EMPLOYEE GROUP SAVINGS PLANS

MARCH 2023

DEFERRED PROFIT SHARING PLAN OR A GROUP RRSP – WHICH IS BETTER?

BACKGROUND

Many employers understand that having an employee group savings plan allows them to attract and retain amazing talent, all the while helping their employees accomplish their financial goals faster.

During a search for the right savings plan, many likely hear about *group registered retirement savings plans (GRSPs or Group RRSPs)* as well as *deferred profit sharing plans (DPSPs).*

A few of the benefits of DPSPs and Group RRSPs are the same, but the two have several important differences as well.

The goal of this newsletter is to provide a high-level overview of each type of plan, the major differences between the DPSP and the group RRSP, and the advantages and disadvantages of each, to help determine which is best in specific circumstances.

In this newsletter

With employee attraction and retention at the top of the mind for many employers, it is tough to decide what savings plan would work best for their business.

For previous newsletters like the **Underused Housing Tax** and how it can cause a $5,000 to $10,000 penalty even for a citizen, permanent resident, corporation, partnership, or trust that has residential property, visit our info centre at: *https://CGLtax.ca/info_centre.html*

HOW DOES A DPSP WORK?

A **deferred profit sharing plan (DPSP)** is an employer-sponsored plan registered with the Canada Revenue Agency (CRA). A DPSP allows employers to share company profits with their employees while allowing the employers to decide if they wish to set up a DPSP for all employees or a just a select group.

The main difference is of a DPSP is that employers are the only ones who may contribute to the plan and employees are not able to invest in it.

The basics of how it works is that contributions are made to a trust fund established by a trustee, which is usually a bank, insurance company, or other financial institution.

It is the trustee's responsibility to ensure that the benefits of the plan are paid only to employees and to oversee its operation.

The maximum contribution limit to a DPSP for employers is 18% of the employee's annual earned income or half of the **money purchase limit**[1], whichever is less.

In years in which there are no profits for the employer, no contributions are required. All contributions are tax-deductible by the employer and grow tax-free for the employees. Employees are only taxed on the employer contributions when they eventually withdraw the funds.

DPSPs can be utilized by employees in conjunction with other retirement saving plan options. However,

employee RRSP contribution room is reduced by the amount of contributions received in the prior year.

For example, if an employer contributes $1,000 to an employee's DPSP, the result will reduce the employees RRSP contribution room by $1,000 in the following year.

Due to the fact that the DPSP is an employee-only plan, it is not open to company owners, relatives or spouses of company owners, or anyone who holds a stake of more than 10% of the company.

A spouse or child of an employer could not participate in DPSP plans, and some senior executives and leaders with a high stake in the organization may be excluded from participating as well.

HOW DOES A GROUP RRSP WORK?

A **group registered retirement savings plan (Group RRSP or GRSP)** is an employer-sponsored retirement savings plan. It works exactly like an individual RRSP, except it is set up on a group basis, so it offers many advantages.

By incorporating payroll deductions, employees contribute pre-tax dollars to the GRSP, which is then invested in a basket of pre-selected investments by the plan administrator.

Plan administrators are typically an insurance company, bank, or other financial institution.

A matching plan can be set up where the employer will match contributions from employees (usually up to 3%–5% of their annual salary).

If the employer wishes to contribute a predetermined amount regardless of whether an employee participates or not, they can also establish a flat employer contribution plan.

Alternatively, the employer may wish to establish a non-matching plan in which the employee contributes whatever they wish and the employer does not contribute.

All contributions made by the employer are considered taxable income for the employee, however, the employee benefits from the tax savings immediately, instead of waiting until tax time for a refund.

WHAT IS THE DIFFERENCE BETWEEN A DPSP AND A GROUP RRSP?

Both DPSPs and Group RRSPs offer tax-deferred returns, but there are important differences that need to be considered when comparing them.

A DPSP takes employer contributions only. Employees are not able to contribute.

With a GRSP, employees are encouraged to contribute and the employer may do so as well.

GRSP Contributions are made regularly, usually on every payroll, unlike DPSP contributions, which can be made monthly, quarterly, or yearly whenever the employer chooses—or even skipped when profits are low or negative.

In addition, employer contributions to GRSPs are immediately owned by employees. If the employer makes a contribution and the employee quits the next day, the employer does not get the money back, and the employee keeps it.

Conversely, when contributing to a DPSP, there is a vesting period. This is a period of time between when the employer contributes and when the employee takes ownership.

If the employee quits or is fired before the vesting period is over, the employer receives their money back.

EMPLOYER'S VIEW: COMPARISON OF A DPSP AND A GROUP RRSP

When comparing the DPSP vs GRSP, be aware of several advantages and disadvantages.

