



## *Financial Planning Quick Tip*

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### **SUBJECT: Rollover Of Severance To An RSP**

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If you anticipate receiving a severance package due to termination or early retirement from your employment, then you should know that all or a portion of a lump sum severance payment received (called a retiring allowance for tax purposes) can be rolled over to an RSP without withholding tax based on your years of service. As a refresher, the formula for this tax-deferred RSP allowance is as follows (part years count as a full year for purposes of this calculation):

- \$2,000 per year of service up to and including 1995, plus
- \$1,500 per year of service up to and including 1988 that the employer's pension contributions are not vested at termination (i.e. if the employee was not a member of a pension plan for years before 1989 then they are eligible for this additional \$1,500 per year).

The "retiring allowance RSP contribution limit" is the **lesser** of the amount from the above formula or the actual retiring allowance received.

A checklist of points that you should be aware of regarding retiring allowances is as follows:

- The "retiring allowance RSP contribution limit" is **in addition** to your regular unused RSP contribution room reported on your Notice of Assessment.
- Only those individuals who have been terminated or have retired are eligible for the "retiring allowance RSP contribution limit". That is, those individuals that terminate their employment but are re-employed with the same company soon after, even as a consultant, could jeopardize their "retiring allowance RSP contribution limit";
- The "retiring allowance RSP contribution limit" **cannot** go into a spousal RSP;
- The "retiring allowance RSP contribution limit" is **not** permitted if an individual is turning 70 in the year of receipt and is thus too old to have an RSP;
- The "retiring allowance RSP contribution limit" must be made on or before 60 days after the end of the year that the retiring allowance was received (i.e. there is no carryforward of the retiring allowance RSP contribution limit);
- Pay in lieu of notice and vacation pay **are not** considered a retiring allowance (i.e. cannot be rolled into the RSP using the "retiring allowance RSP contribution limit");
- An unused sick leave credit payment upon termination is considered a retiring allowance;
- The total retiring allowance and the portion of the total that is eligible to be contributed into an RSP based on the above formula will be reported by the employer on a T4A slip;
- Contributions of the retiring allowance into the RSP will create an RSP contribution receipt that can be used to reduce the income inclusion on the T4A;
- Some employers may allow their employees to defer the receipt of their retiring allowance to a future tax year which may be beneficial if they cannot roll all of the retiring allowance into an RSP and their income is expected to be lower in the future;

- Any portion of the retiring allowance that is not rolled directly into an RSP is subject to withholding tax ranging between 10% - 30% (25% - 38% in Quebec) and will be taxable at marginal tax rates in the year of receipt on their personal tax return;
- If the retiring allowance amount is in excess of the “retiring allowance RSP contribution limit”, then all or a portion of the excess retiring allowance could still be transferred to the employee’s RSP or even a spousal RSP without withholding tax only if the employee has adequate regular unused RSP contribution room. However, in this case the employer has to agree to this transfer and the employer must believe on reasonable grounds that the employee has adequate unused RSP contribution room. This strategy is discussed in the *Financial Planning Quick Tip* titled “Withholding Tax On Severance Payments”.

If you have any questions or require clarification of any of the issues discussed in this document, do not hesitate to discuss these with your advisor.

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