RCF News

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To Wrap or not to Wrap? - That is the Question

By Roy W. Craik

Who's asking? Advisors. RCF's PENSION***Wrap***™ (RRSP***Wrap***™ / IPP***Wrap***™ / MPPP***Wrap***™) and PENSION***Plus***™ programs for funding Retirement Compensation Agreements (RCAs) have certainly captured a lot of attention.

Rather than design a competing product, some companies have elected to focus on offering existing concepts, such as the Insured Retirement Plan (IRP) and the Corporate Insured Retirement Plan (Corporate IRP). However, in many situations the client is better served using an RCA funded by PENSION***Plus***™ with no requirement for a loan arrangement

Who Should Wrap?

The PENSION***Wrap***™ is designed specifically for two groups:

- Private business owners earning over the small business limit, who no longer need to reinvest inthe business, want asset protection and diversification and want to supplement retirement income
- Highly paid executives in both public and private firms who want to secure pension income over and above their capped RRSPs or Registered Pension Plans (RPPs)

It's important to remember that not everyone is eligible for supplementary pension funding in the form of an RCA. The privilege of using this program is extended to people earning substantial incomes – at least $125,000 each year. This program is not available to the vast majority of Canadians whose pension needs are well served by the RRSP and RPP structures. The PENSION***Wrap***™ is intended for those individuals whose pension income from these sources would be woefully inadequate when measured against the currently accepted maximum of 70% of final five-year average pre-retirement income.

Why Wrap?

We've established whom the PENSION***Wrap***™ is intended to serve. Now, what does it do for these individuals? In order of priority:

Establishes Pension Entitlement

Even the competition has acknowledged the wisdom of using the integrated final earnings calculation to arrive at a total pension entitlement amount acceptable to the Canada Revenue Agency (CRA). And it makes sense to start the executive pension planning process – regardless of how it will be funded - by establishing the maximum amount (2% of final five-year average salary X years of service up to a maximum of 70%) allowable by the CRA.

Provides Subsection 207.6(2) Protection

There are many gray areas in the interpretation of *Income Tax Act* regarding the use of corporately owned life insurance and possible benefits to the shareholder or employee. The area of retirement benefits is not one of these! The Act is very clear on this issue – an agreement or obligation to use a corporately owned life insurance policy as a tool to fund supplemental retirement income for an employee will likely be subject to the deemed RCA rules under subsection 207.6(2).

How can the PENSION***Wrap***™ provide protection? Using the illustration to calculate a shareholder/ executive's pension entitlement establishes the degree of eligibility for an RCA. Subsection 207.6 (2) protection is provided in two ways.

First, if the individual is not eligible for an RCA, the CRA would be hard-pressed to make the case that a corporately-owned policy was being used to provide retirement benefits.

And second, if an extremely successful individual has a fully funded RCA in place, the CRA would likely have difficulty justifying that the establishment of a corporately owned policy providing additional benefits could possibly be an RCA.

Avoids Risks associated with Collateral Loans and Leveraging

Borrowing at a lower rate to reinvest at a higher rate has long been an option for sophisticated clients with high net worth, sometimes even with substantial leverage. However, financial advisors who are comfortable recommending such action, also take care to advise their clients of the risks associated with leveraging life insurance policies.

- Insured individual may live far beyond the originally projected life expectancy
- Accumulation of capitalized interest could outstrip policy values
- Dependence on the willingness of lending institutions to lend vast amounts of money for a very long time

In addition to these risks, most advisors recognize that many of their clients want to enjoy a debt free retirement. Leveraging is not recommended for an individual when their retirement income can be put at risk or the arrangement causes them worry. Wise advisors adhere to the old adage, "It doesn't matter how much the investment earns - if it keeps you up at night, it's not worth it!"

Contributions are 100% Tax Deductible

Contributions made to an RCA are 100% tax deductible by the corporation but not taxable in the plan member's hands until paid out in retirement. This is not the case with the IRP or the Corporate IRP approaches. The policies are purchased with after-tax money.

Downside?

Advisors wisely draw attention to three areas of concern with respect to the establishment of an RCA.

- Salary Deferral Rules
- Requirement to send half of annual earnings to the Refundable Tax Account (RTA)
- Complexity and cost

However, these concerns are mitigated by R^CF's PENSION***Wrap***™ and the use of PENSION***Plus***™ for the funding of RCA's, in conjunction with the specialized trustee services provided by BMO Trust Company.

- Salary Deferral Arrangement (SDA) is countered by adherence to the integrated final earnings calculation
- The dormant RTA is offset by tax-sheltered growth of the RCA Investment Account
- Complexity and cost is offset by R^CF's program and the special arrangement fee with BMO Trust Company

Conclusion

For your client's long-term financial security – Let's Wrap!

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R^CF is the creator of the PENSION***Wrap***™ (RRSP***Wrap***™/ IPP***Wrap***™/ MPPP***Wrap***™) and PENSION***Plus***™. RCA trust services are provided by BMO Trust Company.

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