EMPLOYER ADVANTAGES OF A DPSP

- Contribute whenever the employer wants to. They can use the DPSP at any time. Contributions can be made monthly, quarterly, yearly, or whenever suits them best.
- Employers and employees can benefit from tax incentives. DPSP contributions are tax-deductible for the employer, and DPSP contributions are excluded from federal and provincial payroll taxes.
- Encourage employee retention. By using a vesting period of up to two years, employers can protect DPSP contributions and increase employee retention.
- There is some debate about the vesting period actually helping with retention, but the concept is that it reduces employee turnover because employees who leave before the vesting period ends must forfeit their DPSP.
- When an employee leaves before the vesting period is up, the employer gets the DPSP funds back.
- Employee incentive programs can help motivate employees to perform well and so profit sharing can be a powerful motivational tool.

EMPLOYER DISADVANTAGES OF A DPSP

- A DPSP is an employee-only plan, meaning owners, their relatives, spouses, and anyone with a 10% or higher stake are prohibited from having one. This can have an impact on how the employer rewards senior managers, especially if there is significant extra profit.
- Due to the nature of the DPSP, non-profit organizations cannot take part.
- A two-year vesting period and irregular payouts may not appeal to talent. Both new and existing talent may view them unfavorably as aspects of their compensation they cannot count on.

EMPLOYER ADVANTAGES OF A GRSP

- Employers can choose whether or not to match employee contributions and the amount. If necessary, employers can suspend employer matches at any time. They can also choose to have a non-matching program.
- A matching program is especially useful for attracting and retaining employees.
- Employers can move funds directly between the corporation and their employee's RRSPs. If the plan the employer chooses is unrestricted, employees can also move funds between the employer’s RRSPs and their own RRSPs.
- Since there are so many employee benefits to a GRSP (see below), an employer may be able to get employees excited and engaged about the plan as well as attract new talent.

EMPLOYER DISADVANTAGES OF A GRSP

- A GRSP does not have a vesting period, so employees might not feel obligated to remain at the company in order to receive rewards. While this may not have a significant impact on employee retention, it is still debatable.
- Most employer contributions to a GRSP require payroll taxes for EI and CPP. As payroll rules are constantly changing, please check the CRA for the most recent information.

EMPLOYEE’S VIEW: COMPAISON OF A DPSP AND A GROUP RRSP

Consider employees' needs when choosing a plan.

EMPLOYEE ADVANTAGES OF A DPSP

- Funded by the employer. Employees are not required to contribute anything and receive employer contributions. Employees receive free money.
- There is a maximum vesting period of two years, meaning employees are only required to stay for a maximum of two years. Some companies offer shorter vesting periods or automatic vesting.
- There is no waiting period until retirement. Employees can withdraw their funds at any time. However, they will have to pay withholding taxes on the funds they withdraw.

EMPLOYEE DISADVANTAGES OF A DPSP

- It's impossible to rely on this as a retirement plan when contributions are unpredictable. Employers aren't required to contribute when profit is low or nonexistent.
- The employee's RRSP contribution room is reduced as a result of contributions to their DPSP.

EMPLOYEE ADVANTAGES OF A GRSP

- Investing is so simple with payroll deductions. The entire process is automated and money is taken from paycheques before it is spent.
- As employees are generally familiar with the RRSP, confusion about how to use it can be reduced.
- It is up to the individual employee how much they want to contribute. There is no minimum contribution.
- Because employee assets are pooled, fees tend to be lower than those of individual RRSPs.
- It is managed by professionals, making it ideal for those who don't feel confident investing on their own.
- Employees can take advantage of "free money" if their employers offer matching plans.
- An employee's contribution to their GRSP can be immediately deducted from their taxable income, thereby lowering their taxes.
- As soon as a contribution is made, the money becomes the employee’s. GRSPs do not have a vesting period.
- Flexible. Funds can be used to help with a Home Buyer's Plan (HBP) or a Lifelong Learning Plan (LLP).

EMPLOYEE DISADVANTAGES OF A GRSP

- If an employer establishes a restricted plan, they can restrict the employee's ability to withdraw funds while employed. In order to access the funds, an employee may leave the employer.
- The investment options of group plans may be more limited than those of DPSPs.
- GRSP cancellation. Employers can modify or terminate GRSP plans at any time.

DPSP OR GROUP RRSP: WHAT IS THE BEST PLAN FOR EMPLOYEES?

An employer should take some time to think about what they want to accomplish before choosing a group plan for their employees.

