

## Severance transfer to RRSPs Policy

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### Background:

Until the mid 1990s, provisions allowing for transfer of severance to Registered Retirement Savings Plans (RRSPs) had been in place to allow employees faced with difficult career changes to plan for their future. However, in 1995 the federal government removed the transferability of severance to an RRSP. The rationale behind the change, based on the budget supplementary comments, was “the maturation of pension plans, the increase in RRSP limits for those not in pension plans, and the ability to carry forward unused RRSP limits.” The time for reviewing these statements and this policy is well overdue.

- Provisions allowing for the rollover of severance were in place to allow an employee to defer taxation of income necessary to sustain them while new work was sought. As the funds were needed, they could be accessed and tax would only apply at that time. By allowing the rollover of severance, an employee was only taxed on the income as they required it, the employee’s RRSP limits were unaffected, and the employee’s ability to save for retirement uncompromised.
- By not allowing rollover treatment the federal government is essentially treating severance as normal employment income when it clearly is not. Contradictorily, the employee earns no additional RRSP room based on their severance as they would with normal employment income.
- One of the other reasons noted for the repeal of RRSP rollover was the maturation of pension plans; however, severance payments serve a very different purpose than pensions and traditional RRSPs, which are intended as method of saving for retirement. Severance is intended to provide an employee financial support and compensation resulting from an employer’s restructuring, allowing them to sustain themselves until new work is found.
- The deferral of this compensation allows the employee to reduce taxes which are abnormally high due to the receipt of severance in the year of receipt, and allows the employee the ability to use the funds as required. The use of RRSPs serves a simple and existing means of achieving these goals through the tax system.
- By taxing severance in the same manner as normal employment income, an employee is forced to use unused RRSP room to shelter the severance. When the employee withdraws the funds for living expenses while they search for new work, the RRSP room used up is not refreshed. As a result, the employee is forced to forgo the ability to save for retirement in order to defer being taxed on their severance. This is contrary to the purpose for RRSPs.

- Severance resulting from corporate downsizing has been and will be an issue for taxpayers, as can be seen in the recently announced layoffs in various sectors of the economy. As the global economic crisis deepens, many more Canadian employees will be faced with these issues.
- The federal government appeared to recognize the increased incidence of severance when in 1998 it removed the applicability of alternative minimum tax (AMT) to severance. While this was a positive step, it was of limited benefit since the ability of employees to roll severance into an RRSP was already eliminated.

**The Edmonton Chamber of Commerce recommends the Government of Canada:**

1. Review the provisions dealing with an employee's ability to transfer severance to an RRSP and reinstate provisions allowing for the rollover of severance to an RRSP, without impacting the employee's otherwise earned RRSP room.
2. Update the amount of severance an employee is allowed to transfer to an RRSP by reference to today's contribution limits. Employees should therefore be permitted to contribute \$5,000 per year of service with an employer, plus an additional \$8,500 per year that they were not a member of an employer's registered pension or deferred profit sharing plan, with annual indexing thereafter.