



Severance planning: What your clients should consider

We've been dealing with COVID-19 for almost a year and what a year it's been! With repeated lockdowns, it's not surprising that many businesses have had to downsize or even close their doors.

Some of your clients may have lost their jobs and received severance packages, or they might in the future. Many people have no idea what to do with a severance package or even what they need to consider.



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Severance vs. salary continuance



Cole was recently let go from his job due to COVID-19. He has been offered the choice of:

Severance of **\$300,000** OR Salary continuance for **18 months**

What is the best option for him?

What should someone consider when looking at a lump sum severance?

If he goes the route of the lump sum, he wants to know what portion, if any, can be transferred to his RRSP on a tax-deferred basis. The rollover rules are as follows:

- Cole can roll over \$2,000/year or partial year of service prior to 1996, plus
- \$1,500/year or partial year of service prior to 1989 if he did not receive contributions to a DPSP or RPP or those contributions were not vested.

Since Cole has been with LCP Corporation since 1990, he can transfer \$12,000 of his severance to his RRSP on a tax-deferred basis even if he doesn't have any RRSP contribution room. If Cole had RRSP contribution room, he could transfer a portion of his severance, up to his RRSP contribution limit, to his RRSP or to a spousal RRSP. Unfortunately, he doesn't have additional RRSP contribution room, so the balance of his severance will be taxable to him in the year he receives it.

He's lucky that it's the beginning of the year and he hasn't received substantial income so far this year. If the lump sum was received at the end of the year, it could have a huge impact, as it would be added to the substantial income already earned. In that situation, taking the severance this could push him into a higher tax bracket. In that case, he may want to ask the employer to split the severance over two years in the hopes it will keep him in a lower tax bracket.

If he decides to take the lump sum, he's hoping you can help him invest the after-tax proceeds of the severance tax efficiently. Neither Cole nor his wife have ever contributed to a TFSA, so between the two of them they have \$151,000 in TFSA contribution room. He may want to consider contributing all or a portion of his after-tax severance to his TFSA. Since there is no tax payable on TFSA returns, Cole can gift money to his wife to invest in her TFSA without worrying about attribution rules.

Is a salary continuance the right option?

Cole's former employer offered to provide an 18-month salary continuance, and to make it more attractive they'll provide health and dental benefits for that period. Initially, this option was very attractive to Cole because it allows him to continue to receive a salary and benefits and have the stability for his family that he wants. But upon closer examination, he realized both the salary continuance and the benefits would stop if he found another job within the 18 months. This is a big concern for him because he has every intention of finding another job.

Does Cole have additional insurance needs?

As an employee of LCP Corporation, Cole had life, health and dental insurance. If he chooses to go with the lump sum rather than the salary continuance, LCP Corporation has offered to extend his health and dental benefits for six months. Now is a great opportunity to discuss his insurance needs in the future. Does his wife currently have benefits through her employer? Are they sufficient to meet the family's needs or does Cole need additional insurance? If Cole is part of a professional association, he may consider subscribing to the insurance packages offered through his association. Furthermore, you may want to discuss critical illness or disability insurance as well. Since Cole no longer has life insurance through LCP Corporation, now is a great time to discuss his life insurance needs.

Conclusion

With COVID-19 continuing to wreak havoc on our society, it's very likely you'll have clients who come to you with questions about their severance. Every situation is unique and it's important your clients know that you can help them with this in addition to everything else you do for them.