Business Owners

Retirement Compensation Arrangements (RCA)

Education Library

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Executives and senior employees often struggle to find strategies to minimize income tax every year while ensuring sufficient cash flow for longer term retirement savings. A unique retirement savings program, called a Retirement Compensation Arrangement (RCA), is available in Canada which may be beneficial for these individuals.

RCAs may provide high income earners with a solution to significantly increase retirement savings tax efficiently. Executives, professionals and business owners with T4 earnings greater than $150,000 may be ideal candidates. Contributions to an RCA are tax-deductible to the sponsoring company, and are excluded from the members' income. Withdrawals typically occur at retirement and are taxable to the member in the calendar year income is received. RCAs may be helpful solutions for enhancing retirement savings, employee benefits, creating incentives, and funding for employee severance.

RCA advantages include:

- Tax deductible and tax deferred contributions
- Greater contribution room compared to registered plans (RRSP, RPP, DPSP)
- Past service funding available for prior years of employment
- Flexible investment options
- Member retains their RRSP room
- Creditor protection
- Taxation subject to jurisdiction

Navigating the challenges of business ownership

Business ownership, regardless of size or type, holds the potential for abundant opportunities but also unique challenges. That's why selecting the right Advisor who can effectively manage the many facets of your wealth as an entrepreneur is critical. Richardson Wealth provides all types of business owners, including traditional family-run enterprises, with strategic advice and support. This includes tax-efficient wealth strategies, planning for succession or sale, and other solutions.

How an RCA works

To qualify for an RCA, you must receive T4 employment income from the sponsoring company. Therefore, those in receipt of only partnership, self-employed, or dividend income will not be eligible. There is no minimum or maximum age restrictions; individuals age 72 that ordinarily do not qualify for benefits under registered plans may participate. RCAs can be established for current and former employees, individuals or groups of employees. Incorporated professionals and business owners may choose to establish an RCA and optionally include their employed spouse and other employed family members.

Generally, RCAs are best suited for individuals with employment earnings in excess of $150,000. Savings to registered plans, such as Registered Retirement Savings Plans (RRSPs) among others, may be utilized to provide benefits on the first $145,722 of employment income in 2017 while the RCA will provide benefits beyond this earnings level.

RCAs are commonly established through a trust arrangement and settled by the sponsoring company (employer), although RCAs may be created through a life insurance policy, letter of credit or annuity. It is important to note that RCAs must be offered by the sponsoring company and cannot be established independently by the employee. Contribution limits are commensurate with T4 employment income, years of service, and other factors; an actuary is often responsible for assessing these and other factors in order to determine reasonable contribution limits. Contributions are typically expressed through a defined benefit or defined contribution formula, and may be discretionary depending on the plan design. Employer contributions to an RCA are tax deductible, and in some instances, employee contributions to an RCA may be tax deductible to the employee.

Only 50% of RCA contributions may be invested at any time; 50% of contributions are remitted to, and held in a Refundable Tax Account (RTA) with the Canada Revenue Agency (CRA). Funds held in the RTA account are in cash, cannot be invested and do not earn interest. In addition, 50% of any realized capital gains, interest or dividends are also remitted to the RTA account. However, RTA amounts are returned to the member at the time of withdrawal. For every $1 the member withdraws at retirement, $1 is returned from the RTA account, and included in the members' taxable income.

In addition, one must be cognizant of the Salary Deferral Arrangement (SDA) rules when contemplating these types of plans. Subsection 248(1) of the *Income Tax Act* essentially establishes that an arrangement such as an RCA cannot be used to defer receipt of taxable salary, wages or bonuses that are otherwise payable. It is important to speak to experienced tax and legal professionals before creating an RCA to ensure compliance.

The RCA as a solution

RCAs may be useful in a variety of planning scenarios:

- Integration with an existing employee retirement plan
- Employee incentives to attract and retain key employees
- Funding for employee severance
- Professional athletes
- Foreign workers

Integration with an existing employee retirement savings plan

Traditionally, RCAs have been integrated with a pension plan to provide "supplemental benefits" in excess of registered limits. For example, a Defined Contribution Pension Plan (DC) utilizing an 18% benefit formula, can provide a maximum of $26,230 in contributions based on $145,722 of T4 employment earnings in 2017. The RCA could supplement this plan, and provide increased contribution room based on actual employment income. In this example, combining the RCA with this type of DC plan for an executive earning $500,000, would result in an additional $63,700 of tax-deferred employer contributions to the RCA – actual contributions limits are determined by the actuary on an individual basis.

Creating an employee incentive plan

An employer may be unaware as to how RCAs can be structured as part of an employee incentive strategy; often bonuses, or employee stock options form the basis of these incentive plans. These plans may not offer the tax efficiency and flexibility desired by employers and employees alike. Unlike a bonus strategy, RCA contributions remain tax deferred to retirement and may be vested over periods exceeding 3 years. RCAs may include vesting, restricting any entitlement or benefits under the arrangement until a specific performance is met. A "golden handcuff" strategy through an RCA could increase employee retention conditional on the employee remaining at the company for a certain period of time, or by creating strong incentives to align the employee's performance with a desired outcome.

Funding for employee severance

From time to time, companies may be restructured, sold or wound up; key executives may find themselves in a position to negotiate or receive an offer for severance. This may be an opportune time to consider how an RCA can be used to fund and secure a severance offer in a tax efficient way.

Retirement planning for professional athletes

Many professional sports organizations are familiar with RCAs and these plans have been widely adopted as a retirement strategy for athletes. Special exemptions exist under the *Income Tax Act* to allow athletes to benefit from RCAs without being subject to SDA restrictions. Athletes may generate substantial income early in their careers. They may also be subject to early retirement and a significant drop in their earnings ability. An RCA can significantly improve retirement outcomes for athletes by provisioning a larger share of employment earnings, while providing a structure for disciplined savings.

Retaining foreign workers in Canada

Corporations have sometimes utilized RCAs to assist in attracting and retaining foreign workers to Canada. In Canada, RCA income is taxable at retirement and subject to residency; this may create opportunities for employees retiring abroad, possibly in a lower tax jurisdiction. For example, a beneficiary of an RCA who later becomes a resident taxpayer of the United States, may be subject to a maximum of 25% Canadian withholding tax on RCA income, with tax rates as low as 15% where the payments qualify as "periodic payments" notwithstanding U.S. Federal and State tax that may apply. Tax rates may differ depending on jurisdiction subject to treaty and non-treaty tax rates. Cross-border planning may provide significant tax planning opportunities and should always be made in conjunction with advice from professional tax and legal advisors in this area.

Conclusion

Since 1986, RCAs have been commonly used as a standalone retirement solution or in combination with existing pension or supplementary plans. An RCA can assist in bridging the "savings gap" created by the inability of registered plans to provide adequate contribution room for high income earners. RCAs are a possible solution to significantly increase retirement savings and do so tax efficiently.

If you would like more information on RCAs or other retirement savings opportunities, contact your Richardson Wealth advisor to set up a consultation.

Tax & Estate Planning

As an individual investor or a business owner you have unique objectives and priorities that need to be considered. At Richardson Wealth, your Investment Advisor collaborates with our in-house Tax & Estate Planning professionals to deliver customized wealth management solutions designed to address tax, estate, insurance, philanthropic and succession needs.

Our approach. Our expertise. Our experience. **Our difference.**