TD Wealth

# Retiring Allowance

A retiring allowance is a payment received upon retirement in recognition of long service, or as compensation for loss of employment.

Payments that qualify as a retiring allowance include:

- Severance payments;
- Termination payments;
- Unused sick leave credits received on or after retirement (not during employment).

Payments that do not qualify as a retiring allowance include, but are not limited to:

- Accrued vacation pay;
- Superannuation or pension benefits (these may qualify under other rules);
- An amount received as a consequence of the death of an employee (certain amounts may qualify for special tax treatment under different rules).

## Amount Eligible for Tax-Free Rollover

The maximum amount of a retiring allowance that is eligible to be transferred to a personal (not spousal) registered retirement savings plan (RRSP) with no impact on RRSP contribution room or registered pension plan is the lesser of:

1. the amount received; and
2. The amount determined by the following calculation.

| | | |
|---|---|---|
| Number of years or part years before 1996 during which the employee was employed by the employer | | A |
| Multiplied by $2,000 (maximum) | × $2,000 | B |
| Sub-total | | C = A × B |
| Number of years or part years before 1989 for which the employee was employed by the employer but not entitled to receive any benefits under the employer's pension plan or deferred profit sharing plan (i.e. employee was not a member of such plan) | | D |
| Multiplied by $1,500 | × $1,500 | E |
| Sub-total | | F = D × E |
| Amount eligible for roll-over | | C+F |

Note: A year or part-year includes any part of a calendar year during which the employee worked; for instance, if the employee started in November 1994 and was terminated in January 1995 (three months later), the employee would have been eligible to rollover up to 2 × $2,000 or $4,000 of a retiring allowance.

Example:

Sarah has just received a severance package of $60,000 from ABC Company. Sarah has worked continuously for ABC since January 1, 1977, but did not join the company pension plan until January 1, 1982 even though she could have joined on January 1, 1980.

| | | | |
|---|---|---|---|
| Number of years or part years before 1996 during which the employee was employed by the employer | (From 1977 to 1995) | A | 19 |
| Multiplied by $2,000 (maximum) | | B | × $2,000 |
| Sub-total | | C = A × B | $38,000 |
| Number of years or part years before 1989 for which the employee was employed by the employer but not entitled to receive any benefits under the employer's pension plan or deferred profit sharing plan (i.e. employee was not a member of such plan) | (From 1977 to 1981) | D | 5 |
| Multiplied by $1,500 | | E | × $1,500 |
| Sub-total | | F = D × E | $7,500 |
| **Amount eligible for roll-over** | | C+F | $45,500 |
| **Amount NOT eligible for roll-over** | ($60,000 - $45,500) | | $14,500 |

Since the eligible amount is the lesser of the amount received ($60,000) and the amount determined by the preceding calculation ($45,500), Sarah is eligible to roll over $45,500 to her RRSP with no impact to her RRSP contribution room. The remaining $14,500 will be paid out in cash to Sarah (less a withholding tax of 20% - same withholding tax rates as those applied to RRSP withdrawals). Sarah is subject to tax on this cash payment at her marginal tax rate and will need to include this amount as income when filing her tax return.

If Sarah has unused RRSP contribution room, she could contribute all or part of the $14,500 to her RRSP or a spousal RRSP (of which she is the contributor) on a tax deferred basis.

Finally, note that the $60,000 retiring allowance is not considered employment income for purposes of generating new RRSP contribution room for the following year.

## Tax Reporting

The employer will issue a T4 slip indicating the amount of the retiring allowance in Box 66. The amount not eligible for the rollover will be indicated in Box 67 of the slip. This slip is often not received until after year-end. The amount of eligible rollover can often be confirmed with the employer at the time of the rollover.

## Additional Information

The eligible portion of a retiring allowance cannot be rolled over into a spousal RRSP under the retiring allowance rules.

If the recipient has regular carry forward RRSP contribution room, they can contribute the non-eligible portion of the retiring allowance (up to their contribution limit) to a spousal RRSP. The employee may also choose to forego using the rollover rules for the eligible portion of the retiring allowance and contribute some or all of the eligible amount received to a spousal RRSP if they have sufficient RRSP contribution room. This option may be considered in situations where future income splitting is desired and there is a low probability of the client otherwise using the RRSP carry-forward room.

*Example:*
*Mr. Smith has received a retiring allowance of $30,000 and has unused RRSP contribution room of $5,000. It has been determined that Mr. Smith is eligible to roll over $20,000 of his retiring allowance, with the remaining $10,000 to be taken as cash (fully taxable).*

- *Mr. Smith can roll the $20,000 amount into his personal RRSP (but not a spousal RRSP) under the retiring allowance rules. This will not affect his RRSP contribution room.*
- *Since Mr. Smith has unused RRSP contribution room, he can choose to contribute up to $5,000 (from the $10,000 cash portion) to a personal or spousal RRSP.*

A retiring allowance does not have to be rolled directly into an RRSP.

Although a retiring allowance does not have to be rolled directly into an RRSP the advantage of a direct transfer is that the employer will not withhold taxes. If the full retiring allowance is paid to the employee, the employer will withhold an amount for income taxes. If the employee subsequently decides during the year to contribute the retiring allowance to an RRSP (possibly because another job has been found), the client will only have the net amount of cash available to contribute. Additional funds will be required to top up the contribution to the full retiring allowance amount. The amount of tax withheld should be refunded when the tax return is filed the following year.

A retiring allowance can be received over a number of years.

An employer may offer to pay the employee the retiring allowance in instalments over one or more years. In this case the amount is taxable in the year received. The amount of each instalment that may be rolled into an RRSP up to the maximum eligible amount is determined using the same rollover rule as discussed above. The employer should issue a T4 tax reporting slip every year for the amounts paid.



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