

# Investor Guide




**TAX & ESTATE**

**YOU AND YOUR SEVERANCE — PUT YOUR MONEY TO WORK!**









Are you facing a change in your employment?  
Severance, early retirement, extended layoff?  
Transitions like these can be stressful, but with  
planning, good advice and focus, you can  
cushion the blow and open doors to the future.

This guide takes you through some of the key  
considerations regarding a severance. Along with  
your financial advisor, you can make the most of  
a tough situation.

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# 3 steps

## to putting your money to work

**STEP 1** Objectively review your situation

**STEP 2** Minimize the tax you pay, so that you  
can build a strong financial foundation

**STEP 3** Put your money to work by investing wisely

## STEP 1

# Review your situation

1

When employees receive termination notices, one of the most common thoughts is, “How will I pay the bills?”

This is the time to call your financial advisor to review your overall financial and investment plan. Your advisor can keep things in perspective and provide objective advice at a critical time. Here are some points to consider in your meeting:

1. If you have a spouse or partner, will he or she be bringing in any income?
2. Review your assets and debts and estimate how much cash you will need in the short term and long term
  - a. Short term (the next 12 months)
    - What income, assets, commitments, salary and benefits do you have?
  - b. Long term (after the first 12 months)
    - What do you need until your pension benefits begin, if any?
    - What savings have you set aside for longer-term spending?
    - Are there assets that can be sold or downsized to provide cash?
3. Will your salary and benefits continue for a number of months, or will you be receiving a lump-sum payout? Salary and benefits continuance can help you budget over the continuance period. If your benefits cease and you receive a lump sum on the other hand, you will have to create a more detailed plan.
4. Will you need extra funding for health or insurance coverage that was covered by your employer?
5. How much of your severance will you need or want as liquid assets to pay bills, take a vacation or make a special purchase?
6. Do you have a pension plan that will provide income? When does it start?
7. Do you have other assets set aside for retirement already, such as an RRSP?
8. Do you have any loans outstanding that you may be required to pay back to your former employer?

A look at your balance sheet will let you determine whether you need to find new employment right away. It may also help you to see that you can take some time out of the job market, or even retire. An advisor can help you to assess your options as part of your overall plan.

# What monies can you expect?

Under Canadian income tax rules, a severance or retiring allowance is generally made up of termination pay that is provided either voluntarily by a company, prescribed under provincial laws, or in some cases, is the result of a court settlement. You may receive one or a combination of any of the following:

- Severance or termination pay
- Long service pay
- Unused sick leave credits
- Unused vacation pay
- Bonus pay earned but not yet paid

For tax planning purposes, it is important to know which payments are classified as “employment income” and which are considered a “retiring allowance”. Compensation for unused vacation time, bonuses earned or payment in lieu of notice is “employment income”. That means that these payments are taxable to you in the year they are paid. The other payments are “retiring allowances” which can be tax-deferred in certain circumstances. The following example will help clarify the tax rules.

**Renée had been working for XYZ Corporation since 1982, and was terminated in July 2010 when XYZ Corporation closed its operations. XYZ did not have a pension or deferred profit sharing plan. Renée received the following monies:**

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Termination Pay:	\$65,000
Unused sick leave credits:	2,000
Unused vacation pay:	<u>1,500</u>
Total payout:	\$68,500

Since unused vacation does not qualify as a retiring allowance, Renée must include the \$1,500 vacation pay as income, and pay tax on it in 2010. The balance of \$67,000 is eligible for direct transfer to Renée’s RRSP within the transfer limits. If taken in cash, Renée will have to include the full amount in income in the year received, which will likely push her into a higher (and therefore more expensive) tax bracket.

## STEP 2

# Minimize taxes

# 2

Effective tax-planning techniques can minimize the tax consequences of severance monies, thereby increasing family after-tax income.

