depend on the facts of the situation. For instance, the procedures differ depending on whether the spouse is a beneficiary under the will or directly under the RRSP/RRIF, and whether or not the RRSP has matured at the time of death. In some cases, elections need to be filed with CRA in order for the transfer to be tax deferred. You should discuss this matter with your professional advisor.

### **Individual Pension Plans**

The federal government originally introduced Individual Pension Plans (IPPs) into the Income Tax Act in 1991 to compensate high-income earners disadvantaged by the RRSP rules. With many executives seeking retirement benefit packages that meet their individual needs, IPPs are becoming more popular in today's business world.

They are primarily suited for incorporated businesses looking to add benefits for their owner managers and high net worth individuals. IPPs can offer a better solution for individuals 45 years of age or older, with employment earnings of more than \$105,000, and who have historically maximized their RRSP contributions.

Any contributions made by the company are **tax deductible**.<sup>7</sup> Contributions to an IPP can significantly exceed normal RRSP deduction limits. The amount of the IPP contributions depends, in part, on your age - the older you are, the higher the allowed contributions.

An IPP is a **defined benefit** plan tailored for retirement where the benefits to be paid during retirement are actuarially determined based on your age, your career employment earnings, and other actuarial assumptions. Once the retirement benefits are estimated, the company, as plan sponsor, **must** fund the annual IPP contributions needed to create the benefits required for retirement.

Contributions to the IPP, are tax deductible to the employer, and are based on the following:

1. Funding for **current service** must be done annually with the yearly limit based on your earnings and age. The annual IPP limits generally start to exceed the RRSP annual limits if you are over 40 and have annual T4 employment earnings from the company of at least \$105,000.
2. **Past service** may also be funded by the company. The past service contribution is computed from the *later of* (i) January 1, 1991 and (ii) the date of incorporation of the employer/employment of the employee. To make past service contributions, it is generally necessary to transfer RRSP assets related to the time of your past service to the IPP. RRSP contributions made for the period of past service reduce the amount of past service to be funded by the company. Funding of past service can occur over a number of years, but the IPP must be fully funded by the time you reach 65.
3. **Additional funding** is required if the IPP does not maintain an annual compounded net rate of return of 7.5%. An actuarial valuation must be

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<sup>7</sup> To be deductible, contributions must be made to the IPP within 120 days of the corporate year-end.

done every 3 years to determine if the IPP is underfunded or overfunded.

The IPP can be 'overfunded' if the investment return exceeds 7.5% annually. In this case, it is necessary that funds be taken out of the IPP, on a taxable basis.<sup>8</sup>

The annual rate of return of 7.5% ensures that the plan will be funded so that you receive a defined benefit on retirement.

The following table illustrates the higher annual contributions possible with an IPP, for an employee who is 50 years old and starts an IPP in 2006:

Year	Employment Earnings <sup>9</sup>	IPP/RRSP Contribution <sup>10</sup>	RRSP Contribution
2006	\$105,556	\$23,450	\$18,000
2007	\$111,362	\$25,100	\$19,000
2008	\$117,486	\$26,900	\$20,000
2009	\$123,948	\$28,900	\$21,000
2019	\$211,721	\$59,000	\$35,600 <sup>11</sup>

As illustrated, the annual IPP/RRSP contribution limits exceed the annual RRSP contribution limits, with the disparity increasing as the employee gets older. In addition, if the employee had been continuously employed since 1991, the company would be able to make an IPP contribution for past service of \$97,900. This amount presumes that the employee has maximized his RRSP contributions since 1991.

Assets accumulating in the IPP are locked-in, and can generally only be withdrawn during retirement. Like an RRSP, the funds in the IPP must be withdrawn from the plan at age 69. There are options at this time – withdrawals can be in the form of a monthly pension from the IPP, an annuity, a life income fund, or a life retirement income fund. If you terminate your employment or the IPP before

<sup>8</sup> If a plan is in a surplus position, the employer could also be restricted from making current contributions.

<sup>9</sup> Assumed to increase by 5.5% per year.

<sup>10</sup> Combined IPP/RRSP contributions reflect \$600 of RRSP contributions annually.

<sup>11</sup> Estimated amount for 2019.

retirement, the assets of your IPP will be transferred to a locked-in RRSP or a locked-in retirement account (LIRA).

As the IPP is not an asset of the company,<sup>12</sup> it is not available for corporate creditors to attack. Also, pension legislation provides creditor protection to you personally in respect of the IPP – your IPP retirement assets are held by a trust, not you personally.

Where your spouse and/or other family members are also employed by the company, the IPP can continue after your death to provide [retirement] benefits to surviving members.

In addition to allowing the company to fund past, current and future services of its owner/manager(s) and/or key employees and provide creditor protection, IPPs also offer other key advantages.

- The ability to attract key executives to your organization may be enhanced if an IPP is provided for them.
- An IPP provides lifetime income to members of an IPP and their spouses.
- Another feature of an IPP is the possibility of terminal funding. While there are limits on benefits that can be pre-funded, the plan can be amended at retirement. Terminal funding payments can be made to provide for enhanced benefits in the case of early retirement.

