

Tax implications of buying back credit

Introduction

If you take a leave or reduced workload due to childcare or disability, you may be able to buy back credit in the Ontario Teachers' Pension Plan for the time that you're away. Buying back credit can maximize your pension and help you qualify for a pension sooner.

While buying back credit is almost always a good financial choice, it's important to understand the tax implications of your purchase. This fact sheet outlines some of the things you need to know to make informed decisions about the feasibility and timing of your purchase.

Tax deductibility

Only payments made from personal (non-registered) funds — by cheque or through online banking — are tax deductible. You can claim the deduction on line 20700 of your annual income tax return.

Your ability to deduct the full cost of your buyback will depend on your taxable income in the year you purchase the credit. Your buyback payments can only be deducted in the tax year in which they were made. You can't carry forward non-deducted amounts to the following tax year.

Buying back affects allowable RRSP contributions

In an effort to create a level playing field for tax-sheltered retirement savings, the Canada Revenue Agency (CRA) limits how much you can save for retirement each year on a tax-sheltered basis. The limit, which the CRA has currently set at 18% of your income, applies to any personal RRSP contributions you make as well as any pension benefits you earn. To determine the value of your tax-sheltered savings, the CRA places a dollar value on the pension benefits you earn in a year. This assessed value of your pension is referred to as your pension adjustment (PA) or past service pension adjustment (PSPA).

Buying back credit will trigger a PA or PSPA to be issued to you. Your future earned RRSP contribution room will be subsequently reduced by the amount of your PA, but it can't make your existing room negative. Your existing RRSP contribution room will be reduced by the amount of your PSPA.

It's important to note that PAs and PSPAs are based on the value of the pension benefit you'll receive, not the cost of your buyback.

Intending to buy back or paying before April 30

Inform us of your intent to buy back via our secure member website.

By informing us that you intend to buy back, you secure eligibility for a PA.

Example

Tony takes a parental leave from January 1, 2020 to June 30, 2020. He declares his intent to pay for his buyback online via our secure member website in January 2021, a few months before the April 30, 2021 deadline. Since Tony has locked-in his tax treatment in advance, he now has until June 30, 2025 (5 years) to pay and receive a PA. In February 2021, he'll receive a T4A showing a PA that was triggered by his 2020 parental leave.

Intending to buy back or paying before April 30 (cont'd.)**Payments before April 30 will trigger a PA**

If you make any payments towards your buyback prior to April 30 of the year following the end of your leave or reduced workload, you'll receive a PA. Your PA will be reported on your T4A, which is issued in February. The year in which the PA will be issued to you depends on when you made your payments.

Example

Radha takes one month off in November 2019. She makes two payments toward her buyback, one in December 2019 and one in March 2020. Both payments are made before the April 30, 2020 deadline. She'll receive a T4A showing a PA that was triggered by her December payment. She'll also receive a T4A showing a PA that was triggered by her March payment.

For a leave or reduced workload that spans more than one calendar year, we'll issue you a PA for each of the tax years affected by your payment if you've informed us of your intent. You'll receive one T4A for each year in question. If you've already received a PA for one of your affected years, you'll receive an amended PA. You must file a form, called a *T1 Adjustment Request* (T1-ADJ), with the CRA for each year covered by a T4A. The form is available in the forms and publications section of the CRA website at www.cra.gc.ca.

Example

In March 2020, Martin makes a lump-sum payment to buy back an adoption leave he took from September 1, 2017 to June 30, 2019. He receives a PA for each of the 2017, 2018 and 2019 tax years, which will affect his RRSP contribution room for 2018, 2019 and 2020, respectively. The PAs are reported on the T4As Martin receives from us. Martin will need to file a *T1 Adjustment Request* form for each of the 2017, 2018 and 2019 tax years. We'll also provide a tax receipt in February 2021 for Martin's 2020 tax return.

Heads up!

- Sign in to your Ontario Teachers' account and visit your Buyback Centre to tell us you intend to buy back.
- The number of years for which you can buy back pension credit and be issued a PA is limited by the CRA. The limits vary depending on the type of buyback. For example, you can buy and receive a PA for up to five years of credit for any eligible leave or reduced workload, plus up to three more years for pregnancy and parental leaves.
- If you over-contribute to your RRSP, the CRA will request that you withdraw funds from your RRSP. Your over-contributions may be subject to a penalty tax, and any money you withdraw from your RRSP will be taxed as income in the year it is withdrawn. You may find yourself in this position if, for example, you maximize your RRSP payments in the calendar year for which we subsequently issue a PA.
- If you inform us of your intent to buy back but haven't made a payment before April 30, you'll still receive a PA.

