



# THE NAVIGATOR

## PENSION INCOME SPLITTING

### How you and your spouse may be able to benefit

Since the introduction of the pension income splitting rules in 2007, many families can now significantly reduce their total tax bill by allocating certain types of retirement income to a spouse who is taxed at a lower rate. This article summarizes these rules, as well as some of the key opportunities that you and your spouse may wish to consider as part of your overall plan to draw upon your retirement income.

*This article outlines several strategies, not all of which will 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.*

### PENSION INCOME SPLITTING –THE BASICS

#### INCOME SPLITTING

If you or your spouse receives eligible pension income during the year, you and your spouse can split or allocate the eligible pension income for tax purposes. Generally, you or your spouse can allocate an amount of 0% to 50% of the eligible pension income. In order to lower your family tax bill, the higher income earner will generally allocate their eligible pension income to the lower income earner.

You may be subject to withholding tax on the eligible pension income you receive. When you allocate eligible pension income that was

subject to withholding tax to your spouse, a proportionate amount of the withholding tax is also allocated to your spouse. For example, consider an individual that receives pension payments from a company pension. They may be subject to withholding tax on these payments. If the individual chooses to allocate 40% of the pension payments to their spouse, 40% of the withholding tax on these payments would also be credited to the spouse. When the spouse files their tax return, the credit can be used to reduce their taxes payable or result in a tax refund.

#### WHO CAN BENEFIT FROM PENSION INCOME SPLITTING?

These rules benefit couples where

the primary recipient of the eligible pension income is subject to tax at a higher rate than their spouse.

Married couples as well as those who satisfy the definition of “common-law partners” under the Income Tax Act qualify for pension income splitting. This includes same-sex couples.

#### ELIGIBLE PENSION INCOME

Only certain income is eligible to be split under the pension income splitting rules. The type of income that is eligible also depends on the age of the person who is the **primary recipient** of the income. The age of the spouse who is being allocated the eligible pension income is not relevant for the purposes of the pension income



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splitting rules. However, the spouse’s age may be relevant for purposes of determining whether they qualify for a non-refundable pension tax credit, discussed later.

In most cases, if you are under 65 during the entire tax year, you will only be able to split the payments you directly receive from a registered pension plan or a Saskatchewan Pension Plan (SPP).

If you are 65 or older by the end of the tax year, you are eligible to split more types of income with your spouse.

Here are some examples of eligible pension that may be split with your spouse (please note that this list is not exhaustive):

**FOR PRIMARY RECIPIENTS WHO ARE 65 YEARS OF AGE OR OLDER DURING THE YEAR:**

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; and
8. payment from certain foreign pension plans (including U.S. Social Security).

**FOR PRIMARY RECIPIENTS WHO ARE LESS THAN 65 YEARS OF AGE DURING THE YEAR:**

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 described in 3 to 7; and
3. a payment from certain foreign pension plans (including U.S. Social Security).

**INCOME THAT DOES NOT QUALIFY**

The types of income which do not qualify for pension income splitting 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 TO MAKE THE ELECTION TO SPLIT PENSION INCOME**

If pension income splitting is an appropriate strategy, both you and your spouse must complete the proper

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\* 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.

If pension income splitting is an appropriate strategy, both you and your spouse must complete the proper election in order to split eligible pension income.

election in order to split eligible pension income. There is nothing in particular that needs to be done at the time you receive the income. In fact, as a couple, you can make the decision about how much income to reallocate between the two of you at the time you and your spouse prepare your income tax returns. You also do not have to transfer the pension income you allocate for tax purposes to your spouse. This election allows you to split the income on your tax return in order to calculate your taxes payable without the requirement of physically splitting the money.

You and your spouse must file a joint election form together with your income tax returns in order to split your pension income. The filing due date is generally April 30 of the year following the tax year or June 15 for self-employed taxpayers and their spouses.

The election form that you and your spouse will need to file is the Canada Revenue Agency (CRA) Form T1032 — “Joint Election to Split Pension Income”. This form is available on the CRA public website at [www.cra-arc.gc.ca](http://www.cra-arc.gc.ca).

