

Pension income splitting

In 2006, the federal government introduced a new planning opportunity for Canadian seniors: the ability to split pension income. This *Infopage* explains what pension income splitting is and how it can help to lessen your tax burden.

Under Canadian tax law, everyone files his or her own tax return and is taxed on the income he or she earns on an individual basis. Since we have a progressive tax system, the more you make, the higher your tax rate. This has always been a source of concern for senior couples, where one of them is receiving a pension and the other has very little income. The couple would pay significantly less tax if the pension income, which is being used to support the couple jointly, could be split between both partners.

Eligible pension income

Under the current rules, any Canadian resident who receives income that qualifies for the existing \$2,000 pension income credit (see page 3, "Pension income credit (PIC)") is entitled to allocate to his or her resident spouse or common-law partner up to one half of his or her "eligible pension income."

What is eligible pension income? The definition essentially mirrors the definition of eligible pension income for the purposes of the federal pension credit. Based on the type of income received and the age of the pension income recipient, eligible pension income is divided into two subsets and defined as either *qualified pension income* or *pension income*.

Recipients under age 65 - a subset of eligible pension income defined as *qualified pension income*:

- pension income from a registered pension plan (RPP) (i.e., a pension from an employer-sponsored defined benefit or defined contribution plan); and
- pension income from a specified pension plan (SPP), which includes the Saskatchewan Pension Plan.

Recipients aged 65 or over – a subset of eligible pension income defined as *pension income*:

- pension income from a RPP;
- pension income from an SPP;
- income from an annuitized registered retirement savings plan (RRSP);
- registered retirement income fund (RRIF) withdrawals or withdrawals from RRIFs subject to federal or provincial locked-in legislation, such as life income funds (LIFs) and locked-in retirement income funds (LRIFs);
- income from an annuitized deferred profit sharing plan (DPSP);
- income from retirement compensation arrangements (RCAs)¹; and
- a payment from a pooled registered pension plan (PRPP).

Why the age 65 requirement for RRSP annuity, RRIF and LIF income? The government has stated that the purpose of this age requirement is to target the pension income credit to retired individuals.

Since individuals have much greater personal control over the timing of withdrawals under RRSPs, RRIFs and LIFs compared to RPPs, without the age 65 rule, individuals who aren't retired could gain tax advantages through income splitting well before age 65; for example, by withdrawing RRIF income annually while still saving for retirement.

On the other hand, pensioners who receive RPP income generally have little control over the timing of their pension payments, since they usually (although not always) only receive such payments when they're retired.

Ineligible income

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

- Old Age Security (OAS)
- Guaranteed Income Supplement (GIS)
- Canada Pension Plan (CPP)/Quebec Pension Plan (QPP)
- RRSP annuities, RRIFs and DPSP annuities (if recipient is under age 65)
- RRSP withdrawals

How does it work?

During the course of the 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 withheld taxes so that the effects are felt immediately on filing rather than having to await 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. The ability to split (or not to split) any amount up to half of one's eligible pension income presents a huge opportunity to maximize tax planning for seniors. One such area of planning involves the OAS clawbacks.

¹ As of 2013 and subsequent taxation years, certain income from an RCA is eligible for pension income splitting.

Pension income credit (PIC)

The PIC provides a non-refundable reduction in taxes payable on eligible pension income. Since 2007, the maximum amount of eligible pension income that qualifies for the credit is \$2,000.

Planning opportunity 1

How can you take advantage of this PIC without actually receiving any pension income in the traditional sense? If you're 65 or over, ensure you receive at least \$2,000 a year from a RRIF. If you're aged 65 to 70, consider transferring some of your RRSP money to a RRIF so you'll be in a position to claim this credit.

Planning opportunity 2

If your spouse or common-law partner has received eligible pension income by way of a joint CRA Form T1032 election, the receipt of income retains its characteristics in the hands of the spouse or common-law partner. Depending on the spouse's age, they may also be entitled to claim the PIC on the split amount.

CPP/QPP sharing

Note that while CPP/QPP income doesn't qualify as eligible pension income for either the pension income credit (PIC) or pension splitting, existing rules do permit CPP/QPP recipients to split their CPP/QPP retirement benefit. 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, with the split between the partners determined by the number of years they lived together during the period they were required to contribute to the CPP/QPP.

OAS clawback planning

The OAS clawback only kicks in at net income greater than \$73,756 in 2016² and is fully clawed back when net income reaches approximately \$119,512.

The new possibility of being able to split pension income may be extremely beneficial for individuals subject to the OAS clawback. Why? Pension income that pushes an individual above \$73,756 could now potentially be transferred to a lower-income spouse or partner's income tax return, thus preserving OAS payments.

Example 1

Assume Barry and Lisa are married and are aged 67 and 60, respectively. Barry receives RRIF withdrawals of \$15,000 annually. Since Barry is receiving pension income and is over the age of 65, he is eligible to split up to 50% of this income with Lisa. Additionally, Barry is able to claim the PIC for the pension income that is included on his tax return. Lisa has included the split income on her tax return as pension income (since it retains its characteristics), and would like to know if she could also qualify for the PIC. Since Lisa is under the age of 65, RRIF income is not eligible pension income for the purpose of the credit, and she is therefore ineligible for the credit. Once Lisa enters the year in which she will turn 65, any split RRIF income received from Barry would qualify for the PIC up to the maximum claimable amount.

