Severance Agreements Quiz



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Al Loha has worked at Sweat Shoppes Ltd. (SSL) for 32 years. But all good things come to an end and SSL is under enormous pressure to downsize. Al's position is one that the company would like to eliminate. So SSL offers Al an early retirement package that includes, among other things, a $75,000 "severance" lump sum payment. Al is to receive the money the week after he stops reporting to work. And while he can't keep accruing benefits under the SSL pension plan, Al can stay in the company health and dental plan for 2 more years. Al accepts the severance deal.

QUESTION

Is the $75,000 severance payment subject to deductions as a retiring allowance?

ANSWER

A. Yes because it's paid by SSL to Al as a result of the cessation of Al's employment.
B. Yes because Al only gets the money after he stops reporting to work.
C. No because Al's continued participation in the SSL health plan shows he hasn't really retired.
D. No because Al voluntarily accepted the package and wasn't forced to retire.

ANSWER

A. The $75,000 would be considered a retiring allowance, not a severance payment, because Al received the money due to his loss of employment.

EXPLANATION

Under Section 56(1)(a)(ii) of the *Income Tax Act*, retiring allowances are generally included in an employee's taxable income in the year they're received. Sec. 248(1)("retiring allowance")(b) defines "retiring allowances" as amounts received "in respect of" the taxpayer's loss of an office or employment. Courts use a 2-prong test to determine if payments are "in respect" of employment losses:

The taxpayer wouldn't have gotten the money but for the loss of employment; and

- The purpose of the payment was to compensate the employee for the loss.

The $75,000 payment from SSL to Al would satisfy both parts of this test.

WHY WRONG ANSWERS ARE WRONG

B is wrong because it's the right conclusion for the wrong reason. A payment can also be considered a retiring allowance if it's made by the employer to the employee in recognition of long service (Sec. 248(1)("retiring allowance")(a)) if such payments are made on or after retirement. But a retiring allowance in respect of a loss of employment under clause (b) doesn't have to be made on or after retirement. In this case, the $75,000 payment to Al is an "in respect of" retiring allowance. So the fact that he got the money after he stopped reporting to work is irrelevant.

C is wrong because CRA Interpretation Bulletin IT-337R4 clarifies that an employee can still be considered retired even if he keeps participating in his former company's health plan for a "restricted period of time."

D is wrong because early retirement incentive payments are generally considered to be retiring allowances under the (b) clause. According to IT-337R4, loss of office or employment "usually refers" to the elimination of a job or position "for economic reasons." In addition, IT-337R4 states that retiring allowances may include payments for loss of employment that an employee elects under an early retirement incentive plan. SSL's elimination of Al's position was motivated by economic reasons; and the $75,000 payment was an early retirement incentive.