#### **HOW MUCH WILL THE TAX SAVINGS BE?**

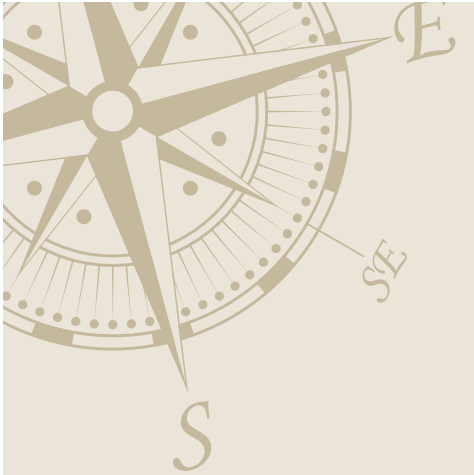
The amount of tax savings will depend on a number of factors including the amount of eligible pension income you receive and the difference between

you and your spouse's marginal tax rates. There is a limit to the amount of income tax that a family can save in any given year as a result of reallocating eligible pension income. Once the lower income spouse's taxable income reaches the level at which the highest marginal tax rate applies, no further tax savings will result from additional income splitting strategies. This includes pension income splitting. You should also be aware that pension income splitting may impact certain government benefits and tax credits such as OAS. The appendix at the end of this article provides some examples.

#### **SPOUSES WHO ALREADY HAVE SIMILAR AMOUNTS OF INCOME**

There are a few instances where you may still be able to benefit from reallocating pension income even if you and your spouse have similar amounts of income. Some of the reasons why you would want to reallocate eligible pension income are as follows:

**Reallocating eligible pension income to enable both spouses to receive the pension income tax credit:** If you are currently receiving eligible pension income but your spouse is not, you may wish to allocate \$2,000 of your pension income to your spouse. This will allow you and your spouse to claim the pension tax credit. This credit is typically worth between \$350 and \$440



If the spouse receiving the eligible pension income is **at least 65** during the tax year, they will be able to claim the pension income tax credit on any type of pension income allocated to them by the primary recipient.

per year depending on your province or territory of residence.

While the age of the recipient spouse does not matter when pension income splitting, the spouse’s age is relevant in determining whether they qualify for the pension income tax credit. If the spouse receiving the eligible pension income is **at least 65** during the tax year, they will be able to claim the pension income tax credit on any type of pension income allocated to them by the primary recipient. If the spouse receiving the eligible pension income is **less than 65** during the entire tax year, they will only be able to claim the

pension income tax credit on income that is eligible for income tax splitting where the individual is under age 65.

**Reallocating income to reduce or eliminate the clawback of OAS benefits:** If you are receiving OAS benefits, you will be subject to a 15 cent OAS clawback for every dollar your net income exceeds the OAS clawback threshold. The pension income splitting rules provide an opportunity to reallocate eligible pension income from one spouse to another. By reallocating and reducing your taxable income, you can reduce or eliminate the impact of the OAS clawback.

	Net income and taxable income	Marginal tax rate excluding the effect of OAS clawback
James	\$75,000	33.0 %
Mary	\$65,000	31.2 %

When reallocating your eligible pension income to increase cash flow, you should ensure that both you and your spouse continue to be in the same tax bracket so that you do not increase your overall family tax bill.

For example, consider James and Mary, a couple living in Ontario. James is receiving a company pension while Mary's primary source of retirement income is through investment income. The amount of pension James is receiving is sufficient to enable the couple to equalize their incomes under the pension income splitting rules.

Also, assume that James is currently receiving OAS benefits. Some of his OAS benefits will be subject to clawback since his net income exceeds the OAS clawback threshold for the year.

While the **income tax savings** for the couple will be nominal (under \$100), the reallocation of \$5,000 under the pension income splitting rules will also result in a **reduction of OAS clawback** and, therefore, additional savings of \$660 (or about \$454 after tax).

**Reallocating income to manage your cash flow:** If you and your spouse are in the same income tax bracket, you may not generate any tax savings by reallocating your pension income. However, pension income splitting may provide additional cash flow if you can reduce either you or your spouse's tax payments. For example, one spouse may have to pay taxes at year end while the other spouse is entitled to a tax refund. Since you must pay your

taxes before the tax return filing due date, you lose access to the funds until you or your spouse receives their tax refund. You may consider reallocating your pension income, which will have the effect of reducing the amount of taxes you must pay (as well as reducing the tax refund that is due to you) and free up some cash.

