Defined Benefit Pension

To commute or not commute

A defined benefit pension plan sets out the benefits you will receive upon retirement. If you are a member of a defined benefit (DB) pension, you may be faced with the decision whether to receive monthly pension payments upon retirement, or commute the present value of the pension payments in a lump sum amount (the commuted value) and manage the assets yourself. You may be able to transfer all or part of your pension to another DB pension plan, for example, if you switch employers and both sponsor DB plans for their employees.

To Commute...

For some people, the option to commute offers access, flexibility and control over investment of their pension funds, and the ability to manage risk perhaps with the assistance of an advisor. It also can offer the ability to leave an estate to beneficiaries. The commuted value is typically equivalent to the lump-sum present value of your future pension entitlement and is based upon the interest and mortality rates at the time you are no longer a plan member.

When taking the commuted value option, a portion of the commuted value can be transferred on a tax-deferred basis into a locked-in plan, such as a Locked-in Retirement Account (LIRA), up to the maximum amount prescribed by the federal Income Tax Act.

The formula for determining the maximum amount that can be transferred to a locked-in plan is: *Annual Retirement Benefit x Present Value Factor related to your Age = Maximum Transfer.* For example, based on the present value factors set out in Chart A, if you are 58 and your estimated annual pension benefit at age 65 is $30,000/year, then the maximum transfer amount to a locked-in plan would be $330,000 ($30,000 x 11).

Chart A: Present Value Factors

Attained Age	Present Value Factor	Attained Age	Present Value Factor
Under 50	9.0	73	9.8
50	9.4	74	9.4
51	9.6	75	9.1
52	9.8	76	8.7
53	10.0	77	8.4
54	10.2	78	8.0
55	10.4	79	7.7
56	10.6	80	7.3
57	10.8	81	7.0
58	11.0	82	6.7
59	11.3	83	6.4
60	11.5	84	6.1
61	11.7	85	5.8
62	12.0	86	5.5
63	12.2	87	5.2
64	12.4	88	4.9
65	12.4	89	4.7
66	12.0	90	4.4
67	11.7	91	4.2
68	11.3	92	3.9
69	11.0	93	3.7
70	10.6	94	3.5
71	10.3	95	3.2
72	10.1	96 or over	3.0

Source: Canada Revenue Agency

The difference between the commuted value and the amount transferred into a locked-in plan is generally taken in cash and taxable in the year you receive it. However, you may be able contribute the difference into an RRSP to defer tax, provided that you have adequate unused RRSP contribution room.

If you transfer the funds into a locked-in plan, you can defer withdrawals until age 72, however, the funds must be transferred to another locked-in plan (such as a Life Income Fund [LIF]), or used to purchase an annuity by the end of the year that you turn 71. A new plan will typically be subject to annual minimum and maximum withdrawal amounts.

There may be certain circumstances in which amounts in a locked-in plan can be withdrawn (such as reduced life expectancy or financial hardship). Depending on the pension jurisdiction (federal, provincial/territorial), you may also have a one-time opportunity to unlock a lump sum amount and transfer it to a more flexible Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF). For more information on locked-in plans, please ask your TD advisor for our article: *Locked-in Plans: their role in retirement income planning.*

> The commute option also provides the flexibility of purchasing a life annuity.

For estate planning purposes, the balance of a locked-in plan can be transferred to a designated beneficiary (except in Quebec) or distributed through your estate. The rules governing pensions and locked-in plans may differ depending on jurisdiction: federal or one of the provinces/territories. Speak with your TD advisor about which pension rules apply to your DB pension or locked-in plan. If the balance is rolled over to a spouse or financially dependent child/grandchild on death of the pensioner, tax deferral may be available on the balance amount. The balance may be rolled-over on a tax deferred basis.

Please note that the beneficiary of your locked-in plan must usually be your spouse, but some pension rules allow your spouse to waive his or her right to your locked-in plan, allowing you to name another beneficiary.

Commuting may also be a beneficial alternative in instances where the long term ability of the employer/ company to fund the pension or the longevity of the employer/ company is in question.

...Or Not Commute

For others, having a guaranteed monthly pension income may provide a sense of stability. In some instances, a company pension may be indexed to inflation rates, which can help protect against increases in the cost of living during your retirement years. Meanwhile, you will not be required to take on the risk of managing the assets personally. The employer-pension plan sponsor is responsible for the investment risk involved in managing the pension assets. Finally, under pension legislation the pension funds are required to be kept separate from the employer's assets. In some provinces, when pension funds are underfunded, legislation mandate employers to make up any deficiencies. Some provinces also provide a certain level of guarantee for pensioners in an underfunded plan.

In addition to the guaranteed monthly pension, the employer may also provide its pensioners with medical benefits, as well as survivor pension benefits for spouses or common-law partners.

Another benefit of not commuting a pension is that Canadian residents receiving eligible pension income can allocate up to half of that income to their spouse or common-law partner. Under Canadian tax rules, income from a defined benefit plan can be split at any age, while income from a RRIF, LIF or annuity can only be split when the pensioner is at least 65 years-old or more. Pensioners in Quebec are only permitted to split their pension income once they are 65, whether the income is paid from a DB pension or otherwise. Upon the death of the pensioner (or surviving spouse/ partner) pension payments will cease.

Final Thoughts

Choosing to leave your pension funds with your employer or taking the commuted value involves several complex factors. Consider speaking with your TD advisor who can guide you through your individual circumstances to make an informed decision.