

Buying Back Pensionable Service

Will it give your retirement a boost?



Canadian employees who are members of a defined benefit (DB) pension plan may have an opportunity to purchase years of service for periods when they did not participate in their employer's pension plan. Perhaps the employee waited to join the plan. Perhaps he or she took a leave of absence for a variety of reasons such as starting a family, travelling or pursuing continued education.

A buyback may result in increased pension benefits upon retirement. Typically with a DB pension plan, a formula is used to determine the monthly pension a member will receive upon retirement. The formula takes into account the years of pensionable service along with the member's earnings.

Consider the following illustrative buyback scenario: Jing, currently 42 years old, is a teacher who took a leave of absence for two years to finish her Master's degree. She is considering buying back the pensionable service for the years she was studying and did not participate in her employer's pension plan. The cost of funding the buyback is \$19,500.

The following chart illustrates the potential impact of her choice:

	With Pension Buyback	Without Pension Buyback
Added Credit	2 years	0
Cost to buy back employer pension credit	\$19,500	0
Additional Annual Pension	\$3,000	0
Annual Pension at age 65	\$45,610	\$42,610

As a result of the buyback, Jing can retire at age 65 with a full annual pension of \$45,610 as opposed to \$42,610 without the buyback.

Administrators of DB pension plans typically provide a package that outlines the cost of the buyback along with important details about the tax implications that may be involved.

Funding a Buyback and Tax Considerations:

With most pension buybacks, plan members have the option of funding the buyback with cash (i.e. from accrued savings/investments), or by transferring funds from a registered account (such as a registered retirement savings plan [RRSP] or a locked-in plan), or a combination of both.

To reflect the value of the additional pension purchased, a past service pension adjustment (PSPA) may be issued as part of the buyback process.

Pension administrators are required to calculate and report PSPAs to the Canada Revenue Agency (CRA) for approval to ensure that the tax limit on contributions to an RRSP are not exceeded. Where applicable, the CRA will reduce the available RRSP contribution room for the current year by amount of the PSPA.

Funding a buyback using non-registered proceeds or cash will usually result in a PSPA, however the full amount may be tax deductible in the year the buyback is completed. If registered proceeds are used to fund the buyback, a PSPA may not be required; however, no tax deduction is available as the deduction would have already been received when the contribution was made to the registered account.

Advantages and Disadvantages of Buying Back Pensionable Service

There are several implications to consider when evaluating whether to complete a pensionable service buyback.

Potential advantages may include:

- The opportunity for enhanced pension income at retirement, or the potential to retire earlier
- Reduced longevity risk by providing a fixed income stream during retirement
- Enhanced creditor protection is available to registered pension plans
- Availability of a tax deduction depending on how the buyback is funded

Potential disadvantages may include:

- Reduced RRSP contribution room
- No access to the pension funds in an emergency, as compared to RRSP funds that can be withdrawn (less any applicable withholding taxes)
- Limited estate planning options. DB pensions have features such as spousal/survivor pension benefits; however, pension payments cease upon the survivor's death. Personal savings (non-registered and registered) on the other hand can be transferred as part of an estate or directly to named beneficiaries (where available)
- The opportunity cost that the contributed capital may outperform the increased income stream from the pension buyback

Considerations

Deciding to buy back pensionable service from a DB plan involves weighing several factors and may involve complex calculations. Speak with your pension administrator, a tax specialist, and your TD Advisor when evaluating your buyback options.



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