

After a decade of service in a senior position, you suddenly find yourself redundant or forced into retirement. You're without a job, but not without means, as you've been given the "golden parachute". So, how do you keep that money in your pocket, and make it work for you?

THE PAYOFF

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When Rachel heard the insurance company she worked for was being bought out by a competitor, she worried she would be out of a job. As the seniority lists were made, and the redundancy notices handed out, Rachel learned, sure enough, she was out the door. The company was transparent about the takeover and gave their laid-off employees more than 18 months notice. The senior claims adjuster with 13 years of solid service received a severance package of a half a year's salary, and a sizeable contribution to her RRSP.

"It was lots to process," recalls Rachel. "To have just lost a job was overwhelming enough, but then to try and figure out the best way to deal with a large severance package and manage my finances added to the stress."

Rachel's husband was in school at the time, so she couldn't count on him to cover their day-to-day expenses, which meant she had to make sure that she put aside part of her severance to maintain their standard of living — until she found another job — but was unclear as to what to do with the rest of her package.

"The company offered some options regarding how I wanted the severance structured," she says. "I had no idea what would be best. So I just took the money and ran."

With a contracting economy, Rachel isn't the only one who is suddenly unemployed. As of early 2016, almost

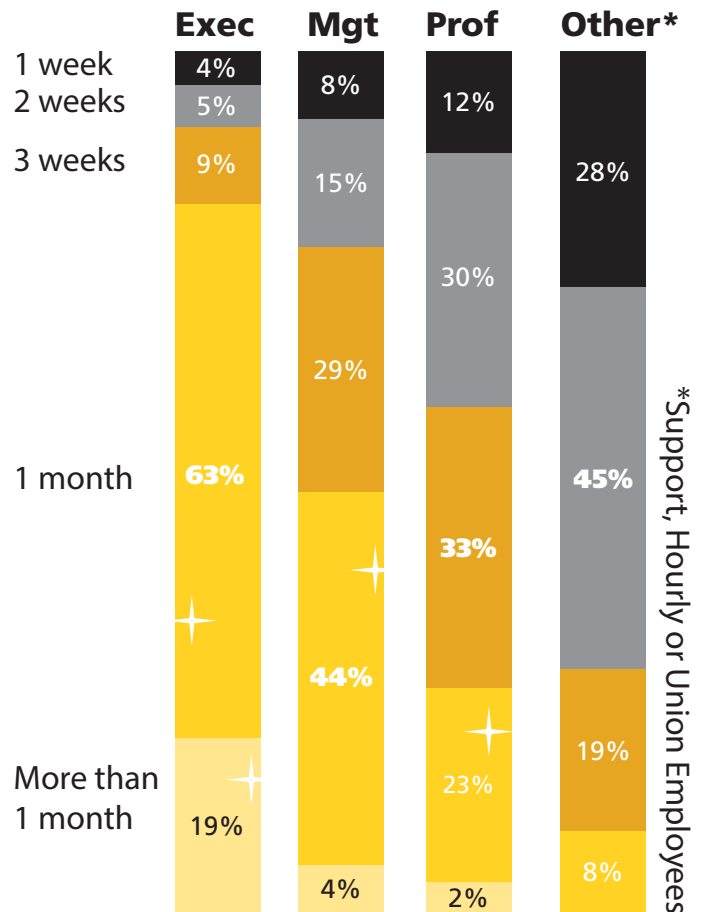


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485,000 Canadians were laid-off permanently by their employers¹. Losing a job may be traumatic, but a large severance package can ease the pain. A 2014 survey of employers by Logan HR and law firm Gowlings found that the typical severance package for an executive was a month or more per year of service. With a few decades of service² under your belt, you could get a farewell package worth hundreds of thousands of dollars.

May Fung, a high net worth planner with TD Wealth, says she is seeing more and more of this. "I have certainly worked with many people in their 40s and 50s, and in senior positions, that have either been terminated or have the expectation that their career may end abruptly and involuntarily," says Fung. "It is not uncommon for executives in senior positions to sign an employment contract with a termination clause that spells out each party's obligations, and often, this could involve a hefty termination pay for the employee."

Typical Severance Per Year of Service



Source: Logan HR, Gowlings

What are you entitled to?

If your work contract doesn't spell out the severance obligations, there are laws in place that dictates the minimum amount of

severance employees should receive. Specifically, what each terminated employee is entitled to will depend on a few things, including how long you worked for your employer, your age, your position, availability of other comparable work, and your ability to find a similar job.

