Randall J. Ladell, MBA

Chartered Accountant

Licensed Public Accountant

1210 Sheppard Avenue East, Suite 405
Toronto, Ontario, M2K 1E3
Email: randall@rjladell.ca
Website: www.rjladell.ca

Business: (647) 436-8782
Mobile: (647) 280-4248
Fax: (647) 436-8742

GROUP RRSP AND DPSP

Introduction

Group Registered Retirement Savings Plans (Group RRSP) and Deferred Profit Sharing Plans (DPSP) have one major thing in common. They are intended as employee benefit plans that reward employees for the quality of their service and their dedication to the company in order to help to retain the key talent that exists in every company's workforce. They are an alternative benefit plan for smaller companies that are growing in popularity because they are less costly and easier to administer than a formal Registered Pension Plan.

A Group RRSP is an informal plan that is primarily driven by employee contributions usually supplemented by some amount of matching by the employer. A DPSP on the other hand is a formal plan to share the profits of the company with its employees.

Group Registered Retirement Savings Plans (RRSP)

Group RRSPs are entirely flexible and although the plans are not governed by any pension standards legislation, they are afforded the same protections and have the same limitations as any individual RRSP plan.

Advantages

Some of the advantages to a group RRSP are:

- No locking in – on termination the benefits can be transferred to the employee's individual RRSP, transferred to a Registered Retirement Income Fund (RRIF) or withdrawn subject to the normal income tax requirements.
- Employer contributions can be varied in amount and timing, for example an employer could agree to match employee prior year contributions at 25%, 50% or 100% up to some preset limit of 2%, 5% or 9% of the employee's total salary. The deferral for one year is an incentive for the employee to stay with company and the matching contribution encourages him or her to participate in the plan.
- There are no restrictions on the beneficiary designation and no requirements for a joint and survivor pension when there is a spouse.
- There is no requirement for a pension committee but generally employees are the dominant group in the investment committee as they make the lion's share of the contributions.
- There are opportunities for income splitting at retirement as an employee's or employer's contribution may be directed to a spousal RRSP.
- Employees receive an immediate reduction in source income tax deductions on contributions rather than waiting until after year end for a tax refund.
- Employees benefit from greater purchasing power through a pooled RRSP that has low administration and fund management costs, which may be partially paid by the employer.
- Employees benefit from an opportunity to better diversify their retirement portfolio by participating in a larger variety of investment funds.

Disadvantages

Some of the disadvantages for an employer in creating and contributing to a group RRSP are:

- An immediate "vesting" of employer contributions. The employer is contributing directly to the individual's RRSP account and has no further control of the contribution after it is made.

- The employer contributions to a group RRSP attract payroll tax, CPP, EI and Worker's Compensation as part of the employee's taxable salary and benefits.
- The employer has no opportunity to be "paternalistic" by ensuring that funds are used for the employee's retirement. The employee has full control of withdrawals from the Group RRSP.

In order to avoid these difficulties, the Group RRSP may be established with no employer contributions and a separate DPSP may be created to capture employer contributions based on the company's profitability. As discussed in the DPSP section this approach avoids all of the above disadvantages.

Fiduciary responsibility

In setting up a Group RRSP, the employer is accepting a fiduciary responsibility to select the administrator and fund manager with prudence and diligence. To reduce the risk of difficulties and to ensure employee satisfaction with the plan and its performance an employee committee should have a major role in the approval process.

Contributions, taxation and investments

A Group RRSP is governed by all of the rules of an individual RRSP.

Contribution limits are 18% of earned income to the maximum allowed each year under the provisions of the Income Tax Act (2008 - $20,000) and the employee is limited to a deduction that is based on his or her prior year's unused RRSP contribution room.

Income earned on a Group RRSP is tax deferred until withdrawals are made from the plan. Qualifying investments are the same as a normal RRSP but usually given the nature of the plan and the use of a plan administrator or trustee are usually limited to mutual funds; GICs and savings accounts; and similar investments.

Transfers, termination and wind up

Because a Group RRSP is an informal arrangement, termination and wind up of the plan can be affected quite easily. On termination or winding up of the plan the employee's account balance can be transferred to his or her individual RRSP or a RRIF without tax consequences.

Deferred Profit Sharing Plans (DPSP)

A deferred profit sharing plan is a formal arrangement whereby the employer contributes to the plan and the amount of the contributions is calculated by "reference to the employer's profits" or "out of profits" from the employer's business.

