Gonzales Bay Financial Services

FundEX INVESTMENTS INC.

How to Make the Most out of a *Severance* or *Early* Retirement Package

This report will help you better understand the components of a severance or early retirement package, as well as the options and considerations related to each. The main components typically include**:** ***a retiring allowance, pension assets, and group benefits.***

Retiring Allowance

As part of a severance, you may receive fully taxable termination benefits in lieu of reasonable notice, and possibly a retiring allowance if you have worked for your employer for many years. **If you have been with your company since before 1996, you have a one-time opportunity to soften the tax hit.** A retiring allowance is a specific tax term defined as an amount received on or after retirement of an employee in recognition of long service, or in respect of a loss of office or employment. It includes pay for unused sick leave or damages *(such as those paid for wrongful dismissal)*, but excludes pension benefits, amounts for unused vacation and termination payments. **What's special about a retiring allowance is that you may be able to roll over part of the payment to your RRSP on a tax-free basis – without using up existing contribution room**.

The eligible amount is calculated as:

• *$2,000 for each calendar year or part year of employment up to but not including 1996 PLUS*

• *an additional $1,500 for each year or part year of employment before 1989 during which you did not earn benefits in a registered pension plan or deferred profit sharing plan.*

For years worked after 1995, no preferential tax treatment or carry forward is given. However, you can always use your personal RRSP contribution limit to shelter the excess.

As an example, suppose you are laid off in 2014 and have worked at the same company since October 1993. You receive a retiring allowance of $100,000.

Amount of retiring allowance eligible for tax-free rollover to RRSP:

1993 to 1995 = $6,000 (3 *years, including 1993, x $2,000)*

TOTAL = $6,000

Let’s say you also have $25,000 in unused RRSP contribution room for 2014. Adding this to your $6,000 in eligible retiring allowance means you can shelter up to $31,000 of your $100,000 allowance *(and possibly more if you receive a pension adjustment reversal, or PAR – see page 3)*.

Be sure to ask your employer to transfer your retiring allowance directly to your RRSP so taxes are not withheld on the amount. Otherwise, you will have to wait until after you file your next annual income tax return to get the tax back.

A large cash payment may push you into a higher tax bracket, severely eroding your severance payout. If you have used all allowable RRSP contributions, it is recommended that you consider negotiating with your employer to delay and spread out the payments and related tax consequences. **Note that severance payments cannot go longer than three years**.

So, for example, if you made $75,000 in salary up to the time of your termination date and you receive a severance of $120,000, your total income for the year would be pushed up to $195,000 – of which a large portion would be taxed at a much higher marginal tax rate. If instead you arranged to receive two annual severance payments of about $60,000 starting the following January, your income for all three years could be kept in a lower tax bracket.

Pension Assets

Deciding what to do with your pension assets can be an extremely complex matter. Your options will depend on the type of pension plan you have, whether your pension contributions have vested in your name and whether you are at retirement age. If you are a member of a registered pension plan, you will likely have three choices:

• *keep your pension with your previous employer*

• *move it to a new employer’s pension plan, or*

• *transfer the commuted value of the pension to a Locked-*in *RRSP or, if you are retiring, to a Life Income Fund or Locked-In Registered Income Fund.*

You may receive your company pension benefit as guaranteed monthly payments beginning now, or in the future if you choose a deferred pension. You may have the option of receiving a lump sum, or the commuted value, of this monthly income instead. The decision to take the commuted value or monthly pension is a very serious one, as it cannot be reversed and has long-term financial implications on you and your family.

Taking the commuted value may appeal to someone who wishes to leave an estate or whose pension is not indexed to inflation, while the pension may be a good choice for people with few other assets. If you choose to take the lump sum, your funds can be invested according to your personal goals, financial situation and comfort with risk.

Can you benefit from a PAR?

If you decide to transfer your pension assets to a locked-in RRSP and you belonged to a defined benefit pension plan, you will be eligible for a pension adjustment reversal (PAR). PAR was created by the federal government to compensate former pension plan members for RRSP room they lost as a result of overstated pension adjustments (PAs). **This newly created RRSP room, which is calculated by the plan administrator, will allow you to contribute some of the cash portion of your severance that is not eligible for tax-free rollover to your RRSP and to claim a tax deduction.**

Group Benefits

Here again, timing is critical. Depending on the conditions of your severance package, you may lose coverage of your group benefits within 30 days – or the opportunity to continue them at standard rates – unless you act right away. It is often possible to convert an existing group life insurance to a personal policy without proof of health. **This is a particularly valuable option if you have serious health issues which might make you otherwise uninsurable, or insurable only at high rates**. On the other hand, if you are healthy, it may be more cost-effective to shop around.

The same applies to health and dental benefits, which typically continue only 30 days, unless they are included in the same or modified format as supplemental benefits to a company pension.

Long-term disability insurance is not portable, so you may want to consider obtaining a personal disability insurance plan to protect your income going forward, even if your next employer offers coverage.

How We Can Help

As with any material change in your life, you will need to reassess your cash flow needs against your desired lifestyle and available resources and to possibly reprioritize your goals. As well, your estate and insurance plans will need to be reviewed.

Once your overall plan has been updated, we can then help determine how best to invest your retiring allowance, RRSPs and non-registered assets based on a comprehensive understanding of your financial picture.

As with so many events in life, it’s not so much about what you’re dealt as how you respond. Take control of your situation by knowing your options.