

If you or a member of your family is facing a permanent lay-off, voluntary early retirement or “forced” early retirement, there are many important decisions to be made – decisions that can have a significant impact on your financial future. There are some major issues that must be addressed at the termination of employment, and we’ve laid out some effective strategies that can help secure your financial independence. Although early retirement is the theme of this Special Report, please note that most of the information also applies to those who are facing their “regular” retirement date.

When you find yourself facing an early retirement package, the first thing you should do is obtain any written documentation provided by your employer and review it very carefully. Likely, this documentation will have been prepared with the consultation of lawyers, pension consultants and group benefits experts, and will clearly spell out information on severance amounts, pension options and other termination details that relate to your particular package.

You may not always be able to determine straightforward rules, regulations and “universal” guidelines regarding all of the issues involved, as there are many different factors that come in to play. For instance, the Income Tax Act has a major impact on pension plan issues, as does federal and provincial pension legislation. In fact, pension legislation is evolving so rapidly that it is often difficult to get definitive answers, even from government offices, and it is not unusual to run across conflicting information. Overall, the actual text of your particular pension plan and the design of your total benefits package will generally override many other considerations.

Since it is increasingly common for employers to offer formal retirement counselling these days, you may find that you have professional help readily available to you at no cost. However, if you seem to have an unusually complex package to sort through you may wish to consider enlisting the help of an actuary or other pension and benefits specialists.



Severance Pay

At termination, employees are typically offered some sort of severance payment. If your severance is paid out as a retiring allowance it may receive special tax treatment. Subject to certain limits, it may be eligible for a tax-free rollover to your Registered Retirement Savings Plan (RRSP).

The Definition Of A Retiring Allowance

A retiring allowance is broadly defined under the Income Tax Act as a payment in respect of a loss of employment, or a payment upon or after retirement in recognition of long service. This includes unused sick-leave credits, as well as damages for loss of employment (whether paid voluntarily by the employer or not). According to Canada Revenue Agency (CRA), the definition does not include a pension benefit, vacation pay or pay in lieu of statutory notice. Payments that qualify as retiring allowance may be eligible for a tax-free rollover to a Registered Pension Plan (RPP) or to your individual RRSP (not to a Spousal RRSP), but only up to specified limits. This special rollover does not affect your annual RRSP contribution room.

Maximum Retiring Allowance Eligible For Tax-Free Rollover To An RRSP

- \$2,000 for each year or part year of employment, up to and including 1995; **plus**
- \$1,500 for each year or part year of employment, up to and including 1988, if you were not entitled to receive any benefits you earned under a pension plan or deferred profit sharing plan from contributions that your employer made for each such year.



Direct Or Indirect Transfer To Your RRSP

The tax-free transfer of a retiring allowance to an RRSP may be indirect; that is, the retiring allowance may be paid to you, but then it must be contributed to an RRSP within 60 days following the end of the year of receipt. You must complete Schedule 7 with your tax return. It is also possible to have your employer contribute the eligible retiring allowance directly to your RRSP, in which case the tax normally withheld from the payment would be waived. You should still receive an RRSP contribution slip, report the amount as income, then claim the RRSP deduction and complete Schedule 7 with your tax return.

Salary Continuation Or Retiring Allowance?

Severance money is usually paid out in one lump-sum amount and, if it is paid out on or after your termination date, it is generally characterized as a retiring allowance. However, if your severance pay will total more than the maximum retiring allowance that you can rollover to your RRSP, and you would like to increase your regular RRSP contribution room, your employer may be able to structure your final compensation to make this possible.

If you are entitled to a severance amount that exceeds the maximum permitted retiring allowance, consider receiving the excess severance amount as a continuation of salary in order to increase your earned income for RRSP contribution purposes.* You can then make use of your increased RRSP contribution room by depositing the maximum retirement allowance to your RRSP, and, on your termination date (the date that your continuation of salary ceases), transferring the maximum lump-sum amount that you can rollover to your RRSP or RPP.

