Retiring Allowances – The Silver Lining (RRSPs)

Job security is no longer something we take for granted. While most of us will work for four or five different companies before retirement, the decision to move on is not always voluntary. Losing a job is difficult under any circumstances; however, it may present you with an opportunity to significantly increase the value of your RRSP.

Under the retiring allowance rules, all or part of your severance package may be rolled into your RRSP. Inside the RRSP, assets grow on a tax-deferred basis just like your regular RRSP contributions and are taxed only when withdrawn.

A retiring allowance is an amount you receive on or after your retirement or termination from employment in recognition of long service. It includes payment for unused sick leave and any amounts that you may have received for loss of office or employment, whether as a payment of damages or a payment under an order or judgement of a tribunal.

Your former employer will issue you a tax slip for the full amount of the retiring allowance and it will be taxed as regular income. However, you will receive an offsetting RRSP contribution deduction for the eligible portion that you transfer into your RRSP.

Since Canada Revenue Agency (CRA) views a retiring allowance rollover as a special RRSP contribution, it has no impact on your regular RRSP deduction limit. Also, the rollover must be made into your own RRSP, not a spousal plan.

How Much Can You Roll To Your RRSP?

Under the retiring allowance rules, you may roll $2,000 into your RRSP for every calendar year or part year, that you were employed by your company prior to 1996. No rollover is allowed for years of service after 1995. You may roll another $1,500 for every calendar year or part year, before 1989, that you were not a member of a vested registered pension plan or deferred profit sharing plan (DPSP). A registered pension plan or DPSP vests when the company can no longer take back the contributions it made to the plan on your behalf.

Vesting dates vary from province to province, but usually occur within the first few years of plan membership.

Let's look at an example for an employee who began working in June of 1986, joined the company's pension plan in January of 1988 (all pension benefits have fully vested), was terminated in March of 2006 and given a severance package which includes a $30,000 amount which qualifies as a retiring allowance. The maximum amount this individual can roll into an RRSP as a retiring allowance is determined as follows:

RRSP Rollover Amount

Years employed pre–1996	10 X $2,000 = $20,000
Pre–1989 years when not a member of a vested pension plan or DPSP	2 X $1,500 = $3,000
Total	**$23,000**

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In our example, the former employer would issue a tax slip for the full $30,000. If the former employee rolls the eligible portion of the retiring allowance ($23,000) into his RRSP, he will receive an offsetting RRSP contribution receipt for $23,000. This results in the former employee only having to pay income tax on $7,000. However, if the employee has unused RRSP room, he can use the funds from the retiring allowance to make a regular RRSP contribution to his own plan or a spousal plan.

If instead of $30,000, let's assume the retiring allowance is only $15,000. Based on our previous example the former employee will be eligible to roll $23,000, however, he will be limited to the actual retiring allowance dollar amount of $15,000. That is, he cannot use his savings to top up his retiring allowance and take maximum advantage of the rollover opportunity.

What Happens When You Terminate Employment?

When you terminate employment, you can either:

- have your employer transfer all or part of the retiring allowance directly into your RRSP (any portion rolled directly into an RRSP by your employer will not be subject to withholding tax); or
- take the cash, however, your employer will be required to withhold tax.

If you take the retiring allowance in cash (net of the income tax withholding), you have until 60 days after the end of the year in which you receive the retiring allowance to take advantage of the rollover otherwise your opportunity is lost. However, if you wish to put the entire amount into your RRSP, you will have to make up the withholding tax amount out of your own savings. When you file your tax return, the tax which was withheld will be included as taxes paid and may be refunded to you.

For example, a $7,000 cash payment would require withholding tax of $1,400, or 20% of the amount paid. Withholding tax rates are as follows:

Amount of Payment	Withholding tax in all provinces except Quebec	Withholding tax in Quebec*
Up to $5,000	10%	21%
$5,001 to $15,000	20%	26%
More than $15,000	30%	31%

* In Quebec the withholding tax is higher because it includes Provincial as well as Federal tax.

Unless you know that you require immediate cash, you should consider transferring as much of the retiring allowance as possible directly into your RRSP. If later on you find that you need to use part of your retiring allowance to meet expenses, you can simply make a withdrawal from your RRSP and pay tax on the amount withdrawn. On the other hand, if things work out so that you do not have to make any withdrawals, you have taken full advantage of this one-time opportunity to significantly supplement your RRSP, and benefit from the tax-free growth the RRSP will provide.

Pension Adjustment Reversal

If you are a member of a registered pension plan or deferred profit sharing plan (DPSP) when you leave your employer, you may be entitled to a pension adjustment reversal (PAR).

For defined contribution pension plans and DPSPs, only employees who leave their employer before the company's plan contributions vest will benefit from the PAR.

The PAR primarily affects defined benefit pension (DBP) plan members. With DBPs, the amount of the pension payment at retirement is known. Because the formula that determines the payment is based on the employee's earnings, years of membership in the plan, and certain actuarial assumptions, calculating the pension adjustment for DBPs is much more complicated. Employees who change jobs prior to retirement may find that the commuted value that may be transferred out of the pension plan is less than the amount of RRSP contribution room they lost over the years due to the pension adjustment.

If this happens, the PAR will restore your lost RRSP contribution room. Your pension plan administrator will calculate the amount of your PAR and notify both you and CRA. CRA will add the value of the PAR to your RRSP contribution room in the year you receive your termination benefit. Since the PAR restores RRSP room, there are no restrictions as to how or when the "new" room is used. You may use the extra RRSP room to make an RRSP contribution to your own plan, or a spousal plan. You may contribute now or carry the room forward and contribute later.

We encourage clients to think about both the financial and non-financial aspects of retirement. This information is intended to provide you with a starting point for some of the things that you may wish to consider for your retirement. Upon reviewing this material, if you have any questions with regards to your specific personal situation, we recommend seeking advice from your BMO financial professional.

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For more information, speak with your BMO financial professional.

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