TD Wealth

Early Retirement Options: General Considerations

In recent years, corporate restructuring and downsizing has resulted in many people being given the option of early retirement. When this occurs, decisions must be made with regard to pension options, severance payments and company benefits. This article is designed to help you take an organized approach to consider all the relevant issues and make an informed decision, when presented with an early retirement proposal.

In this article, we will look at some of the issues involved in evaluating an early retirement proposal; while the article "Early Retirement Options: Pension Options" examines the issues relating specifically to a member of a defined benefit pension: the pension versus commute decision.

Forms of Severance Payment: Salary Continuance vs. Retiring Allowance

Departing employees are typically offered one of two types of early retirement or severance packages: a salary continuance or a retiring allowance. The following is a comparison of these two different types of payment.

	Salary Continuance	Retiring Allowance
Nature	Similar to receiving a normal paycheque, complete with regular wages, health benefits and pension contributions (but no long-term disability coverage).	A retiring allowance refers to a payment in respect of a loss of employment or a payment upon or after retirement in recognition of long service but does not include any pension benefits.
	Note: although retiring allowances tend to be paid as a lump sum, there may be situations when a retirement allowance is paid in instalments over a period of time. Where periodic payments subsequent to an employee's loss of employment in fact represent instalments of a retiring allowance, confusion may arise as to whether it is a salary continuance or a retiring allowance. CRA has indicated that this has to be determined by a review of all relevant facts; and the important considerations are whether such payments are treated as income for the purpose of computing EI and CPP premiums as well as pension plan purposes.	
Tax Implications	▪ Considered to be salary for income tax purpose. ▪ Payments are reported on a T4 slip. ▪ Subject to EI and CPP with-holdings. ▪ Considered to be earned income for RSP contribution room purposes.	▪ A retiring allowance is usually paid in a lump sum which is subject to income tax withholding. However, there are provisions in the *Income Tax Act* (Canada) that allows all or part of a lump-sum retiring allowance to be sheltered through an eligible rollover into your RSP. The maximum amount that can be transferred on a tax-free basis to an RSP is calculated with reference to years of services prior to 1996. For more information on these rules, refer to the article on "Retiring Allowance". ▪ Payments are reported on a T4A slip.

		▪ CPP or EI premiums are not required to be deducted from the payment. ▪ Not considered to be earned income for RSP contribution room purposes.
Main Advantages	▪ From a cash management perspective, salary continuance provides a regular income stream to fund ongoing lifestyle expenses while seeking alternative employment. ▪ Continuation of company benefits (medical, dental etc.) and accrual of pension credits.	▪ Flexibility – if you have lump sum cash flow requirements, such as paying off a mortgage. ▪ If there are doubts as to the financial health of the company you are leaving, it may be preferable to obtain the whole payment right away.
Additional Information	Often, salary continuance ceases once the departing employee is "re-employed". It is therefore important to determine what being "re-employed" means. Does it cover any form of employment, whether full-time or part-time, or does it refer to employment in a similar position? Also, does it include self-employment?	Tax deferral may also be possible with retiring allowances. Thus, if you leave your position at the end of the year say November; consider negotiating with your employer to defer the payment of the lump sum to the next year say, January. This way the payment will be included in the next year's tax return rather than your current year's tax return, providing a whole year of tax deferral on any additional tax in excess of tax withheld.

Pension Payment Options

If the pension plan that the departing employee belongs to is a defined contribution (or money purchase) plan, the decision is relatively straightforward. Most people will simply choose to transfer the account value to a Locked-in Retirement Account (LIRA) or Locked-in RSP. The advantage of this is greater flexibility in terms of investment options, compared to the investment options offered in a company pension plan. *Note: if you are a member of a group RSP, your option is to transfer to a regular (*i.e., *non-locked-in) RSP.*

If the pension plan is a defined benefit plan, the decision is not as straightforward. Refer to Part 2 of this article for a detailed discussion of the various options available for defined benefit pension plans.

Company Benefits

Companies often extend some form of medical, dental and life insurance coverage to retired employees. In some cases, whether such benefits are offered depends on whether or not the pension money has transferred. Thus, if you take the commuted value rather than opt for a deferred pension, you may be considered a terminated employee rather than a retired employee, and therefore lose your eligibility to such benefits.