The way your severance amount is paid not only affects its treatment under the Income Tax Act, it may also have an impact on payroll taxes and premiums. For instance, salary or regular employment income is subject to Canada Pension Plan (CPP) contributions and Employment Insurance (EI) premiums, and the employee may have to continue contributions to his or her pension plan if it is a contributory pension plan. On the other hand, a retiring allowance is not subject to CPP contributions or EI premiums.

*Your annual RRSP contribution limit is based on 18 percent of your previous year's earned income, up to the current tax year's maximum annual contribution limit, less your pension adjustment (PA). For example, to be eligible for the full \$22,970 maximum contribution for 2012, your 2011 earned income must have been approximately \$127,611, assuming no PA.

Employment Income (Continuation of salary until termination date)	Retiring Allowance (Payment on or after termination date)
Earned income for RRSP purposes	Not earned income for RRSP purposes
Subject to CPP contributions and EI premiums by the employer and employee (as well as continued contributions to company/employer pension plan, if required)	Not subject to CPP contributions or EI premiums (does count as earnings when determining start of EI benefits)
Upon payout, employer withholds tax at ordinary rates for salary	Upon payout, employer withholds tax (if lump-sum payment is made) at the same rates as RRSP withdrawals
Not eligible for rollover to an RRSP	Eligible for rollover to an RRSP, subject to the maximum permitted amount
Normally reported on a T4 for tax purposes	Normally reported on a T4A for tax purposes



Tax Withheld At Source

Commonly referred to as withholding tax, this type of tax is not an additional tax; rather it is the “withholding of tax at source.” Just as employers are required by law to keep back a certain percentage of tax on amounts paid out as salary or bonus (essentially a down payment on your taxes based on an estimate of your financial situation for the year), they are also required to withhold tax on severance amounts that are not directly transferred to a registered plan. In addition, financial institutions are also required to withhold tax at a prescribed rate on withdrawals from RRSPs and other registered plans. However, the tax you owe the government when you file your income tax return, or the refund the government owes you, is dependent on your total annual income.

Amount of RRSP Withdrawal	All Provinces Except Québec	Québec
\$0 – \$5,000	10%	21%
\$5,000 – \$15,000	20%	26%
More than \$15,000	30%	31%

Make sure you will be able to take advantage of the maximum retiring allowance rollover. This special tax treatment is not eligible for the carry forward treatment available for your regular RRSP contribution room.

Pension Plan Options

If you are a member of a money purchase pension plan, also referred to as a defined contribution plan, then you should have a specific accumulated value made up of contributions and tax-sheltered investment earnings in the plan (this basically works much like an RRSP). If you are facing early retirement, you will probably be given the option of immediately rolling the accumulated value to a locked-in registered plan.

Deferred Pension Vs. Commuted Value To Locked-in Registered Plan

If you are a member of a defined benefit plan, your pension income is generally calculated according to a formula based on a number of factors (e.g., final average employment earnings). The employer must provide this guaranteed income stream regardless of the investment climate. In many cases, if you are a member of a defined benefit pension plan and facing early retirement, you will generally be given the option of staying with the plan and receiving a pension at retirement, or winding up the plan by transferring a lump-sum commuted value to a locked-in registered plan or purchasing an annuity.

If you choose to transfer the commuted value to a locked-in registered plan under your own control, you will then have to manage the money appropriately in order to provide adequate retirement income. When comparing the deferred pension option versus the commuted value option, there are many factors which should be weighed. Professional actuarial advice is required if you wish to make a true actuarial comparison between the two options. Please refer to the Deferred Pension Option vs. Commuted Value Option table in this report.

Transferring Benefits To Another Employer Or Purchasing A Deferred Life Annuity

If permitted, you may also be able to transfer locked-in pension benefits to a new employer’s pension plan. In addition, you may be able to use the commuted lump sum to purchase a deferred life annuity - buying an annuity to start at some time in the future based on a quote using today’s interest rates, and which is payable for life. However, if interest rates are low, this is usually not perceived as a worthwhile option. If you roll the commuted value to a locked-in registered plan, you will still have the option of buying an annuity at a later date.



The Commuted Value

The commuted value is the amount of money you would have to invest today in order to replace your deferred pension. Basically, an actuary uses various assumptions to calculate a present value for your future pension benefits. The actuarial assumptions may include projected investment rates, mortality rates, your retirement age, marital status and the value of inflation protection terms in the pension plan.

