

Benefits of an Employee Profit Sharing Plan

An exciting strategy has emerged that allows business owners the opportunity to have more control over their retirement savings, increased opportunities for income splitting with family members, and tax deferral on shareholder bonuses. All of these benefits can be accomplished through use of an Employee Profit Sharing Plan (EPSP).

The EPSP is a special purpose trust that allows the beneficiaries of the plan to share in the profits of the company, established under section 144 of the Income Tax Act. One of the unique attributes of the EPSP is the ability to pay a connected employee a portion of their income (i.e. bonus) in a manner that does not attract employer and employee CPP and EI contributions through the use of this trust. Other very important features would be a 14-month tax deferral on any shareholder bonuses and the elimination of Employer and Employee CPP and EI contributions through the use of a Profit Sharing Trust. A final feature of the EPSP trust is the ability to income split with family members who are employees to a greater extent than their appropriate salary. Once moneys flow from the Company into an EPSP bank account, trustees have the ability to split them between participants regardless of their prior salary, creating a vehicle to split income and dramatically reduce participants' overall income tax burden. The key here is that payments from the EPSP to the spouse or adult children may be greater than their prior earnings without justification.

Here are some of the mechanics of an EPSP and how it works: a trust called The Employee Profit Sharing Plan for XYZ Company is set up using a three-person trust agreement. The company makes the contribution to the trust. All funds in the trust account must be allocated to the participants of the plan

at the end of the fiscal year. The company issues a T4PS (profit sharing) slip. These earnings are RRSP and IPP eligible.

One limitation of the trust is that T4PS income is not eligible for research and development grants. Please consult your accountant if your company applies for these types of grants. Loss of E.I. and CPP benefits should be considered; however, properly investing the savings should more than make up for lost benefits as will be illustrated.

The chart on the following page shows what you are paying today as well as the history of CPP and EI contributions in Canada.

Since Payrolls processed through EPSP avoids Employer & Employee CPP Contributions, Employer & Employee EI Contributions and Source Deduction of Income Tax, additional planning must be implemented as a result of the loss of these government benefits and requirements. The most glaring planning opportunity is the ability to free up \$4237 of CPP contributions each year the participant is paid from the trust, and subsequently the loss of any additional CPP benefit. It should be noted, when an employee begins to receive compensation through the EPSP trust, all CPP benefits accrued up to that date will not be lost. Any CPP benefit accrued to that date will still be available to the employee upon retirement.

Case Study: Investing your CPP Contributions

XYZ Corporation decides to implement an EPSP for Mr. Smith, a 40-year-old shareholder employee of XYZ Corporation. Mr. Smith is very concerned about the loss of additional CPP benefits on retirement, and Mr. Smith wants to see some detailed numbers as to what he could accumulate with the \$4237 per year to make up for his lost CPP. If Mr. Smith contributes the CPP premium every month to a tax-free savings account, and indexes the payment at 2%, Mr. Smith will have accumulated \$253,076 at 5% interest. This



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*** EPSP's –Maximum Combined Employer and Employee Contributions**

Year	CPP	EI	Total	Percentage Increase
1966	\$158.40	-	\$158.40	-
1975	\$241.70	\$323.44	\$564.64	256%
1985	\$759.60	\$1,348.88	\$2,108.48	273%
1995	\$1,701.00	\$3,051.38	\$4,752.38	125%
2000	\$2,659.80	\$2,245.20	\$4,905.00	3%
2002	\$3,365.20	\$2,059.00	\$5,424.20	11%
2004	\$3,663.00	\$1,853.28	\$5,516.28	2%
2005	\$3,722.40	\$1,825.98	\$5,548.38	1%
2006	\$3,821.40	\$1,750.00	\$5,571.40	0.5%
2007	\$3,979.80	\$1,728.00	\$5,707.80	2%
2008	\$4,098.60	\$1,706.47	\$5,805.07	2%
2009	\$4,237.20	\$1,756.30	\$5,993.50	3%

is a lump sum amount that Mr. Smith can either turn into an income stream, or simply withdraw tax free and buy the vacation property he always wanted. If Mr. Smith started this program when he was 25, Mr. Smith would have \$700,474 at his disposal. This is substantially more than the commuted value of his future CPP pension. Interestingly enough, at the age of 57, any further contributions to CPP will not increase the benefit at age 65 if the employee has already paid the maximum amount since the age of 18. The EPSP solves the problem of wasted CPP premiums for those employees age 57 or older who are contributing their hard earned dollars to the greater good of the CPP pool.

Benefits received from EPSP remain eligible for:

- RRSP Treatment
- Pension Benefit Accrual Treatment

Participants selected by the Company each calendar year may include:

- Business Owners
- Family Employees of Business Owners
- Executives
- Key Employees
- Long-time Loyal Employees

Items needed to establish an employee profit sharing plan include:

- Directors' Resolution
- EPSP Trust documentation

- 3 individuals (1 independent of company)
- Plans are registered with CCRA
- 2 person EPSP Committee required.
- Other employees MUST understand impact on CPP & EI Benefits
- Plan is flexible with respect to beneficiaries
- Other employees offered plan membership may decide each calendar year whether or not to participate
- Employees, prior to participating, sign waiver
- Company to establish a group RRSP/IPP/TFSFA for employer/employee CPP and EI contribution savings

There is a defined process and detailed procedure in properly setting up an EPSP, and consultation with an informed professional should always be considered.