Not intending to buy back or paying after April 30

If you didn't inform us of your intention to buy back via our secure member website or by telephone, and/or are paying after April 30 of the year following the end of your leave, you'll receive a PSPA.

What is a past service pension adjustment (PSPA)?

A past service pension adjustment (PSPA) is the CRA's measure of the value of the pension benefit you've earned in the past. If you pay for some or all of your buyback after April 30 of the year following the end of your leave or reduced workload, you'll receive a PSPA. The CRA must determine if you have enough RRSP room to accommodate your PSPA before you'll be allowed to complete your buyback.

PSPA must be issued *before* you can pay

According to the *Income Tax Act*, we can't accept payments made before we submit your PSPA to the CRA. If you send your payment before the date we provide, we must return the money to you.

How does a PSPA affect my RRSP room?

If you have enough RRSP room to accommodate your PSPA, the CRA will certify your PSPA and the purchase will be approved. You'll receive a copy of the CRA statement of approval and in the following February, we'll provide you with a tax receipt reflecting the payments you completed.

A PSPA can make your RRSP room negative by up to \$8,000. This is because a purchase of credit can trigger a significant PSPA. For example, purchasing one year of credit will, for a teacher earning \$65,000 a year, result in a PSPA of more than \$11,000.

After your PSPA has been deducted from your available RRSP room, your purchase will be approved provided your RRSP room isn't negative by more than \$8,000. If your RRSP contribution room is negative by more than \$8,000, the CRA will ask if you want to withdraw RRSP funds to make room. If you don't withdraw the necessary funds, your PSPA will be denied.

If you chose to withdraw funds, you'll need to complete the form *Designating an RRSP withdrawal as a qualifying withdrawal* (T1006) and submit it back to the CRA within 30 days. The CRA will send you this form.

Keep in mind that any time you withdraw funds from your RRSP, your withdrawal will be taxed as income in the year it's withdrawn. Another option to consider is to reduce the size of your PSPA by paying for some or all of your credit with an RRSP transfer. Note that there is no tax deduction for credit purchased with transferred RRSP funds.

Heads up!

If your RRSP contribution room is negative, you won't be able to contribute to your RRSP again until you generate enough new room to eliminate the negative balance. A teacher earning \$65,000 a year generates only about \$1,600 in new RRSP contribution room each year. This means it may be several years before you can make RRSP contributions again.

Not intending to buy back or paying after April 30 (cont'd.)**If your PSPA is denied**

If your PSPA is denied by the CRA, we'll contact you to determine whether you want to:

- buy back as much credit as the CRA will approve based on your available RRSP room; or
- not buy back at all.

In either case, we'll refund any payments you may have made, with interest less applicable taxes, for credit you aren't able to purchase. You'll likely not be able to buy back this credit within five years of the end of your leave or reduced workload unless you build up additional RRSP room.

Transferring RRSPs can reduce your PSPA

If you think your PSPA will exceed your available RRSP room, you may want to pay for some or all of your purchase with funds transferred from your RRSP. To transfer RRSP funds, complete a *Direct Transfer from RRSP* form, which is available on our website at www.otpp.com.

Using RRSP funds will result in a corresponding reduction in your PSPA. There's no tax deduction for credit purchased with transferred RRSP funds.

Tell us your plans

You can't pay for leaves in a PSPA situation without informing or contacting us first. Once you tell us, you'll need to allow three business days for us to issue and submit your PSPA before making payment.

Please sign in to your Ontario Teachers' account and visit your Buyback Centre to tell us you intend to buy back. Once we've recorded your decision, we'll tell you the date you can start paying. If you send your payment before the date we provide, we'll return your money.

Remember

- To ensure your eligibility for a PA and to avoid the complication of having to get CRA certification, inform us of your intent to buy back or pay for your buyback before April 30 following the end date of your leave or reduced workload.
- A PA or PSPA is the CRA's assessment of the benefits represented by your purchase of credit. This value isn't the same as the cost of your buyback.
- Your RRSP contribution room will be decreased by the amount of your PA. Your existing RRSP contribution room will be reduced by the amount of your PSPA.
- The CRA must certify your PSPA before we can complete your purchase of credit. Paying for some or all of your purchase with funds transferred from an RRSP will reduce the size of a PSPA.
- Any money you withdraw from your RRSP will be taxed as income in the year it's withdrawn and will have to be reported as income on your tax return for that year.
- Any money you transfer from your RRSP to pay for your buyback won't be taxed as income in the year it's transferred, because you're simply moving money from one tax-sheltered savings to another. Note, however, that there's no tax deduction for credit purchased with transferred RRSP funds.

Additional information

Sign in to your Ontario Teachers' account and visit your Buyback Centre for details on buybacks. For questions relating to your specific tax situation, we recommend that you consult with a personal tax advisor.