



HELPING YOU BUILD, PRESERVE AND TRANSFER YOUR WEALTH

At ScotiaMcLeod, our knowledgeable advisors have helped many people successfully transition through major life events, including early retirement, company restructuring or downsizing and unexpected layoffs. For some, the transition can be a frightening concept, particularly during times of economic uncertainty. At times like these, receiving the right financial advice can make all the difference and provide peace of mind.

Retirement Planning Options: Pension Plans, Severance Payments and Retiring Allowances

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If you think you may be receiving a severance or early retirement package from your company, the benefits of starting to plan early can make all the difference and provide peace of mind. The decision on how to handle your options on retirement can impact your financial security for the rest of your life. Therefore, if possible, these decisions should be planned in advance, instead of under the pressure of tight deadlines as is the case in most severance situations.

Electing to opt for early retirement or take your pension as a lump sum (also referred to as "commuting") is not a decision you may change later. Therefore, it is important to take the time to consider all of your options and look at your entire family financial

picture. Discussing your options with a qualified financial advisor can help you navigate the tax issues, investment decisions and income options that should be looked at in order to make the right decision for your personal situation.

PENSION PLANS: LUMP SUM OR MONTHLY PAYMENTS?

Retiring employees or employees who otherwise leave their jobs are often faced with a tough decision regarding their employee pensions. In many instances, companies will offer their employees the choice between taking their pension in a lump sum form (commuting) or taking the pension in the form of a monthly pay-out over a period of time.

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Unfortunately, in many cases very little support is given to the employee to help make this choice and, as a result, much stress ensues. This is unfortunate given that the analysis can really be quite simple, if the right tools are used.

THE DECISION

So, is one better off taking the lump sum payment (if it is offered), or sticking with the monthly pension? In assessing your options you need to consider both qualitative and quantitative issues. For example:

ADVANTAGES / DISADVANTAGES TO COMMUTING YOUR PENSION

Advantages:

- Potential to pass remaining assets into your estate upon death.
- A broader range of investment options and choices.
- Greater flexibility in tailoring your income stream to meet your personal priorities and objectives (within minimum and maximum locked-in plan withdrawal rules).
- Potential opportunity to “unlock” some of the locked-in funds.
- Elimination of the risk associated with the company administering your pension plan.

Disadvantages:

- You are forfeiting your **lifetime guaranteed** pension.
- Deciding to commute your pension is irreversible.

- A potential tax liability can be associated with commuting your pension.
- Introduction of “investment risk” - your investment choices determine the growth potential of your locked-in plan assets.
- Longevity risk – what if you outlive your funds in your locked-in plan?
- May be giving up some additional benefits that come with being a member of a pension plan (i.e. health benefits, indexing with inflation).

The decision to take the lump sum value of your pension or the monthly payments can affect your financial security for the rest of your life. It is important to take the time to consider all the important variables, such as rates of return, life expectancy and personal estate planning issues.

SEVERANCE PAYMENTS AND RETIRING ALLOWANCES

Employees leave their jobs for a number of reasons on both a voluntary and involuntary basis. An employee may have been encouraged to retire early through the offer of certain payments from an employer. Additionally, an employee may have been terminated by an employer due to the elimination of a position or the closure of a business.

Whatever the reason, terminated employees may be eligible to receive various types of payments from their employers. The nature of the payments varies depending on the reason for the termination of employment. The rest of this article will briefly describe severance payments and how these payments can be sheltered from tax in whole or in part, and for a period of time, as a retiring allowance.

SEVERANCE PAYMENTS

A severance payment is compensation paid to a qualified employee who has his or her employment "severed." It may be paid to compensate an employee for loss of seniority and job-related benefits. It may also be paid in recognition of an employee's long service. Severance pay is not the same as termination pay, which is given in place of the required notice of termination of employment.

Payment of severance pay is governed by the laws of the province in which the employee resides and, in the case of federally regulated employers, by applicable federal laws. Generally, the amount of the severance payment depends on the length of the employee's period of service with the employer and the employee's regular wages for a regular work week at the time of the termination of employment.

