

RETIRING ALLOWANCES

A retiring allowance is an amount paid to an employee who is leaving a job. It can be paid either as recognition for long service, or as compensation for the loss of the employment. Generally, the retiring allowance is treated as taxable income. Where the employee held the position prior to 1996, however, a portion of the retiring allowance may be eligible for tax-deferred rollover to an RRSP.

In general terms, the amount that can be transferred into an RRSP is calculated as follows:

- \$2,000 times the number of years prior to 1996 that the employee was employed with the employer or a related employer; and
- \$1,500 times the number of years of employment, prior to 1989, during which the employee was not a member of a

pension plan or deferred profit sharing plan (DPSP) of the employer or a related employer.

As simple as the general rule sounds, there are a few details worth noting.

The first part of the formula allows \$2,000 per year of employment. Any full or partial calendar year of employment is included in the formula as a whole year. For example, consider an employee who was hired in December 1980 and left the position in January 2002. Based on these facts, he or she would be entitled to 16 years in the first part of the formula (i.e., 1980 to 1995 inclusive).

The second part of the formula allows \$1,500 per year of employment while the employee was not a vested member of a pension plan or DPSP. However, the calculation is somewhat more complicated.

The actual formula begins with the number of years of employment prior to 1989, and reduces this by the “equivalent number of years” that the employee was a vested member of a pension plan or DPSP.

The equivalent number of years is equal to the number of calendar years for which the employer made a plan contribution, times the vested portion at the time the retiring allowance is paid. A partial year of employer contributions is counted as one year. However, because of the “vested portion” formula, the equivalent number of years can be fractional.

A third issue that must be considered relates to the years of service: the years are in respect of service with the employer and any related employers. Employers would be considered related if one is controlled by the other or both are controlled by the same person or group of persons.

Another consideration often overlooked is that the eligible amount can be

transferred to an RRSP directly or indirectly. An employer can submit the eligible amount directly to the taxpayer’s RRSP. (A retiring allowance cannot be transferred to a spousal RRSP.) If a direct transfer is utilized, then the taxpayer can avoid salary withholding tax on the amount transferred.

Alternatively, the taxpayer may receive the funds directly (less withholding taxes) and later decide to make a transfer to an RRSP. Such a transfer must be made in the same year as the receipt of the retiring allowance, or within 60 days following the end of that year. The taxpayer should be able to recover some or all of the taxes withheld when filing his or her tax return and claiming the appropriate deduction for the amount transferred to an RRSP.

Remember that this transfer and deduction is over and above the regular RRSP contribution limit.