Deferred Pension Option	Commuted Value Option
Stay with the plan and receive pension at retirement.	Roll lump-sum preset value to a locked-in registered plan or purchase an annuity.
Employer provides guaranteed lifetime income according to set formula (usually based on final average earnings).	Employee controls management of the funds.
Employee may feel more comfortable knowing that he or she will receive guaranteed pension payments for life, and that no investment decisions need to be made with respect to the pension benefit.	If employee has excess income, and wealth accumulation is a main objective, this option offers tax-deferred compounding within a locked-in registered account.
By law, the spouse or common-law partner of a pension plan member must receive the pension upon the death of a member, unless this right has been formally waived by the spouse. Therefore, pension for the surviving spouse or common-law partner is guaranteed even though payments are typically a reduced percentage of what the pension plan member received.	The surviving spouse or common-law partner will receive full value of the plan to be rolled into the spouse's own registered account upon the death of the plan holder. Under some pension laws, this account must be a rollover to a regular registered account or a cash withdrawal subject to taxation.
<p>The plan may provide significant benefits above and beyond the basic pension entitlement, such as:</p> <ul style="list-style-type: none"> • Early retirement rights (although usually reflected in commuted value). Early retirement rights may or may not be extended to deferred pensions granted on employment terminations • Option to delay pension past age 65 • Inflation protection over and above regular indexing provisions • Supplementary benefits if pension exceeds CRA limits for defined benefit pension plans 	<p>Additional benefits under the pension plan and other factors should be evaluated. For instance, if life expectancy is greater than average, guaranteed lifetime income from a deferred pension may be the better choice.</p> <p>If an employee opts out of the pension plan, the employer could require that other group benefits be forfeited (such as dental, health and life insurance).</p>



Excess Transfer Amounts

The Income Tax Act sets limits on the amount of money that can be transferred tax-free from a defined benefit pension plan to a locked-in registered plan. If the commuted value of your pension happens to exceed the prescribed limits, your employer should notify you of this fact in your termination documentation. Amounts that cannot be transferred to a locked-in registered plan are called “excess transfer amounts,” and in most cases are paid out directly to the employee as fully taxable income. While a lump-sum commuted value within the limits can be rolled over to a locked-in registered plan and earn tax-deferred compounding investment returns, an excess transfer amount is fully taxable and future investment returns are not tax-sheltered. This means that it may be very difficult for the commuted value option to compare favourably with the deferred pension option if the commuted value exceeds the limits.

However, if you have sufficient RRSP contribution room, excess transfer amounts may be transferred to a non locked-in RRSP as a regular RRSP contribution.

Locked-In Plans: Locked-In Retirement Account (LIRA)*

Locked-In Retirement Accounts (LIRAs) are RRSPs that are subject to restrictions under provincial or federal pension legislation. Funds transferred to a LIRA are allowed to grow tax-deferred until the end of the year in which you turn 71. As with an RRSP, the plan matures when you reach age 71 and funds must be used to purchase an approved retirement income producing vehicle. Ordinarily you are not allowed to withdraw funds from a LIRA; access to the funds is permitted by pension law only under very limited circumstances.

*For the purpose of this report, a LIRA also represents a Locked-In RRSP (LRSP) and a Federal Restricted Locked-In Savings Plan (Restricted LSP), as applicable in those provinces where these accounts are available.

LIRA Maturity Options*

The following registered vehicles were created as an alternative to buying a life annuity with matured funds from a LIRA. The LIRA maturity options vary from province to province and not all account types listed below are available in every province.

- Life Income Fund (LIF)
- Locked-In Retirement Income Fund (LRIF)
- Prescribed Registered Retirement Income Fund (Prescribed RRIF)
- Federal Restricted Life Income Fund (Restricted LIF)

A LIF, LRIF, Prescribed RRIF and Restricted LIF are similar to a RRIF. Each allows individuals to retain investment control over their funds, and a minimum annual payment is required from each account. Unlike a RRIF, locked-in registered plans have a maximum annual payment. The maximum annual payment does not apply to Prescribed RRIFs. There are general differences between these plans in that in some cases maximum annual payout formula calculations can differ, and in Newfoundland & Labrador, funds have to be transferred to a life annuity at age 80.