- Is the main goal to help employees save for retirement?
- Want to attract the best talent?
- Is there concern about employee retention?
- Want to provide incentives to attract employees?

Here are some additional questions to consider when determining the goals of a group savings plan:

- Is it important for employees to be able to contribute to the plan? If so, then choose a GRSP.
- Want to contribute to the plan only if the company makes money? Choose the DPSP.
- Want employees to receive their company contributions immediately? consider the GRSP.

A GRSP and a DPSP each have their pros and cons. It all depends on what the employer wants to do with the offering:

- provide retirement savings plans, or
- incentive plans to encourage performance.

THE PROCESS OF SWITCHING BETWEEN A DPSP AND GRSP

AN EMPLOYER'S GUIDE

Switching from one registered plan to another is possible, including the DPSP and the RRSP.

In order to switch group plans, the employer must first decide which plan they want to use and which provider (bank, insurance company, other financial institution) they wish to use.

Then they should contact their current provider and let them know that they have a new provider. The

new provider will usually take care of all the heavy lifting.

The employer should share the benefits and reasons behind the switch with their employees before making the switch. This is so that they have enough time to ask questions and decide how they would like to use their investments.

If employees switch between plans, they can cash out their DPSP or RRSP instead of transferring it.

The money, however, must be reported as income and taxed as such.

THE EMPLOYEE'S INSTRUCTIONS

Employers can assure employees that if they don't want to make the switch from one group plan to another, they also have the option of investing their money in an individual plan.

The employer can easily convert a group DPSP or GRSP to a personal RRSP by providing that the employee is 71 or younger at the end of the year in which the transfer is made.

WHAT TO DO TO MAKE EMPLOYEES EXCITED ABOUT GROUP SAVINGS PLANS

Employees will not always be thinking about group retirement plans. With retirement so far away, younger employees may not recognize that saving for retirement is important.

In addition, other employees may have experienced negative experiences with past group benefits plans, leaving them confused or intimidated.

Consider these three tips for engaging employees and getting them excited about the group plan:

1. MAKE IT SIMPLE.

Employees must be able to understand a program before they can take advantage of it. Help them out by putting together an ongoing education program explaining your company's benefits in plain English.

2. EMPHASIZE THE BENEFITS

Focus on the specific advantages of the plan when presenting it to employees.

- What makes this plan exciting for them?
- How can it improve their life and that of their family?

Be sure to emphasize if there is a matching employer contribution to the plan and explain how it will help employees reach their retirement goals faster if the employer matches it.

3. NEW HIRES SHOULD BE AUTO-ENROLLED

As part of a company retirement program, new employees can also be automatically enrolled. People are hardwired to follow the path of least resistance. This is why they always look for the easiest option.

Auto-renewal simplifies the enrollment process by eliminating a barrier.

As an alternative to giving employees an option to opt in, this gives them an option to opt out.

TIME TO CHOOSE: A DPSP OR AN RRSP?

What an employer hopes to accomplish with their group plan ultimately determines the type of plan that is best for them and their employees.

Employers can use the GRSP to motivate employees to save for retirement or to buy their first home if they want an easy way to do so.

DPSPs might be the way to go if the employer wants to encourage employees to stay for a couple of years and only contribute when the employer has a profit.

In the end, the DPSP and RRSP are both attractive plans that can help attract talent and make employees' financial goals more attainable.

OTHER RESOURCES

- CRA: Deferred Profit Sharing Plan Administration
  - *https://www.canada.ca/en/revenue-agency/services/tax/registered-plans-administrators/deferred-profit-sharing-plans.html*
- CRA: Registered Retirement Savings Plans and Registered Retirement Income Funds (RRSPs/RRIFs)
  - *https://www.canada.ca/en/revenue-agency/services/tax/registered-plans-administrators/registered-retirement-savings-plans-registered-retirement-income-funds-rrsps-rrifs.html*
- Income Tax Act Section 147
- IC77-1R5, Deferred Profit Sharing Plans (2007-Aug-17)
- T4084, Pension Adjustment Guide
- RC4137, Pension Adjustment Reversal Guide

ENDNOTES

1 The annual money purchase limit is the same as the RRSP limit for the following year. In other words, the 2022 money purchase limit is the same as the 2023 RRSP limit. This can also be found in subsection 147(5.1) of the *Income Tax Act*.

This information is for educational purposes only. As it is impossible to include all situations, circumstances and exceptions in a summary such as this, a further review should be done by a qualified professional. No individual or organization involved in either the preparation or distribution of this document accepts any contractual, tortuous, or any other form of liability for its contents or for any consequences arising from its use.

© CGL Tax Professional Corporation 2023. Distributed with permission. Date of Issue – March 2023