

## THE TAXATION OF SEVERANCE PACKAGES

Businesses do not like to hand over their books to the Taxman. In fact, many organizations carefully structure their affairs to avoid the hardships associated with tax audits. Illegal payroll practices will almost certainly attract unwanted attention from Canada Revenue Agency. Therefore, getting it right is important. Employment income is subject to statutory deductions and withholdings. Employers are legally obligated to deduct and withhold the appropriate amounts at source for remittance to CRA. This obligation applies to wages, vacation pay, and amounts received under employee benefits plans. But what about severance packages?

The Taxman will invariably want his cut. Severance payments are subject to the same tax rules as employment income. However, in some circumstances the rules may vary. The following outlines the basic tax principles applicable to severance packages.

### *The Retiring Allowance*

A dismissed employee may be eligible to receive a severance payment as a retiring allowance. A retiring allowance is an amount paid to a person in respect of a loss of employment, and provides for tax treatment that is advantageous to the recipient. Specifically, deductions for CPP and EI do not apply, a portion of money can be transferred to an RRSP account on a tax-free basis, and a cash payment will be subject to fixed withholding rates.

Not all severance payments can be legally characterized as retiring allowances. For example, a severance that includes the continuation of salary and/or benefits after the dismissal cannot be deemed a retiring allowance.

If a former employee qualifies for a retiring allowance, the employer must be cognizant that only the amount exceeding the statutory termination pay can be characterized as such. Pursuant to the Income Tax Act, statutory termination pay must be subject to normal withholdings and deductions at source, without exception.

### *Non-taxable Payments*

Severance packages may include payments that do not constitute income from employment or a retiring allowance.

Whitten & Lublin is a team of legal experts who provide practical advice and advocacy for workplace issues.

### UPCOMING EVENTS

#### NOVEMBER 26<sup>TH</sup>

David Whitten will conduct the program at the HRPA on the topic of Executive Employment Agreements, where he will discuss how to structure the relationship, the various aspects of effective executive compensation, executive severance packages and much more.

#### DECEMBER 7<sup>TH</sup>

David Whitten will be speaking about taxation and law at an upcoming seminar "Employment Law 101" organized by the Certified General Accountants of Ontario.

### IN THE MEDIA

Daniel Lublin was interviewed on Canada AM regarding the fallout of being fired for Amanda Todd comments on Facebook.

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In the fast paced social media era, it is becoming almost impossible to determine who owns the rights to employees' personal media sites, their contacts and their posts. As those and similar questions are becoming very common among employees and employers, Daniel Lublin was asked to express his opinion on this issue in the recently published article in Law Times. The whole article can be read in the Law Times titled Focus: Who owns employees' social media accounts?

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First, an amount paid to reimburse a dismissed employee for legal fees incurred is not counted as income. An employer can consent to designate a portion of a severance for this purpose. However, it is advisable to receive written confirmation from the former employee's lawyer that the amount allocated to this heading does not exceed the actual amount of legal costs incurred. Requesting an invoice for the precise amount of legal fees is a good practice.

Furthermore, where there is a legitimate basis, a portion of a settlement can be allocated toward payment of general damages, which are also not treated as income. Such damages can be based upon, for example, allegations of discrimination. There must be legitimate basis for such a claim, and the amounts allocated must be reasonable and proportional to the allegations. This practice is generally discouraged, and should be reserved for exceptional cases.

It is always open to CRA to investigate payments and make its own determination regarding the appropriateness of the allocation. Accordingly, employers should invest the necessary time and energy in understanding proper payroll practices, including those applicable to severance payments. This will not only avoid increasing the likelihood of a tax audit, but will also help manage a company's tax liability.

**LAW BLOG**

Is your social media account really yours?

Is your boss spying on you at and off work?

When the workplace becomes intolerable

Read more at  
<http://blog.toronto-employmentlawyer.com/>

**LATEST NEWS ON TWITTER**

See my comments in the Law Times re whether an employer can "own" an employee's social media account? <http://www.lawtimesnews.com/Focus-On/Focus-Who-owns-employees-social-media-accounts...>

Do employers spy on you at work and off work? Is it legal? See in my @globeandmail column from today <http://bit.ly/S2bn41>

Just read one of my old Metro articles. Pretty funny actually: see "workplace losers" at <http://metronews.ca/news/210403/the-type-of-worker-who-can-wreck-a-case/...> via @metrotoronto

**OUR LAWYERS**

DAVID WHITTEN

DANIEL LUBLIN

CÉDRIC LAMARCHE

ELLEN LOW

AARON ROUSSEAU

DANIEL CHODOS

**CONSULTATIONS**

For a consultation  
 please call us at

416-640-2667

or submit your  
 online request at

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