

# Making the Most of Your Retirement Gratuity

The retirement gratuity you receive after many years of service with your school board or district is a wonderful opportunity to build financial security and enhance your lifestyle in the future. To make the most of it, good planning is required.

## What is a retirement gratuity?

It's generally a special payment made to a retiring teacher or other educational worker in recognition of long service.

## Tax implications

Generally, a retirement gratuity will be fully taxable at your marginal tax rate in the tax year it is received. In fact, the gratuity amount may push you into a higher tax bracket, leaving you even less to enjoy after tax. Someone reaching the highest tax bracket in Ontario, for example, could be subject to 46% tax.

No matter what your marginal tax rate, any lump-sum amount of gratuity paid directly to you will be subject to withholding tax at the following rates:

- 10% on amounts up to \$5,000
- 20% on amounts from \$5,001 to \$15,000, and
- 30% on amounts over \$15,000.

And be prepared: there may be more tax payable on the income when you complete your tax return the

following April, depending on your total income for the tax year. Fortunately, there are ways to minimize tax on a retirement gratuity. One way is to roll over eligible amounts to an RRSP.

## Rollover opportunity

Canada Revenue Agency (CRA) offers special tax treatment for eligible amounts of retirement gratuities. Under certain conditions, CRA allows you to directly transfer – or “rollover” – all or part of your gratuity to an RRSP (but not a spousal RRSP), with no immediate tax consequences. This rollover provision is in addition to your annual RRSP contribution room.

While a T4 slip will still be issued for the gratuity, a corresponding tax deduction will help offset tax on the extra income. This is similar to what happens with regular employment income offset by RRSP contributions.

A tax-free rollover is generally advisable, as your annual income in the year you retire may be significantly higher than in subsequent years. By rolling it over to an RRSP, you can avoid extra tax in that year and then control the amounts you withdraw as taxable income in future years, when you may be in a lower tax bracket. What's more, a rollover allows your money to compound on a tax-deferred basis within your RRSP until it is eventually withdrawn.

## Example: How a rollover can reduce tax in the year of retirement

	Gratuity taken in Cash	Gratuity rollover
Gratuity	\$30,000	\$30,000
Salary (part year)	\$50,000	\$50,000
Pension Income (part year)	\$14,000	\$14,000
<b>Total Income</b>	<b>\$94,000</b>	<b>\$94,000</b>
Less offsetting deduction for gratuity rolled over		\$30,000
Taxable Income	\$94,000	\$64,000
<b>Approximate tax (2007)</b>	<b>\$26,600</b>	<b>\$14,550</b>

*This example is for illustration purposes only.*

## How much is eligible for the rollover?

The amount of your gratuity that is eligible for the rollover is \$2,000 a year for each calendar year or part year of service you worked before 1996 with any publicly funded school board in the province. Even if you worked a single day of occasional teaching during one of those years, it counts as a part year.

The 1996 federal budget eliminated eligibility for years after 1995. With each year, the eligible portion of gratuities for today's working educators is therefore shrinking. However, you have another option to minimize tax. If you have unused RRSP room, you may still be able to shelter all or part of your gratuity from tax by rolling it over to your RRSP (or a spousal RRSP, in this case) and claiming it as a tax deduction.

And if you don't have available RRSP room, but your spouse does, you can always take the gratuity in cash and ask your spouse to contribute it to their own RRSP. Although the gratuity will be taxed in your hands, your spouse can claim a deduction at their own tax rate for the contribution to their own RRSP.

## When to draw from your RRSP

Having transferred your gratuity to your RRSP, you may wonder how best to draw from it. One option is to maximize tax-deferred growth within your RRSP by waiting until the year you turn 71 and are required to convert the plan. Consider this: an investment of \$30,000 earning an average annual rate of 7% could grow to more than \$82,000 in 15 years.

Alternatively, you could withdraw smaller amounts each year to level out your income and possibly stay in a lower tax bracket (especially before you begin receiving OAS and CPP).

The best solution for you will depend on your individual circumstances – for example, your income needs, other income sources and expected tax bracket for the current and future years.

## How an OTG financial advisor can help

With their exclusive focus on members of Ontario's education community, our OTG financial advisors have developed deep knowledge of your financial needs, including a full understanding of your pension plan and gratuities.

Based on an assessment of your financial situation and goals, an OTG financial advisor can help you determine the optimal amount of a gratuity to transfer to an RRSP – as well as when and how to withdraw funds in your retirement.

Through an OTG advisor, you can invest in OTG Funds, which have been recognized by independent rating firms for their strong performance and low fees. You can also choose from thousands of other mutual funds available in Canada.

Be sure to take advantage of the expertise of our OTG financial advisors – all at no cost. Call today for customized advice and planning around your retirement gratuity: 1-800-263-9541 or 416-752-6843.

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