Consider the following strategies with your advisor:

### 1. Direct transfer to your Registered Retirement Savings Plan (RRSP)

If you receive a retiring allowance, you may be able to transfer some or all of the allowance directly to your RRSP without any income tax withheld by your employer. This can minimize the tax payable by you on the severance, and does not require you to have any unused RRSP contribution room. The maximum amount eligible for direct transfer to your RRSP (your individual RRSP and not a spousal RRSP) is as follows:

- \$2,000 per year or part year of service with your employer before 1996, plus
- An additional \$1,500 per year or part year for years of service prior to 1989, for which employer pension plan or deferred profit sharing plan contributions, if there were any, were not yet vested. “Vested” means that you are entitled to take these contributions with you when you retire or terminate, usually after a specified waiting period.

This strategy works best if you know you will be returning to the workforce quickly (within the taxation year), or if you plan to be in a lower tax bracket in future years and can wait to withdraw as needed from your RRSP.

Depending on how long you worked for your employer, these rollover rules may or may not apply to you. If you were employed in 1996 or later, the amount you receive will not qualify for tax-deferred transfer. You will have to have unused RRSP contribution room available, or face taxation in the year of payment. If this applies to you, consider asking your employer to defer payment. The non-eligible amount of your retiring allowance (the amount over any eligible amount) can be transferred as a regular contribution to your RRSP without tax withheld, provided your employer is satisfied that you will be able to use the full amount transferred as an RRSP deduction in the year of transfer and you have sufficient RRSP contribution room available. The non-eligible amount, or part of it, can also be contributed to your spouse's or common-law partner's RRSP. You will have to include the amount of the allowance in your income for tax purposes, but the contribution receipt for your RRSP will give you an offsetting deduction, thereby allowing you to avoid immediate tax.



Renée can shelter her retiring allowance from tax by transferring the eligible amount directly to her RRSP. The maximum amount eligible is calculated as follows:

14 years of employment before 1996 (\$2,000 per year of service x 14)	\$28,000
7 years of service before 1989 (\$1,500 per year of service x 7)	10,500
Total eligible for a tax-deferred transfer:	\$38,500

The remaining \$28,500 plus the \$1,500 vacation pay will be subject to tax, unless Renée has \$30,000 in unused RRSP contribution room available. If so, Renée can make a tax-deductible contribution to her RRSP, or to a spousal RRSP.

## 2. Take your retiring allowance in installments

If you don't need all of your retiring allowance at once, and your employer agrees, you may want to consider receiving monies in installments over more than one year. This strategy works best if you are near the end of the year (for example one-half paid in 2010 and the other half in January of 2011), as it can benefit you by splitting the taxable income over, usually, two tax years. You will be taxed on your retiring allowance only as you receive it. Some or all of each installment can be transferred to your RRSP to the maximum eligible amount, as outlined in 1).

Renée decides to spread her retiring allowance over two years – half in August 2010 and the remainder in January 2011.

Taxable Portion in 2010 (\$67,000 x 50% plus \$1,500 vacation pay)	\$35,000
Taxable Portion in 2011 (\$67,000 x 50%)	\$33,500

### The tax slips you will receive

Your financial advisor will be able to help you understand the tax slips and how to use them to your best advantage, but here is a brief overview. Your employer will prepare a T4A tax slip for you that will indicate what amounts are eligible for the RRSP transfer. You can, of course, choose to transfer less than the maximum, but consider deferring as much tax as you can – you can always withdraw from your RRSP later if you need the funds. You will have to report the full amount of your retiring allowance from box 26 and box 27 of the T4A on your annual tax return. If you transfer the eligible portion directly to your RRSP, your employer is not required to withhold any tax at source. This will allow you to maximize the rollover amount for your future. When this transaction is completed, although you will record the eligible amount as income, you will also receive what is called a “60(j.1)” receipt for the RRSP transfer. You then use this receipt as a deduction on your tax return. If you also transfer non-eligible funds to your RRSP, you will receive an RRSP contribution receipt that you may use as a deduction against your income.

# Other issues to consider

## Legal Fees

If you pay legal fees to establish your retiring allowance, you can deduct the fee against the taxable income from your retiring allowance. Legal fees can be deducted in the current year, or carried forward over seven years (if you have a continuing severance payment). If you have significant legal fees, you may want to consider not transferring the maximum amount of your retirement allowance to your RRSP. Keep out just enough to ensure your legal fees are fully deductible.

