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Kim Inglis, BCom, CIM, PFP, FCSI, AIFP

Retirement planning for business owners

Entrepreneurs need to be diligent

A recent study by BMO Financial Group found that 51% of small business owners plan to fund their retirement through the eventual sale of their businesses, while 49% admitted to having to choose between contributing to their RRSPs or investing in their businesses.

Putting all the retirement eggs into the company basket has risks. The valuation of a business can fluctuate considerably over time; the business may hit a down cycle just when the owner is nearing retirement or, even worse, it could fail. A personal financial plan, reflecting retirement goals, should accompany an owner's business plan.

One easily structured retirement plan is the group RRSP. Business owners can establish group RRSPs that in turn benefit themselves as employees. Group RRSPs are employer-sponsored retirement savings plans wherein the company makes contributions to an RRSP on the employee's behalf within individual contribution limits. Contributions are deductible by the company and reportable as earned income by the employee, who then receives a tax deduction for the contribution. Group RRSPs are creditor-proof, providing additional security for the owner should something catastrophic happen to the business.

Group RRSPs are an easy way for small business owners to build retirement savings and provide some benefit for the company too. Included as a part of a total compensation package, group RRSPs add appeal for prospective employees. They may also help control payroll costs when re-assessing the overall salary picture.

Another option is the Individual Pension Plan (IPP). IPPs are highly specialized, one-person defined benefit pension plans achieving pre-determined retirement income streams by using tax-deductible contributions. Allowable contributions are generally higher than for RRSPs, enabling tax-free growth of a larger pool of retirement assets. IPPs are typically used by business owners, incorporated professionals and executives over the age of 45 who have an annual income exceeding $100,000.

IPPs offer advantages such as higher tax-deductible contributions and tax sheltering of asset growth. An added bonus is that the assets are 100% protected from creditors. IPPs allow for past service funding, and, if an individual retires earlier than 65, a terminal funding contribution can be made to provide further retirement benefits. Essentially, the IPP offers the small business owner a chance to have the kind of defined benefit income security enjoyed by executives in large corporations.

Small business owners often use Retirement Compensation Arrangements (RCAs) because they provide income greater than traditional registered plans. Contributions are made to RCAs by the business to a custodian on behalf of an

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individual such as the business owner. Half the contribution is deposited with the custodian and is invested, while the other half is deposited with the Canada Revenue Agency in a Refundable Tax Account (RTA). Additionally, half of income earned in the custodian account is directed to the RTA.

When the business owner eventually receives the benefits, 50% is fully taxable and the other 50% comes in the form of a refund from the RTA. Taxes paid on the benefits are often lower though, since taxable income tends to decline upon retirement.

Entrepreneurs should be as diligent with retirement goals as they are in developing business objectives. And, just as they value advice in business, they should seek professional guidance to ensure their retirement plans are the best fit for their personal and business needs.

Kim Inglis, CIM, PFP, FCSI, AIFP is an Investment Advisor & Portfolio Manager. The views in this column are solely those of the author. www.kiminglis.ca