

In this edition of the Canadian Tax Planners Newsletter, we shall review a number of tax effective strategies that employers may consider to reduce labour costs. There are also certain strategies that may provide a tax benefit to employees who are about to lose their job. We shall also provide an update on steps to maximize the Ontario tax rebate, plus how to take advantage of the 1% prescribed rate of interest that has been set by CRA for the fourth quarter of 2009. We shall also review the potential tax liability of directors who serve on the board of directors of non-profit organizations.

Reducing Labour Costs

Whether the goal is to maintain profitability or ensure their survival, many companies are reducing payroll. We shall review a number of tax issues related to reducing labour costs, including

- termination payments
- replacing full time employees with agents, contract employees and part time workers
- salary deferral arrangements
- working from home

Termination Payments

Retiring Allowances – Prior to 1996, the payment of a retiring allowance was the prime tax planning strategy related to termination payments. For each year of service before 1996, \$2,000 could be transferred to a RRSP plus an additional \$1,500 for years of employment prior to 1989, if the individual did not have a vested interest in a pension plan. Despite the rule change in 1996 that restricted the transfer of a retiring allowance to a RRSP, they still offer certain advantages in terminations.

A retiring allowance is defined by CRA as an amount paid to employees when they retire in recognition of long service after the loss of employment. They are also known as severance payments. A retiring allowance includes payments for unused sick time but does not include:

- death benefits

- payments for accumulated vacation leave not taken prior to retirement
- pay in lieu of termination notice
- damages for violations or alleged violations of an employee's rights awarded under human rights legislation

If an employee was terminated in 2009, the payment of a retiring allowance may still offer a number of potential advantages, including

- if any portion of the employment relates to the period prior to 1996, a portion of the retiring allowance can be transferred on a tax free basis to a RRSP
- a retiring allowance is not subject to Canada Pension Plan or Employment Insurance deductions
- a retiring allowance can be paid as a lump sum amount or as a series of payments. The amount is taxable to the individual in the year received. As a result, the employee may be able to negotiate the time frame in which the payments will be received in order to maximize the individual's personal tax position
- if the individual dies prior to receiving the retiring allowance, the payment will qualify as a death benefit. These benefits, to a maximum of \$10,000, can be received tax free by the spouse or child of the deceased
- legal fees related to termination may be deductible under certain circumstances. If an individual disagrees with the amount that should be paid upon termination, any fees that relate to collecting a "retiring allowance" are deductible. However, the legal fees are only deductible against income from a retiring allowance. Thus, if individuals were unsuccessful in their court case, the fees would not be deductible

Note – The remainder of this article is only available to subscribers of the Canadian Tax Planners Newsletter. If you elect to subscribe and wish to receive a copy of this newsletter, advise us accordingly and the complete article will be forwarded by return mail.