As with any tax or retirement planning vehicle, there are disadvantages to weigh against the benefits of an IPP.

- The rules regarding IPPs are complex, and are governed by applicable pension legislation.
- There is little flexibility regarding annual funding requirements, which are mandatory pursuant to pension legislation.
- You no longer can make spousal RRSP contributions. Thus, the ability to split income using your retirement assets is not available with an IPP.

<sup>12</sup> Not being a corporate asset, an IPP is not available to secure corporate debt.

- Assets inside an IPP are locked in, as opposed to RRSP funds, which can be liquidated should there be an emergency cash need.
- There are costs including set-up, administrative and compliance fees to consider.<sup>13</sup> Compliance costs include fees to maintain records, file tax and information returns etc., as applicable. The 'good news' about these costs is that they are tax deductible.<sup>14</sup>

In conclusion, an IPP may be suitable for a key executive and/or an owner/manager who:

1. is over 45 years old,
2. earns a base salary of more than \$105,600 and expects to continue to do so,
3. has worked for the company for several years (back to 1990), and
4. has no foreseeable need to access the funds set aside for retirement (i.e. the retirement funds will *not be needed* for an emergency).

In addition, the company should have a stable cash flow such that it will be able to comfortably afford the requisite IPP contributions.

The key advantage of an IPP, compared to an RRSP, is the ability to make past, current and future service contributions in excess of normal RRSP contribution limits. IPPs are becoming an attractive option for high-net worth individuals and should be considered as a viable retirement planning vehicle.

### Retirement Compensation Arrangement

A Retirement Compensation Arrangement (RCA) can be a valuable retirement and estate planning tool

<sup>13</sup> The costs to set up an IPP may range from \$3,000 to \$5,000. Annual administrative costs may range from \$500 to \$600, with an additional triennial fee of \$1,000 to \$2,000 for an actuarial report.

<sup>14</sup> Management expenses of an RRSP are not tax deductible.

that, in some circumstances, can also lead to reduced taxes. In appropriate circumstances, an RCA can be used as an alternative to paying a bonus to a shareholder/manager, and can be attractive for higher income owners and executives who are looking for retirement benefits in line with their present and future income. The RCA can be used to supplement other retirement plans, i.e. RRSPs or IPPs.

RCAs are a useful means of providing for the retirement of a key employee, including the owner-manager of a business. Tax savings may be realized where the employee expects to be taxed at lower marginal rates after retirement.

An RCA is a trust arrangement between an employer and an employee. Contributions are made by the employer<sup>15</sup> to an RCA trust, under which the employee is the beneficiary. The trust is then required to make payments to an employee (or an employee's beneficiary) on, after, or in contemplation of the employee's retirement or loss of office.

The RCA is subject to a 50% refundable tax on (i) contributions made to it and (ii) any income earned or gains realized by the RCA. When distributions are made from the RCA to the beneficiary, this 50% refundable RCA tax is recovered by the RCA at a rate of \$1 for every \$2 distributed to the retired employee.

Since the RCA is subject to the 50% tax on contributions to it and on its income, the employee is not taxable in respect of employer contributions to the plan or the income earned in the RCA. Instead, the employee pays tax on distributions from the

<sup>15</sup> Contributions made by the employer are based on actuarial calculations, and are deductible to the employer on a paid basis.

RCA on or after retirement, and in this way may be able to take advantage of the lower graduated tax rates. This may be of particular benefit after retirement if the key employee has few other sources of income, or plans to retire in a lower-taxed jurisdiction, so that lower tax rates will apply to amounts received from the RCA.

Other potential advantages of an RCA include:

- it can be used as a vehicle to raise funds for the operating business, and
- its assets can be creditor-proofed - since RCAs are established within a trust, the RCA assets are separated from the operating business assets.

As with any planning vehicle, it is necessary to consider the pros and the cons. Some pros have been outlined above. The cons include the added complexity and the initial and on-going costs to set-up and administer the RCA. In addition, a prepayment of income tax occurs since the 50% RCA tax rate is currently higher than the highest income tax rate that applies to a bonus in Ontario in 2005 [46.41%, rising to 47.44% when the Employer Health Tax is payable on the bonus].

#### Exempt Life Insurance

An exempt life insurance product can provide insurance coverage together with retirement income that has benefited from tax-deferred growth. These products allow you to pay insurance premiums and, at the same time, make deposits to a tax sheltered investment account. The insurance premiums are generally not tax deductible when made, but the ultimate insurance receipt on death is tax free.

This type of tax-sheltered investment is usually appropriate if you have maximized your RRSP contributions.

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As the above discussion indicates, there are options available to fund your retirement, and we would be pleased to advise and assist you to evaluate opportunities in the regard.

A memorandum of this nature cannot be all encompassing and is not intended to replace professional advice. Its purpose is to highlight tax-planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

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