Wealth Management

RBC Wealth Management Services

The pension income tax credit

How to receive a tax credit on $2,000 of your pension income

If you are receiving eligible pension income, you may be entitled to claim both a federal and a provincial/territorial tax credit. The federal non-refundable pension income tax credit is on the first $2,000 of eligible pension income, which translates into maximum federal annual tax savings of $300. The amount of additional provincial/territorial tax savings varies depending on where you reside. This article addresses which pension income qualifies for the tax credit and evaluates whether it is beneficial to structure your investments to take advantage of this credit.

This article outlines a strategy which might not apply to your particular financial circumstances. The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax advisor before acting on any of the information in this article.

Please contact us for more information about the topics discussed in this article.

What is the pension income tax credit?

If you receive income from sources such as a pension plan, certain annuities, a registered retirement income fund (RRIF) or other locked-in registered retirement income funds, you may be able to claim a tax credit on amount up to $2,000 of that income. The federal tax credit rate is 15%, resulting in maximum federal tax savings of $300 ($2,000 × 15%). There are also provincial/territorial pension income tax credits.

The pension income tax credit is non-refundable. It means that you only receive the credit if you owe federal income tax. It reduces your federal taxes payable. If you do not need to claim all of the credit in order to reduce your federal taxes to zero, you may transfer any unused amount to your spouse or common-law partner. However, any unused amount cannot be carried forward or back to other tax years.

Which pension income qualifies for the credit?

If you are 65 years of age or older during the year

If you are 65 years of age or older at any point during the year, you can

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claim the pension income tax credit if you receive the following types of income:

1. a life annuity payment from a superannuation or pension plan (including the Saskatchewan Pension Plan);
2. a life annuity payment from a Retirement Compensation Arrangement (RCA);
3. an annuity payment from an Registered Retirement Savings Plan (RRSP), which is an old insurance product no longer available;
4. a payment from a Pooled Registered Pension Plan (PRPP);
5. a payment from a RRIF, LIF, RLIF, LRIF or PRIF;
6. an annuity payment from a Deferred Profit Sharing Plan (DPSP);
7. a payment (including the income portion) from a regular annuity or an income averaging annuity contract;
8. a payment from certain foreign pension plans (including the taxable portion of the U.S. Social Security); and
9. elected split pension income reported on your tax return.

If you are less than 65 years of age for the entire year

If you have not reached 65 years of age by the end of the year, you can claim the pension income tax credit if you receive the following types of income:

1. a life annuity payment from a superannuation or pension plan (including the Saskatchewan Pension Plan);
2. a payment you received as a consequence of the death of your spouse or common-law partner described in 3 to 7;
3. a payment from certain foreign pension plans (including the taxable portion of the U.S. Social Security); and
4. elected split pension income reported on your tax return that your spouse or common-law partner received from a life annuity payment from a superannuation or pension plan*.

Which pension income does not qualify for the credit?

The types of income which do not qualify as eligible pension income for purposes of the pension income tax credit include:

- Old Age Security (OAS) benefits;
- Canada Pension Plan (CPP) benefits;
- Quebec Pension Plan (QPP) benefits;
- death benefits;
- retiring allowances;
- RRSP withdrawals other than annuity payments from an RRSP;
- amounts from a RRIF that are transferred to an RRSP, another RRIF, or an annuity;
- any foreign source pension income that is tax-free in Canada;
- income from a U.S. Individual Retirement Account (IRA); and
- amounts received from a salary deferral arrangement.

How much tax does the credit save?

If you are in the lowest marginal tax bracket (with taxable income generally below $31,000 to $44,000 depending on your province or territory of residence), you can receive the first $2,000 of pension income tax-free for federal tax

* For 2014 and subsequent taxation years, if you live in the province of Quebec, you will only be able to split pension income for provincial tax purposes if you are 65 years of age or older.

purposes. This is because the federal tax credit and the lowest federal marginal tax rate on income are both 15%. If you are in the higher tax brackets, you will pay tax on the first $2,000 of pension income, but at a reduced rate.

The table calculates your net federal taxes owing on the first $2,000 of pension income, depending on your tax bracket. The provincial or territorial tax credit is not factored into this calculation since it varies depending on your province or territory of residence.

	Low	Middle	Upper-middle	High
Federal tax rate	15%	22%	26%	29%
Eligible pension income	$2,000	$2,000	$2,000	$2,000
Federal tax before credit ($2,000 x respective tax rate) (A)	300	440	520	580
Pension tax credit ($2,000 x 15%) (B)	300	300	300	300
Net federal tax (A)-(B)	0	140	220	280

Should you structure your investments to qualify for the credit?

If you are between the ages of 65 and 71 with no pension income, you might consider converting a portion or all of your RRSP funds to a RRIF and drawing $2,000 per year from the RRIF. This will allow you to use the pension income tax credit. Before implementing this strategy, consider the following factors:

The maximum amount of the federal annual tax savings is limited to $300. If you are in a higher tax bracket, the $2,000 of eligible pension income you receive will not be tax-free. You will have to pay the incremental tax at your marginal tax rate. Any pension income you receive for the year above $2,000 will also be taxed at your marginal tax rate.

The choice to withdraw funds early from your registered plan is a trade-off between the benefit of lower taxes due to the pension income tax credit and the benefit of the years of tax-deferred growth within your registered plan. You should compare the benefit of the $300 in annual tax savings with the value of the forgone future tax-deferred income due to the early receipt of your RRIF income.

Your RBC advisor along with your qualified tax advisor can help you evaluate whether structuring your investments to qualify for the pension income tax credit makes sense for you.

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