Severance payments can be made in either a lump sum or as a series of payments, subject to the employer's willingness to structure the payments according to the employee's interests. The decision as to whether a lump sum or series of payments is preferable from the employee's perspective may depend on a couple of factors, including the employee's financial circumstances and the employee's interest in a possible tax deferral. A series of payments is like receiving a salary and may provide access to other company benefits, including pension benefits, during the period the series of payments is made. However, a lump sum payment may be preferred by the employee to pay off debt, or if the employee is concerned about the employer's ability to meet on-going payment obligations over a period of time.

Severance payments are eligible for treatment as a retiring allowance for tax purposes in certain circumstances. These payments may be eligible in whole or in part for transfer to a registered retirement savings plan (RRSP) in the amounts allowed under tax legislation.

RETIRING ALLOWANCES

Retiring allowances are payments made to employees for the loss of employment in certain circumstances or on retirement in recognition of long service. A retiring allowance is not the same as termination pay, which is given in place of the required notice of termination of employment. A retiring allowance may be paid over one or more years. Like ordinary employment income, if a retiring allowance is received as cash, it is subject to a withholding of income tax at the time of payment. This tax may be deferred if the funds are transferred directly to an RRSP for the year of receipt. You have up to 60 days after the end of the taxation year in which the payment was received to contribute the eligible portion of the retiring allowance to an RRSP.

Canada Revenue Agency (CRA) views a retiring allowance as a special RRSP contribution, so it has no impact on a person's regular RRSP deduction limit (i.e. it can be made over and above normal contribution limits). At the present time, the maximum amount of retiring allowance a person can contribute to an RRSP is \$2,000 per calendar year (full or partial year) of service prior to 1996, plus \$1,500 per calendar year (full or partial year) of service prior to 1989 (provided no "vested" pension plan contributions were made in the year

and no credit was received for any company contributions to a pension plan). This is referred to as the eligible portion of the retiring allowance. The non-eligible portion can be contributed to your RRSP (or spousal RRSP) provided you have the regular RRSP deduction limit available for the tax year of the contribution.

The loss of a job is difficult under any circumstances and the first item you may need to deal with is

how to handle any immediate payments offered. A retiring allowance payment can present you with an opportunity to significantly increase the value of your RRSP.

This article is a summary only, is not intended as specific legal or tax advice that is tailored for individual circumstances, and it cannot be relied upon as such advice. If your employment has been terminated for any reason, you should seek independent legal and tax advice based on the laws applicable in your jurisdiction and the specific facts of your situation. Whether a payment received on termination of employment is a severance payment under applicable law that qualifies as a retiring allowance depends on the facts of the particular case. The laws governing severance payments and retiring allowances are complex, and each case must be examined individually and on its own merit.

CHANGES TO EMPLOYEE STOCK OPTION PLANS

Employees of publicly traded companies who have stock option plans were dealt a double blow as the March 4, 2010, federal budget proposed the following changes to employee stock option plans.

No tax deferral.

Employees who exercise stock options (after 4:00 p.m. EST on March 4, 2010) must now add 50% of the value of the stocks (less the purchase price) into their taxable income for the year of exercise. In the past, the tax bill on up to \$100,000 of stock option benefits could be deferred until the shares were sold. Under the new rules, consider holding stock options until you are prepared to sell your shares immediately upon exercising the options. This way, you will have the cash necessary to pay the tax.

Double deduction eliminated.

Previously, when an employee elected to receive cash instead of shares, both the employee and the employer received a tax break. It's now up to the employer to make an election to forgo the deduction for the cash payment. If they decide against it, you won't get the deduction.

Tax relief on falling stocks.

If you have previously exercised a stock option and the stocks have fallen in value, you pay tax only on the sale proceeds, not the value of the original investment.

If you have exercised or unexercised stock options, your ScotiaMcLeod advisor can help you determine the best course of action.



Reflections

"As in all successful ventures, the foundation of a good retirement is planning"
Earl Nightingale

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