However, employment laws are just the legal minimum, and may vary from province to province, says Fung, and while there are situations where this minimum is appropriate, an employee may be entitled to more. “Ultimately, the actual amount may be a matter of negotiation,” she says. In any event, you should consult a lawyer regarding your legal rights and obligations before you agree to any severance package.

One lump or two?

Even though Rachel chose to take the money and run, there are many ways that you can choose to have your severance package paid out. You can choose to take it in one large lump sum, continue to receive your salary and benefits for a designated period of time, or receive deferred payments which would spread the amount over subsequent calendar years.

“Because I chose to take one lump sum,” says Rachel, “a lot of tax was withheld. I think after all was said and done, my severance cheque came in at just over a half of the original amount.”

Yes, severance pay is subject to income tax. That means that it’s important to look at your financial and tax situation before negotiating the structure of your severance with your employer. One lump sum paid out at the end of a year when you’ve already made a full year of income could push you into a higher tax bracket. But, if you move your payment into the beginning of the next year, when you may be job-searching, you may save

taxes. As Fung says, “It often makes sense to negotiate with your employer to defer, if possible, the payment recognition of the severance payment to next year, or even a few years.” An advisor or accountant can help you decide on the best way to structure your severance.

Save for retirement, and save on taxes

Another way to minimize severance tax hit is to utilize any RRSP room and have your employer contribute directly to your retirement savings. This will mean that you won’t pay any tax now

If you find yourself unemployed:

- Create a budget with monthly expenses and any income or government benefits
- In your budget, factor in monthly repayment of any debt
- Create an emergency fund that will cover you for three to six months

on money that’s directly invested within an RRSP. Some of Rachel’s severance went directly into an RRSP which took up a considerable portion of her RRSP contribution limit accumulated from years of not contributing to the account.

You may also take the same approach to utilize any TFSA room for yourself and even other members of your family. “If the lump sum is large, it might not be a bad idea to save a portion you do not need to access immediately, especially if

you have contribution room in a tax-sheltered account like a TFSA or RRSP,” says Fung. “If you think you may need to access the money in the near future, it may be better to use the TFSA, as there are no tax implications upon withdrawal.”

What to do with all this money?

Conventional wisdom has it that you should pay down debt with excess cash. But is that always the wise thing to do with a substantial severance cheque? “Perhaps not”, says Fung, since

you may need to use the funds to sustain yourself while looking for a job. The average job search takes four months although depending on your skills, age, and salary expectations, it could take longer.³

Fung thinks you should consider a balanced approach to paying down debt. "Paying down debt is definitely a good idea for high interest rate debt, such as credit card debt," she says. "On the other hand, the benefits of paying down your mortgage, which tend to have much lower interest rates, must be balanced with the need to have enough money at hand when you are looking for work."

"This is the also the time to create a detailed budget", says Fung. You must approximate how long it will take to be re-employed, figure out all your monthly expenses, and any income you might receive during the time you are off, including government benefits. Also take into account the servicing of any debts. With that information, create an emergency fund that will cover you for the months that you are unemployed. A general rule is that three to six months should be sufficient.

Rachel was lucky; she was able to line up a new position with another company within a few months. Unfortunately, that company folded just weeks after she started, leaving her unemployed once more.

"I didn't have much of a severance with my new company, because I had only been there for a short time," says Rachel. "I was receiving employment insurance, but I still worried that it wouldn't be enough, or my eligibility would run out before I found a job. I kicked myself for not having an emergency fund."

Rachel is now gainfully employed with a successful software company, but she is not taking anything for granted. She even used some of that severance money to start her own home-based business — as a Reiki practitioner— so that if she is to ever lose her job again, there will always be ways for her to generate an income.

“Just like winning the lottery, receiving a sizable severance may seem like getting a windfall,” says Fung. “However, you should factor what’s happened into your overall financial plan. Your financial advisor can work with you to formulate a new plan to adjust to the change in circumstances. Losing your job is hard. But it’s a challenge that you can overcome, especially with the help of a substantial severance package and an appropriate plan in place. *Denise O’Connell, MoneyTalk Life*

¹Statistics Canada. Table 282-0214 - Labour force survey estimates (LFS), activity prior to unemployment by sex and age group, unadjusted for seasonality, monthly (persons), CANSIM (database).

²Logan HR, Gowlings. “Severance Practices in Canada: Survey Results and Legal Tips”. November 2014. 2016. [slideshare.net/gowlings/severance-practices-in-canada-survey-results-and-legal-tips](https://www.slideshare.net/gowlings/severance-practices-in-canada-survey-results-and-legal-tips)

³Workopolis. “Thinkopolis Time to Work”. April 2014.. hiring.workopolis.com/research/thinkopolis/thinkopolis-time-to-work-infographic/

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