Generally, pension funds can be rolled over directly from a pension plan to a maturity option, providing that any minimum age requirements are met. Some provincial regulations stipulate that spousal waivers must be signed before any funds are rolled into a LIF, LRIF, Prescribed RRIF or Restricted LIF.

*Not all of these retirement income producing products are permitted in all provinces. Please speak with your CIBC Wood Gundy Investment Advisor to find out which retirement income options are permitted under your pension legislation.

Withdrawal And Unlocking Provisions

Many provinces allow for the withdrawal of funds due to financial hardship, shortened life expectancy and small balances based on certain criteria. As well, some provinces offer unlocking provisions which may allow the transfer of a percentage of assets to an RRSP or RRIF. Please check with your Investment Advisor to find out if these provisions are permitted under your plan's legislation.

RETIREMENT INCOME PLANNING

Temporary Unemployment Or Permanent Early Retirement?

Your income planning may depend to some extent on whether you are facing temporary unemployment or permanent early retirement. If you expect to be employed again, then short to medium-term cash flow planning will likely be critical. However, you should still strive to maximize your registered plans.

You can generally roll locked-in registered plans to one of the maturity options previously listed (based on your provincial legislation) and, as long as you are under age 71, you may be able to roll any remaining assets back to a LIRA if you become re-employed afterwards and do not need the income.

Employment Insurance

You may wish to apply for Employment Insurance (EI) payments as soon as possible so there is no delay in your receipt of payments. EI will establish a payout dollar amount and a time when benefits should start. Severance pay will generally delay your start date for benefits. If you are in a certain income bracket, you will be subject to a clawback of EI benefits. Please note that CPP income may reduce your EI benefits.

CPP*: Early Or Late?

Delaying your CPP retirement pension until age 70 will increase your pension amount by more than 30% over the amount you would receive at age 65.

Your CPP is reduced by 0.52 percent for each month you begin receiving pension amounts before age 65, to as early as 60. Conversely, if you decide to delay your pension amounts (up to age 70), your CPP is increased by 0.64 percent per month.

As part of ongoing changes being made to CPP, discounts for starting CPP early, and premiums for starting CPP late, will both be increasing. These changes will be phased in between now and 2016.

Because of increased life expectancies, it could be to your advantage to consider starting CPP payments at age 65 (at the full base pension), or delaying CPP payments until age 70 (at an increased pension), instead of taking a reduced amount early. You can change your mind and withdraw an application for early CPP within six months, providing you return any CPP benefits received.

* QPP in Québec

Integration With Government Benefits

You may be given the option of integrating your employment pension with government benefits. This generally means that your pension is increased before age 65 to make up for the fact that you are not yet receiving government benefits, and then decreased after age 65 (when you start receiving them). If you are given the option of choosing integration, make sure to look at your projected income streams at different ages, with and without integration, before making a decision. In some cases, you may be given an outright bridging benefit or temporary extra pension to tide you over until age 65 (subject to government rules and limits), with no requirement to adjust your lifetime pension.





Replacing Lost Benefits

Sometimes employers offer medical and dental benefits until the regular retirement age. If this is not part of your severance package, then you should explore extended health care coverage as soon as possible. Most major medical costs are covered under provincial medical and health insurance plans, but out-of-country costs may not be covered. A number of insurance companies do offer individual dental and out-of-country health coverage at reasonable rates.

Note that group long-term disability insurance coverage usually stops immediately. However, you can generally convert your group life insurance to individual coverage without medical evidence within 30 days of the expiry of group coverage. If you are not insurable, this may be a very important consideration. If you are fully insurable, you should immediately review your insurance requirements and investigate competitive quotes on the appropriate level of coverage to meet those requirements. Your CIBC Wood Gundy Investment Advisor has access to an Estate Planning Specialist (Financial Security Advisor in Québec) who can assist you with a review of your insurance needs.

We're Here To Help

Please note that pension and tax legislation changes frequently. Your CIBC Wood Gundy Investment Advisor can work with your tax and legal professionals to ensure that any advice is suitable for your individual circumstances.



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