RBC Wealth Management Services

The Navigator

Retiring Allowance Planning When You Leave Your Employer

Leaving an employer can often be an emotional time. Whether you are leaving your employment voluntarily or involuntarily, there are generally three main financial issues that need to be considered: 1) retiring allowance planning, 2) pension plan options and 3) salary continuance and company benefits. It is important to carefully evaluate the options presented to you as the decision is often irreversible.

This article will discuss retiring allowance planning when you leave your employer and the special tax rules provided in the Canadian Income Tax Act (the Act) that may allow for a tax deferral through a rollover to your RRSP. Ask your RBC advisor for our articles on pension plan options, salary continuance and company benefits if applicable to you.

This article outlines several strategies, not all of which will apply to your particular financial circumstances. The information is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax advisor before acting on any of the information in this article.

What is a Retiring Allowance

A retiring allowance is an amount paid to an employee upon termination of employment. The amount of your retiring allowance is usually based on your length of service and position within the organization. It is common to hear the terms retiring allowance and severance package being used interchangeably but they are different. A retirement allowance is one component of a severance package which may also include other payments, benefits and incentives.

The distinction is important because payments that meet the definition of a retiring allowance may qualify for the special tax treatment the Act provides.

Payments that qualify as a retiring allowance include:

- payments for unused sick leave credits on termination; and
- amounts individuals receive when their office or employment is terminated, even if the amount is for damages (such as wrongful dismissal) when the employee does not return to work.

Payments that do not qualify as a retiring allowance include:

- a superannuation or pension benefit;
- an amount an individual receives as a result of an employee's death (these payments may be treated as death benefits);

- a benefit derived from certain counselling services;
- unused vacation;
- pay in lieu of termination notice; and,
- damages for violations or alleged violations of an employee's human rights awarded under human rights legislation to the extent these damages are not taxable.

Eligible Retiring Allowance

Special tax rules contained in the Act allow the portion of the retiring allowance that qualifies as an "eligible" retiring allowance to be transferred to your RRSP on a tax-deferred basis without requiring unused RRSP contribution room. The portion that does not qualify, the non-eligible retiring allowance, can only be contributed to your RRSP if you have unused RRSP contribution room.

The eligible portion of your retiring allowance is determined by your employer using the following formula, which is based on years of service as follows:

Eligible Retiring Allowance = the smaller of the two following amounts:

i) The actual amount you receive as a retirement allowance; or,

ii) The sum of:

   a) $2,000 for each year or part of a year before 1996 where you worked for the employer,

plus

   b) $1,500 for each year or part of a year before 1989 of that employment in which none of your contributions to your pension plan or DPSP were vested in your name when the retiring allowance is being paid (i.e. generally if you were not a member of a pension plan or DPSP for years before 1989 then you may be eligible for this additional $1,500 per year).

An eligible retiring allowance may be paid to you, in whole or in part, directly or transferred to your RRSP. When it is transferred directly to your RRSP, your employer is not required to withhold tax on the payment. Keep in mind, if it is paid to you directly the amount paid will be net of withholding tax.

You can still benefit from the special rollover rules if the eligible retiring allowance is paid to you directly provided you make a contribution to your RRSP within 60 days from the end of the year you received it. However, since there was withholding tax on the eligible retiring allowance received, in order to contribute the gross amount to your RRSP (so that you can maximize the amount contributed without using unused RRSP contribution room) you will need to supplement the contribution with other sources of funds.

Note: to qualify under the special rules that allow the transfer without using unused RRSP contribution room, the eligible retiring allowance must be transferred to the RRSP of the individual receiving the retiring allowance (i.e. an RRSP where that individual is the annuitant). Eligible retiring allowances cannot be transferred to a spousal RRSP under the special rules.

Non-Eligible Retiring Allowance

Although the non-eligible retiring allowance does not qualify under the special rollover rules, you can still make an RRSP contribution to your own RRSP or to a spousal RRSP to defer the payment from tax, provided you have sufficient unused RRSP contribution room and the contribution is made within 60 days from the end of the year you received it. Your unused RRSP contribution room will be reduced by the amount of the contribution.

Your employer may be willing to contribute the gross amount, in whole or in part, directly to your RRSP or to a spousal RRSP based on your unused RRSP contribution room. This can be done without withholding tax by means of a direct transfer. Your employer may require reasonable proof that you have available RRSP contribution room in order to forego withholding tax. A copy of your Notice of Assessment for the previous year showing your RRSP deduction limit might be sufficient for this purpose. Even if you provide this proof, your employer may exercise its discretion not to make a direct transfer to your RRSP.

If your employer intends to withhold tax on the payment, you may wish to consider filing Form T1213 – Request to Reduce Tax Deductions at Source for Year(s), with the Canada Revenue Agency (CRA) to ask for approval to remove the requirement for withholding. Once the application is approved by the CRA, you can provide your employer with the approval. This will allow your employer to make the payment without withholding tax. Filing form T1213 should be considered if you have sufficient time before the payment will be made since it could take several weeks to receive the approval.

