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Is the Personal Pension Plan for You?

It combines the highest levels of tax deductions allowed with the greatest amount of flexibility — and it's gaining groun

On July 18, 2017, the federal government introduced draft legislation that would have profound tax consequences for incorporated dentists who have used their Dental Professional Corporation (DPC) to save money for retirement instead of setting up a true pension plan.

The new tax measures aim to curb certain planning techniques that were quite tax-efficient, namely the splitting of dividends and income with family members who are usually taxed at a lower rate.

Under the new tax rules that came into effect in 2018, the planning techniques will no longer be tax effective because too much passive income earned within a corporation (or associated corporations) will cause the corporate tax rate to increase. In many instances attempts to flow income to shareholder children or spouses that do not render services to the DPC will also attract punitive tax rates. Changes from 2014 had already made it more expensive to draw dividends over salaries, so the idea of avoiding salaries in favour of pure dividends is already tax-inefficient in Ontario

Personal pension plans

In this new environment, financial planners, advisors and accountants have paid greater attention to well-established rules grounded in pension legislation to offer dentists additional ways to weather the tax increases that are facing DPCs. One strategy in particular that is gaining ground is the Personal Pension Plan (PPP), an innovative type of registered pension plan that provides dentists with the highest levels of tax deductions permitted by tax legislation and the greatest amount of flexibilit . Under a PPP, the DPC sets up a pension for the dentist, based on the salary that the corporation pays to the professional. The PPP provides a variety of tax deductions that do not exist in the RRSP environment.

Types of tax deductions

Past service: Where salaries were paid by the DPC in the past, the PPP can recognize this "past service" and enable the DPC to make tax-deductible contributions to purchase these past pension credits. More-over, every year, a PPP client can contribute more than what is permitted into an RRSP. In fact, in the year that the PPP is set up, the dentist gets to contribute to the PPP and to his or her RRSP as well.

Tax-deductible management fees: All investment management fees paid on assets inside the PPP are tax deductible to the DPC, unlike with RRSPs. Annual administration, trustee and actuarial fees are also tax deductible.

Special payments: If the assets of the PPP are invested in highly conservative asset classes (think of a GIC or bond), they are unlikely to have a rate of return exceeding 7.5 per cent. Should this occur, the deficit created by the inability to achieve this CRA-imposed guideline can be made up by the DPC with additional tax-deductible contributions called "special payments." In other words, adopting a very conservative investment strategy translates into the creation of additional tax-deferred registered space for the dentist.

Terminal funding: When it comes time to take money out of the PPP, the plan can be amended to offer early retirement and inflation-protecte retirement benefits as early as age 50. Since the PPP's pension fund would not have the available cash to sustain such an early retirement pension, the DPC has an opportunity to contribute additional pre-tax cash, in the form of "terminal funding" to the PPP, thereby creating a significant corporate tax deduction.

It is not uncommon for a DPC to claim a $900,000 corporate tax deduction in terminal funding for an early retirement pension.

Income splitting: Where the dentist has a spouse who does not have a pension plan, the pension payable from the PPP is eligible for pension-income splitting treatment (as early as age 50), with the bonus that both the member and spouse also get to claim $2,000 each, every year as a "pension income tax credit." Practically speaking, a $100,000/year pension that is income split will save the couple around $6,000 in personal taxes every year.

Other benefits

Passing on: On the demise of the dentist in retirement there would be no deemed disposition on the assets held in the PPP. Family members participating in the PPP would get the full amount without the estate incurring probate fees or income tax. In other words, the PPP can be used a method of transferring wealth to the next generation working in the professional corporation without cost.

Drawbacks

Given the vast array of additional tax deductions granted by pension and tax laws, one often sees PPP clients able to double their retirement income without having to take on any additional market risks. This begs the question of whether the PPP is simply "too good to be true." There are some drawbacks to using a PPP for retirement.

Paperwork: The PPP is highly regulated and government-approved so the volume of paperwork associated with it is significant in comparison to using an RRSP or a TFSA. Using a professional money manager could help alleviate some of that burden.

Fees: To properly set up and administer a PPP there is an annual fee of approximately $2,800 plus HST. The overall annual tax benefits should greatly outweigh this annual expense.

Decreased acquisition cost: If you are selling your dental practice, having already established and funding a PPP would mean a decrease in the acquisition cost. This however would be a good thing as most purchasers are interested in buying the actual business and not spending money to buy your passively invested corporate account. It would also serve to reduce the seller's capital gain and use up less of your lifetime capital gains exemption.

In the right circumstances, the PPP optimizes the size of registered assets one can rely upon to retire on. As with any financial product that is inherently complex, dentists would be well-served by consulting their legal, tax and accounting professionals prior to establishing a PPP.

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