3P Financial: For Doctors, by Doctors

THE EXIT PLAN for Your Personal Pension Plan

You invested into your personal pension plan. You've had a productive and successful career and are now approaching your final year of work. You are looking forward to enjoying the last third of your life in financial independence! How is your Personal Pension Plan released back to you? Let's walk you through a case example.

A 3P client, retiring Ob/Gyn physician, set up a 3P pension plan 15 years prior to retirement. She made the maximum contribution allowed from her past service buyback (about $100,000) and then contributed yearly to the defined benefit account (starting at about $33k per year and increasing to just under $43k as you turned 60). With some help from a booming stock market, she has accumulated $3.6M within the 3 accounts of your pension: the defined benefit (DB), defined contribution (DC) and additional voluntary contribution (AVC) accounts.

Now...what happens and what are her options?

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Retirement savings plans (e.g. RRSPs and pensions) are government created investment vehicles that DEFER the taxes paid on those investments until retirement. The deferral in taxes allows retirement savings to grow unencumbered until retirement. Upon retirement, the government mandates that the retirement savings get paid out as income. Retirement savings plans have to be converted into an retirement income plan at or before the age of 71. The retirement income is taxed and the amount of income is based on the size of the retirement savings accumulated. The 3P Pension plan has three possible retirement savings components (Please refer to the ABC's of retirement savings document for review): Additional Voluntary Contributions (AVC), Defined Contributions (DC) and Defined Benefits (DB). Let's go through them one by one and then go over the nuances a bit.

Where your assets go depends in part on your age at retirement (i.e. before or after the end of the calendar year you turn 71), how much you have accumulated and some choices you get to make.

On a high level you can do the following with your retirement funds:

1. Buy an annuity from an insurance company.
2. Roll the balance into your RRSP/LIRA[1] (or a RRIF/LIF[2] if you are under 71).
3. Sustain the pension plan through retirement and have 3P provide the income you need.

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[1] Locked-in retirement account: the post retirement account for both DC and DB assets for individuals who are still potentially eligible to contribute to the account (i.e. they are <71 years old).
[2] Life Income Fund: the post retirement account that only provides withdrawals, never contributions.

Table 1. Retirement Savings Vehicle converted to Retirement Income Vehicle

Type of Conversion	PPP relationship
RRSP converted to RRIF	AVCs- can be converted to RRSP if < 71 or RRIF mandatory over 71
LIRA converted into LIF	DB and DCs are converted to LIRAs or LIF, LIF mandatory over 71

More specifically:

If you choose to wind up the pension at retirement:

- AVC assets, roll tax-deferred (100%) into an RRSP if the person is under 71, or RRIF mandatory over 71.
- DC assets, roll tax-deferred (100%) into a LIRA if the person is under age 71, or LIF mandatory over 71.
- DB assets, roll subject to ITR 8517 test, tax deferred into a LIRA or LIF (depending on age) and the excess is cash and included in the person's taxable income for the year of the transfer.
- If there is surplus in the DB component, it can be paid to the plan's beneficiaries (taxable in their hands) or returned back to the sponsor company, taxable as investment income to the corporation but can be offset with any corporate tax losses.
- If instead of LIRA/LIF, the client purchases annuities, then you get 3 annuities that together give you a global pension benefit.

If the pension plan is NOT wound up and instead used to create the retirement income stream, then:

- AVC assets, roll tax-deferred (100%) into an RRSP if the person is under 71, or RRIF mandatory over 71.

- DC assets, roll tax-deferred (100%) into a LIRA if the person is under age 71, or LIF mandatory over 71.
- DB assets are used to pay the annual pension promised by the pension plan text, namely the 2% X Salary X Years of service formula.

Although this sounds very complicated (and we admit that it is), it sets up a funding situation that is very flexible in that you can generate several different income streams:

- Discretionary (i.e. for big one-time purchases like a world cruise):
  - RRSP withdrawals prior to 71
  - RRIF withdrawals (no maximum)
  - LIF withdrawals (subject to both minimum and maximums, so should be drawn on first). Once again, CRA has a reference table you need to check periodically.
  - Corporate savings
  - TFSA assets
- Non-discretionary (a reliable, continuous income stream, so you don't need to worry):
  - Life annuity: a guaranteed income for the remainder of your life.

In addition to flexibility, an additional benefit of the discretionary income streams is a legacy: if you don't spend these while living, they can be passed onto your surviving children.

Fortunately, you are able to mix and match according to your needs. For example, you could have an annuity in 1 account, a RRIF and a LIF in another.

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Finally, there are tremendous advantages embedded in the option to continue your pension post retirement and allow it to administer your income, As such, we think it will present the best choice for most professionals because it offers:

1. Income-splitting with a spouse starting at age 55 (v.s. 65).
   - This will substantially reduce the overall tax burden of the couple, on top of the $4000 /yr non-refundable pension income amount.
2. Intergenerational wealth transfer. If adult children are employees of the professional corporation, they can have all assets passed down to their own pensions without probate or taxes due (until they withdraw those funds from the pension at a later date).
3. Deduction of all management fees associated with the pension against corporate income.
4. Maintenance of the GST/HST credit.
5. Avoidance of a surplus tax hit. CRA income tax regulation 8517 stipulates the maximum amounts that can be transferred from a DC and/or DB pension to a RRIF/LIF or annuity. If your pension investments performed really well and you have a surplus well in excess of the actuary's estimation of the pension obligation to you, that excess amount will be removed from the pension and delivered into your hands as a lump sum. As appealing as that sounds at first, you must realize that it will almost certainly trigger a massive (54.7% in BC) tax bill the following year! This isn't a concern if the assets stay within the pension throughout retirement.
6. Cross-funding opportunity: another approach to avoid an enormous tax bill in the scenario of a over-funded DB account is to arrange for the DB account to fund the DC account several year leading up to retirement. The DC account is not subject to a CRA maximum.   It's just an effective way of spreading the funding amongst the accounts!

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Glossary

A **RRIF** is an extension of a Registered Retirement Savings Plan (**RRSP**). While your **RRSP** is used to save for your retirement, a **RRIF** is used to systematically draw income during your retirement. ... The funds you withdraw from your **RRIF** are taxable as this amount is added to your taxable income for that year.

A **LIRA** is a Locked-In Retirement Account and is designed for accumulation of pension money outside a pension plan. If you do not need income from your pension funds, then a **LIRA** allows you to manage your pension funds personally. A **LIRA** is just another type of registered account much like an **RRSP**.

A **LIF** is used to convert **LIRA** money to income just like an RRIF is used to convert RRSPs to income. Just like the **LIRA** has similarities to the RRSP, the **LIF** has a lot of similarities to the RRIF. A Life Income Fund is designed to create regular income. Unlike a RRIF (which have only an age-determined minimum annual withdrawal, LIF withdrawals have both a minimum and maximum set by CRA annually.