Contributions made by "reference to profits" are expressed as a percentage of profits for the year, e.g., 5%. As a result if there are no profits for the year, no contribution will be made. The reference "out of profits" can be more complex and the term can be defined as profits for the year or undistributed profits for the year or any previous year. The contribution calculation can be based on a fixed amount per employee or as a percentage of the employee's salary. The absence of any mandatory relationship between profits and contributions often results in a DPSP that is more of a savings plan than a profit sharing plan.

Under the more formal DPSP agreement all deposits must be paid to a trustee who holds and invests the contributions on behalf of the employees.

A DPSP can be a supplementary pension plan, used in conjunction with a group RRSP or set up as a stand alone retirement vehicle. If it is part of a group of retirement benefit plans offered by a company then the total contributions for all plans are limited to the overall CRA registered retirement plan contribution limit.

Advantages

Some of the advantages of a DPSP over a RPP are:

- Greater flexibility, not subject to the detailed minimum pension standards legislation;
- Lump sum distributions can be made upon an employee's retirement.

The advantages of a DPSP over a Group RRSP for the employer are:

- The contributions to a DPSP do not attract payroll tax, CPP, EI and Worker's Compensation as they are not part of the employee's taxable salary and benefits.

- There is no immediate vesting of benefits and membership in the plan can be delayed. Vesting must begin after 24 months of membership.

Disadvantages (over RPP)

- No employee contributions allowed
- More limited contributions. Because there are no employee contributions the maximum contribution limit is the lesser of 18% of compensation and 50% of the RRSP contribution limit (For 2008 this amount would be $10,000)
- Shareholders and family members cannot participate in the company DPSP.

Vesting and payments

Benefits payable under a DPSP vest after a maximum 24 months of membership in the plan consistent with the rules for other RPPs but the employer can choose to have benefits vest at an earlier date.

Payments under a DPSP must begin 90 days after the earliest of the following times:

- The end of the year in which the beneficiary turns 69;
- The date of the employee's death;
- The date he or she ceases to be employed by the employer; and
- The date of winding up of the plan.

Registration requirements and investment limitations

The registration requirements that must be satisfied for a DPSP to be registered are:

- All payments into the trust and all income earned must be allocated to the beneficiaries;
- Employees may not borrow from the fund
- The trustees must be resident in Canada and must inform all new beneficiaries of their rights;
- All previously unallocated income received, capital gains and capital losses must be allocated to the beneficiaries within 90 days after the end of trust.

The DPSP must invest in qualified investments. The definition of qualifying investments is comparable to that contained in the provincial pension legislation. The exceptions are that the plan can invest more than 10% of its assets in one security and the plan may invest in the company's own common stock, if it is a qualifying investment.

As with a Group RRSP it is always a good idea to include employees on the investment and oversight committee to help to ensure that the investment policies are transparent to the employees, the ultimate beneficiaries of the plan.

Trust company

The trust company plays a major role in the set up of the DPSP as well as the ongoing operation of the plan. The company's duties include:

- Assisting with the initial communication of the plan to employees;
- Obtaining a Group RRSP form or the DPSP application that will serve as a basis for the establishment of the plan, preparing and filing various forms and corporate resolutions with the CRA
- Collecting and processing initial employee applications and processing applications for new employees, terminations and retirements
- Maintaining custody for all plan assets, processing deposits and executing all trading orders
- Providing ongoing reporting of investment performance and balances to both employees and employers.
- Preparing and distributing RRSP receipts for Group RRSP contributions and calculating pension adjustment amounts for DPSPs.
- Preparing and filing annual CRA T3D form.

There are fees for these service but they can be quite modest and may in some instances be negotiable.

Conclusion

Group RRSPs or a DPSP may be a simpler way for a small company to provide retirement benefits for its employees. Neither is appropriate for a new company or one that is just becoming established in its market but they can be appropriate vehicles for a maturing company to attract and retain qualified employees and to reward employees for their service.

Once a company has become established and is profitable a Group RRSP may be a good first step as an affordable benefit. The company is likely to reap goodwill beyond its contributions (which may be minimal in the early stages) for maintaining the plan and the records and through the provision of reduced tax deductions that offset part of the employees contributions.

Once profitability is more firmly established, phase 2 may be the implementation of a DPSP. Instead of making small contributions to a Group RRSP, the company can set up a retirement benefit plan that recognizes the employee's contributions to the overall profitability of the firm.

The rules for Group RRSPs and DPSP are not onerous and neither are compliance requirements.

In the end, either plan is likely to provide a benefit in improved employee morale and performance that is far beyond the dollar cost to the company for setting up and contributing to the plan.

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