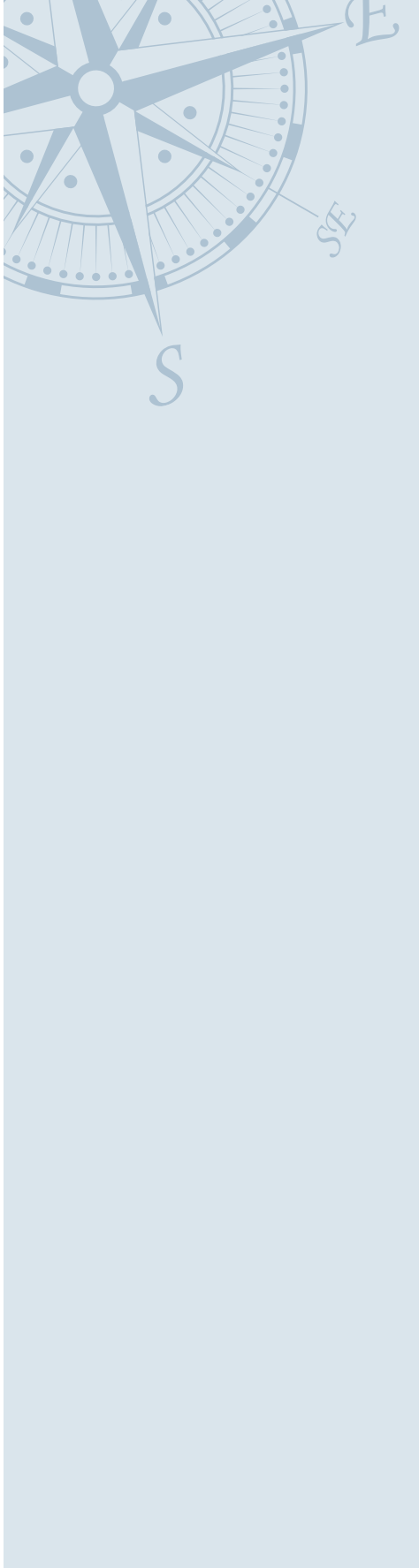
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## SUMMARY

The pension income splitting rules affect both the retirement savings and retirement income planning strategies of many Canadians. In many cases, the opportunity to reduce your family's tax bill during retirement may be significant.

For the most part, you will calculate your tax savings at the time you prepare your income tax return. After you determine you and your spouse's total income, you can determine if and how you should split your eligible pension income.

If you need funds to cover a shortfall during the year, you may need to



decide from which plan to withdraw funds and how much to withdraw. Everyone's circumstances will be different. Whatever your situation is, it will be important to discuss your needs with your RBC advisor and together, with input from your own professional tax advisor, make the best decision possible for you and your family.

## Appendix: Tax Savings — A Few Numerical Examples

The following provides an illustration of how much tax a couple residing in Ontario during the 2014 tax year may be able to save as a result of applying the pension income splitting rules.

The following examples only take into account the basic personal tax credit. Reallocating income may affect other personal tax credits, deductions or government benefit payments which are not shown in these examples.

The potential savings resulting from a reduction of the clawback of Old Age Security (OAS) benefits and the ability to claim certain tax credits can be significant. This is discussed in greater detail in the article.

In the following three examples, the spouse with the higher income, James, has a sufficient amount of eligible pension income to be able to reallocate the amount to Mary, the lower income spouse, needed to equalize the couple's taxable incomes.

		Taxable Income		Tax Payable		Tax Savings
		Before	After	Before	After	
Example #1	James	\$76,000	\$50,000	\$16,891	\$8,694	\$8,197
	Mary	\$24,000	\$50,000	\$2,653	\$8,694	-\$6,041
	<b>Total:</b>	<b>\$100,000</b>	<b>\$100,000</b>	<b>\$19,544</b>	<b>\$17,388</b>	<b>\$2,156</b>
Example #2	James	\$90,000	\$50,000	\$22,099	\$8,694	\$13,405
	Mary	\$10,000	\$50,000	\$17	\$8,694	-\$8,677
	<b>Total:</b>	<b>\$100,000</b>	<b>\$100,000</b>	<b>\$22,116</b>	<b>\$17,388</b>	<b>\$4,728</b>
Example #3	James	\$200,000	\$100,000	\$72,542	\$26,440	\$46,102
	Mary	\$0	\$100,000	\$0	\$26,440	-\$26,440
	<b>Total:</b>	<b>\$200,000</b>	<b>\$200,000</b>	<b>\$72,542</b>	<b>\$52,880</b>	<b>\$19,662</b>

Note that there is a limit to the amount of income tax that a family can save in any given year as a result of reallocating eligible pension income. Once the lower income spouse's, in this case, Mary's taxable income reaches the level at which the highest marginal tax rate applies, no further tax savings will result from additional income splitting strategies. This includes pension income splitting.

Also, note that the *Income Tax Act* limits the amount of income that you may receive directly from a registered pension plan. In Example #3, the eligible pension income of James consists of income from sources other than a registered pension plan, such as a RRIF or an eligible annuity.

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

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