## Death benefit

If you have severed your employment and die before you receive any of your retiring allowance, the amount paid to your estate after death will be fully taxable as income on your last return, or in your estate. Conversely, if you have not yet severed your employment and you die entitled to a retiring allowance, there is a clause in the Income Tax Act that allows for the first \$10,000 to be classified as a “death benefit”. Therefore, the first \$10,000 received by any beneficiary would be tax-free.

## Death

If you die before receiving all of the severance to which you are entitled, any payments made to your dependant or to your estate after your death will normally be included in the income of the recipient. This means that if a child receives a payment, that child must include that amount in his or her income tax return.

There is an alternative to this. The value of the remaining retiring allowance may be included in an income tax return called a “Rights or Things” return. Your estate trustee (executor/administrator) can choose to file this return after your death and have the amount taxed at your tax rate. This is because the Rights or Things return records amounts that were payable to you, but that were not paid out to you until after death (which means these amounts would be paid into your estate). This enables your executor to use your basic personal exemption (which is the amount specified as non-taxable for all taxpayers) to reduce the tax payable on the balance of your retiring allowance, leaving more money for your beneficiaries.



### STEP 3

## Invest wisely

# 3

Now that you have received unexpected monies, review your investment objectives with your financial advisor and make sure this money is put to its best use for your future. Here are some important questions to consider:

- What portion of my retirement allowance requires the safety and price stability that can be achieved with fixed income investments?
- What portion can I use for longer-term growth and investments in equities?
- What portion will I need to draw on for income, and when?

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There are a number of mutual fund choices, including options for a tax-efficient payment (monthly or annually).

Your investments can allow for

- i) a systematic withdrawal plan (SWP), which provides a payment of some taxable capital gains and some return of your own capital (which is non-taxable) in a set amount that you specify; or
- ii) a tax-efficient SWP, known as a T-Series fund. This option provides a set amount of income as well as a larger portion of your own capital (which again is non-taxable).

A financial advisor can explain the various income alternatives, and help you select the best investments for your portfolio. In addition, a combination of withdrawals from your registered and non-registered plans can provide you with tax-efficient income as you will be combining fully taxable income (from your registered account) with lower taxed capital gains (from your non-registered account).

You will also be able to use a “Tax-Free Savings Account” (TFSA) to shelter up to \$5,000 annually. You will be able to invest in most fixed-income and equity products. You can withdraw from your TFSA tax-free (your original investment plus any income) and replenish your contribution amount at your convenience. Your financial advisor can further explain this investment option to you.









# Summary

Severance can be a stressful time, but it can also open up opportunities. A financial advisor can help you manage your financial affairs to fit your lifestyle and personal needs, now and in the future. Proper planning can bring you peace of mind – and get your money working, even when you are not. This checklist will help you get started.

## Severance planning checklist

### ☐ Source of retiring allowance

- Severance/termination \_\_\_\_\_
- Long service \_\_\_\_\_
- Unused sick leave \_\_\_\_\_
- Other retirement allowance \_\_\_\_\_
- **Total retirement allowance** \_\_\_\_\_

### ☐ Other pay

- Unused vacation pay \_\_\_\_\_
- Bonus pay \_\_\_\_\_
- **Total non-eligible** \_\_\_\_\_

☐ Salary continuance including benefits? ☐ Yes ☐ No

☐ Other compensation? ☐ Yes ☐ No

☐ Retiring allowance amount for transfer to RRSP \_\_\_\_\_

☐ Non-eligible amount for transfer to RRSP \_\_\_\_\_

☐ Amount of non-registered cash surplus/available \_\_\_\_\_

☐ Pension available? ☐ Yes ☐ No

This should not be construed as legal or tax advice, as each investor's situation is different. Please consult your own legal and tax advisor.



## GENERAL INQUIRIES

For all of your general inquiries and account information please call:

<b>ENGLISH</b>	1 800 387-0614 (416 922-3217)
<b>BILINGUAL</b>	1 800 387-0615
<b>ASIAN INVESTOR SERVICES</b>	1 888 465-1668
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