PENSION INCOME SPLITTING

Pension income splitting is available between spouses or common-law partners who receive eligible pension income. It provides an opportunity for couples to reduce their overall taxes by moving income from a higher income spouse to the spouse who is in a lower tax bracket. Pension income splitting is a joint election on each spouse/common-law partner's tax returns each tax year. You can allocate up to 50% of your eligible pension income to your spouse or common-law partner with no need to actually transfer funds. This can result in a reduction of family taxes and can also minimize the impact on income-tested tax credits and benefits.

Who should take advantage of pension splitting?

To qualify to split your eligible pension income, you must meet the following conditions:

1. You must be married or in a common-law relationship. (You cannot be living apart for more than 90 days because of a breakdown in the marriage or common-law partnership.)
2. You were both residents in Canada on December 31st of the tax year.
3. You received eligible pension income that qualifies for the pension income tax credit.

Generally, if the pension earner is in a higher marginal tax bracket than the spouse, then it makes sense to move money from the higher tax bracket to the lower tax bracket.

How to split eligible pension income?

During the course of the tax year, the pension income continues to be paid directly to the pensioner. At tax-reporting time, the spouses use Canada Revenue Agency (CRA) Form T1032 ("Joint Election to Split Pension Income") to jointly elect how much of the pension income to split, including a reallocation of any withholding taxes so that the tax savings are applied immediately upon filing rather than having one spouse wait for a refund. The election to split pension income is made one year at a time and can be changed or modified each tax year, depending on financial circumstances and planning needs.

What is Eligible Pension Income?

The definition of eligible pension income mirrors the definition of eligible pension income for the purpose of the federal pension income tax credit. Any Canadian resident who receives income that qualifies for the existing pension income tax credit is entitled to allocate up to 50 percent to his or her resident spouse or common-law partner. Eligible pension income is based on the type of income received and the age of the pension income recipient.

What Type of Income is Eligible?

Pensioners under age 65:

- Pension income from a registered pension plan (RPP), for example, an employer-sponsored defined benefit or defined contribution plan (taxpayers must be age 65 or over for Quebec provincial tax purposes);
- Taxable portion of foreign pensions, including US social security;
- Income from an annuity, registered retirement income fund (RRIF), deferred profit sharing plan (DPSP) and variable pension benefits, as a result of the death of a spouse or common-law partner.

Pensioners aged 65 and over:

- Lifetime annuity payments from a registered pension plan (RPP), registered retirement pension plan (RRSP), deferred profit sharing plan (DPSP), retirement compensation agreement (RCA);
- Payments from a registered retirement income fund (RRIF), life income fund (LIF), locked-in retirement income fund (LRIF), prescribed retirement income fund (PRIF);
- Interest from a non-registered life annuity and a guaranteed interest contract (GIC) provided by an insurance company;
- Taxable portion of foreign pensions, including US social security.

The following table provides a summary of eligible pension income:

Source of Income	Under 65	65 and over
Lifetime annuity payments from a RPP	Yes	Yes
Taxable foreign pensions	Yes	Yes
Lifetime annuity payments from a RRSP, DPSP	No	Yes
Payments from a RRIF, LIF, LRIF, PRIF	No	Yes
Interest from a Non-Registered Life Annuity	No	Yes
Interest from a Guaranteed Interest Annuity (GIA)	No	Yes
Retirement Compensation Arrangement (RCA)	No	Yes*

**amounts paid out must be in the form of life annuity payments and be supplemental to amounts received out of an RPP (payments cannot exceed a limit specified in the Income Tax Act, less the taxpayer's other eligible pension income)*

What Type of Income is Not Eligible?

The following types of income are not eligible for pension income splitting:

- Lump-sum withdrawals from a RRSP;
- Old age security (OAS), guaranteed income supplement (GIS);
- Canada Pension Plan (CPP), Quebec Pension Plan (QPP);
- GIC income;
- Any foreign source pension income that is tax-free in Canada because of a tax treaty that entitles you to claim a deduction;
- Income from a United States individual retirement account (IRA).