If your employer withholds tax and you make a contribution to your RRSP or to a spousal RRSP, you will receive a refund of the withholding tax when your personal income tax return is assessed, or the amount will offset the tax owed on other income on your tax

If you have received an eligible retiring allowance and you have contributed this amount to your RRSP, you must report the RRSP contribution as a transfer on line 14 of Schedule 7 on your personal income tax return.

return, thus resulting in less taxes owed on your assessment.

Tax Reporting

When withholding tax is required, the withholding rate is the same as for RRSP withdrawals made by Canadian residents and is shown in the table below.

When your employer initially advises you of the amount of your retirement allowance, you may not be told what amount is an eligible retiring allowance. However, your employer is required to determine the eligible and non-eligible retiring allowance amounts for reporting on your T4 slip. Your employer must issue this slip to you no later than the last day of February following the year the allowance is paid. Since the CRA allows the special tax treatment only for the eligible retiring allowance reported by your employer, you should ensure this amount was correctly reported on the T4 slip.

The retiring allowances (eligible and non-eligible) reported on your T4 slip are included on your personal tax return on line 130 as other income. Any direct or indirect contribution to your RRSP or spousal RRSP will result in a receipt being issued by the financial institution for the contribution. This RRSP contribution will result in a deduction to offset the income reported from the retiring allowance.

It is important to note that if you have received an eligible retiring allowance and you have contributed this amount to your RRSP, you must report the RRSP contribution as a transfer on line 14 of Schedule 7 on your personal income tax return. This will ensure the contribution does not use your unused RRSP contribution room.

Financial Planning Considerations

It is not necessary to transfer the eligible retiring allowance to your RRSP under the special tax rules. There may be other more important uses for the funds or there may be other tax planning strategies to consider.

Other Uses for the Funds

You can request that all or part of the eligible retiring allowance be paid out in cash, subject to withholding tax, if there are other more important needs for the funds. For example, you may require the amounts to live on before finding a new job, to pay down debts or to fulfill other goals. If you are unsure whether you will require the retiring allowance to support your current expenses, there still may be some value in making the rollover while you can and then withdrawing or deregistering the RRSP funds as necessary. This may allow you to take advantage of some tax-deferred growth of the funds. Speak to your RBC advisor for assistance in determining the best use of the funds.

Income Splitting

One goal in financial planning is often for couples to try to equalize their total incomes to be the most tax-efficient. The ability to transfer 50% of qualifying income to your spouse under the pension income splitting rules may not be enough to achieve an equal split of total income. This may be the case where one spouse has a larger amount of non-registered assets than the other. A spousal RRSP allows you to split future income without the limitations imposed by the pension income splitting rules. If you have a large unused RRSP contribution limit that you may not otherwise be able to utilize and you would like to take advantage of a spousal RRSP, you may want to transfer as much of your retiring allowance as your unused RRSP contribution limit will allow directly into a spousal RRSP, even if some of your retiring allowance is an eligible retiring allowance. The ability to split the future income and the resulting tax savings of this strategy may outweigh the benefit of transferring eligible retiring allowance to your RRSP without using unused RRSP contribution room. Speak with a tax advisor for assistance.

Retirement allowance amount	Province other than Quebec	Province of Quebec*
$0 - $5,000	10%	21%
$5,001 - $15,000	20%	26%
$15,001 and over	30%	31%

* For Quebec the withholding tax is composed of a provincial amount of 16% for all withdrawal amounts plus a federal amount that varies to equal the totals shown.

Please contact us for more information about the topics discussed in this article.

Delaying the Payment

For tax planning purposes, your employer may be willing to allow you to defer the receipt of your retiring allowance to a future tax year which may be beneficial if a portion or all of the retiring allowance is non-eligible and you do not have unused RRSP contribution room, or you choose not to contribute the payment to your RRSP. The deferral will be beneficial if your total income is lower in the future tax year in which the payment is received. However, if the company you are leaving is in any financial difficulty, or there is any other reason to question whether payment will be received, it may be advisable to receive the whole payment now to avoid any risk for non payment.

Other Important Facts on Retiring Allowances

- You may only be entitled to an eligible retiring allowance once you have been terminated or have retired. If you terminate your employment but are re-employed with the same company soon after, even as a consultant, the status of the payment as a retiring allowance may be jeopardized.
- Contributing your eligible retiring allowance to your RRSP is not permitted if you are turning 72 or older in the year of receipt and are thus not permitted to have an RRSP.
- Your eligible retiring allowance must be contributed to your RRSP on or before 60 days after the end of the year that the retiring allowance was received. If it is not contributed to your RRSP before the deadline, the ability to make the contribution without using unused RRSP contribution room is lost forever.
- It is important to note that amounts you receive as a retiring allowance (eligible or non-eligible) are not considered as earned income for the purpose of calculating next year's RRSP contribution limit.
- The retiring allowance you receive, whether contributed to an RRSP or not, may delay the receipt of Employment Insurance (EI) benefits, if you qualify for them.
- You cannot designate any portion of the eligible retiring allowance contributed to your RRSP as a Home Buyers' Plan or Lifelong Learning Plan repayment.

Consider Your Options and Plan Accordingly

Careful planning can go a long way to ease the transition from employment. Take into consideration your cashflow needs (immediate and long-term) and remember to maintain flexibility since circumstances are always changing. Your RBC advisor can assist you in addressing many of these issues.

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