² For 2016, a clawback will affect your OAS entitlements payable from July 2017 to June 2018.

Example 2: Pension Income splitting and CPP Sharing

Illustrates the potential family unit tax savings that can be achieved by pension income splitting and CPP sharing

Province of Alberta	No pension income splitting (\$)		Pension income splitting (\$)		Pension income splitting and CPP sharing (\$)	
	Spouse 1	Spouse 2	Spouse 1	Spouse 2	Spouse 1	Spouse 2
Eligible pension income (RRIF and RPP)	50,000	-	25,000	25,000	25,000	25,000
Part-time employment income	25,000	-	25,000	-	25,000	-
Investment income	15,000	5,000	15,000	5,000	15,000	5,000
CPP income	13,110	7,717	13,110	7,717	10,414	10,414
OAS income	6,880	6,880	6,880	6,880	6,880	6,880
Total income subject to tax	109,990	19,598	84,990	44,598	82,294	47,294
Taxes payable	28,559	1,333	19,865	7,583	19,043	8,368
OAS clawback	5,435	-	1,685	-	1,281	-
Pension income credit	442	-	442	442	442	442
Net taxes payable	33,552	1,333	21,109	7,141	19,882	7,926
Family unit taxes payable	34,885		28,250		27,808	
Increase in OAS due to pension splitting/ CPP sharing	-		3,750		4,154	
Family unit tax savings - Pension income splitting only					6,636	
Family unit tax savings - Pension income splitting and CPP sharing					7,078	

CPP and OAS thresholds and assumptions (\$)

OAS monthly maximum (July–September 2016)	573	Notes: Assumes both spouses are 65 years of age or older. "Taxes payable" assumes graduated tax rates used for the province of Alberta for 2016 taking into account the Basic Personal Exemption only. "Pension income credit" is calculated by claiming the maximum amount federally (\$2,000 x 15%) and provincially (\$1,421 x 10% in Alberta) for 2016 to reduce taxes payable. OAS clawback is calculated as "Total income subject to tax" less the "OAS clawback range minimum" and then multiplied by 15%. CPP sharing assumes that both spouse's entire CPP retirement income is eligible to be shared.
CPP monthly maximum @ 65 (2016)	1,093	
CPP monthly average @ 65 (2016)	643	
OAS clawback range minimum	73,756	
OAS clawback range maximum	119,512	

Future of spousal RRSPs

In light of these rules, have spousal RRSPs become a thing of the past? Are they still needed and, if so, in what capacity?

As a quick refresher, a spousal (or common-law partner) RRSP is a plan in which one spouse or partner has contributed and the other spouse or partner is the annuitant or owner. It's often used by couples to accomplish post-retirement income splitting, as funds withdrawn from a spousal RRSP are taxed in the hands of the annuitant spouse instead of the contributor spouse. If the annuitant spouse is in a lower tax bracket than the contributor spouse in the year of withdrawal, there may be an absolute and permanent tax savings.

The rules have not heralded the death of spousal RRSPs, primarily due to the definition of eligible pension income that qualifies to be split, as discussed earlier.

Splitting under age 65

Remember, if you're under 65, eligible pension income typically includes only payments from an RPP and will not generally include amounts paid from an RRSP or RRIF. Thus, anyone who wants to retire before age 65 and doesn't have an RPP should still consider the use of spousal RRSP contributions that would allow the ultimate withdrawals to be taxed in a lower-income spouse's or partner's hands without having to wait until age 65.

Splitting more than 50%

Spousal RRSPs also continues to play a role for individuals who may wish to split more than 50% of their pension income. With a spousal RRSP, one could transfer up to 100% of one's RRSP income to a lower-income spouse or partner. This may be advantageous to some couples, depending on their individual retirement incomes and tax brackets.

Contributors over age 71

Spousal RRSPs may also play a critical role if you're over age 71 - the age when you can no longer have an RRSP in your own name. You can, however, continue to contribute to a spousal RRSP if you have RRSP contribution room beyond age 71.

In fact, with many seniors working well into their seventies, you may still be generating "earned income" and thus be able to contribute to a spousal RRSP as long as your spouse or partner is under age 72. And keep in mind, you don't necessarily have to be working to have earned income; you might simply own a rental property that generates net rental income, which is specifically included in the definition of earned income for the purposes of calculating eligible RRSP contribution room.

Home Buyers' Plan (HBP) withdrawals

Another continuing advantage of spousal RRSPs can be for younger couples looking to save enough money for a down payment on a first home. Often, the only savings they may have are in an RRSP. If one spouse is working and the other isn't, the working spouse, over the years of accumulation, could contribute a total of \$25,000 to his or her own RRSP and then contribute \$25,000 to a spousal RRSP while building up savings for the new home. Then each could withdraw \$25,000 under the HBP - something that can't be achieved without the spousal RRSP.

Post-death RRSP contribution

Finally, the spousal RRSP still plays a role in situations where individuals die with unused RRSP contribution room. In this scenario, the executor or estate representative can make an RRSP contribution to a surviving spouse's or partner's spousal RRSP and obtain one final RRSP deduction on the deceased's terminal return; planning that isn't possible without the spousal RRSP.



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