Retirement Income Splitting Strategies

CPP/QPP Sharing

Canada Pension Plan or Quebec Pension Plan income does not qualify as eligible pension income for either the pension income tax credit or pension splitting. However, existing rules do permit CPP/QPP recipients to split their retirement benefit, referred to as pension sharing. Under these rules, spouses and common-law partners who are both at least 60 years of age can share up to half of their CPP/QPP retirement benefit. The split between spouses is determined by the number of years they lived together during the period they were required to contribute to the CPP/QPP. Pension sharing may reduce overall family taxes by reducing the income of the higher income earner and generating income for the lower income spouse. Unlike pension income splitting, the election to pension share only needs to be made once, and each spouse will receive a monthly cheque or deposit for the shared amount. To benefit from this strategy, pensioners can find the application form and list of necessary supporting documents on the website of Service Canada (for CPP) or Retraite Québec (for QPP). The completed application form must be mailed to the appropriate pension provider with the necessary supporting documents.

Spousal RRSPs

One objective of spousal RRSPs is to enable the spouse or common-law partner in the higher tax bracket to contribute to a spousal RRSP in the name of the spouse or common-law partner who is expected to be in a lower marginal tax bracket when withdrawals are made. The contributing spouse uses his or her RRSP deduction room and can claim the tax deduction on his or her own tax return. The receiving spouse will own and control the funds and will be taxed on the withdrawals of these funds on their own tax return. However, attribution rules state that contributions must remain in the spousal RRSP for the remainder of the current year, and the next two calendar years, otherwise withdrawals will be counted as taxable income for the contributing spouse.

Pension Income Amount

The pension income amount is a tax credit that enables taxpayers to deduct, from taxes payable, an amount equal to the lesser of his or her eligible pension income or $2,000. In the event a spouse or common-law partner does not have pension income, the spouse with pension income can allocate a minimum of $2,000 to the spouse without a pension, to take advantage of the tax credit if they meet the age criteria for the pension income type. Also, if the taxpayer is age 65 or older and does not have any eligible pension income, he or she may consider transferring $2,000 of RRSP funds to a RRIF and withdraw the money, to claim the tax credit. Note, taxpayers do not receive the tax credit automatically and must claim the credit on line 314 of their tax return.

OAS Clawback Planning

The OAS recovery tax, also know as the clawback, is applicable when a taxpayer's net income is greater than the minimum threshold determined by the CRA. The OAS benefit is reduced or "clawed back" by fifteen-cents for every dollar of net income over the minimum threshold, and is fully clawed back once net income reaches the maximum threshold. By transferring pension income to a lower-income spouse or common-law partner's income tax return, OAS payments can potentially be preserved. However, the impact on other income tested benefits and tax credits should be considered, such as the age amount and the spousal credit.

Retirement Income Splitting Example: Using Basic Strategies

The following example is for illustrative purposes to demonstrate the potential family tax savings and increase in combined after-tax income that can result from pension income splitting and CPP sharing.

The following assumptions have been made:

1. John's OAS income is fully clawed back before income splitting and CPP sharing, and is partially recovered after income splitting and CPP sharing
2. The Pension Income Amount ignores the provincial credit and only claims the maximum federal amount ($2,000 x 15%)

	No Pension Income Splitting ($)		**Pension Income Splitting and CPP Sharing ($)**	
	John (Age 67)	**Jane (Age 65)**	**John (Age 67)**	**Jane (Age 65)**
Average Tax Rate*	**30%**	**5%**	**25%**	**15%**
RPP Income	60,000	0	30,000	30,000
Investment Income	50,000	10,000	50,000	10,000
CPP Income	13,000	8,000	10,500	10,500
OAS Income	7,000	7,000	7,000	7,000
Total Income	**130,000**	**25,000**	**97,500**	**57,500**
Taxes Payable	(39,000)	(1,250)	(24,375)	(8,625)
OAS Clawback	(7000)	0	(3,400)	0
Pension Income Credit	300	0	300	300
Net Taxes Payable	(45,700)	(1,250)	(27,475)	(8,325)
Family Taxes Payable	**$46,950**		**$35,800**	
Family Tax Savings	**$11,150**			

**A combined federal and provincial rate used for illustration purposes*

For more advanced strategies, please speak to your Raymond James Advisor.

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