Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Pension income tax credit

Potential tax credit on $2,000 of your pension income

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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 a maximum federal annual tax savings of $300. The amount of additional provincial/territorial tax savings varies depending on where you reside. This article addresses the type of pension income that qualifies for the tax credit and what to consider if you would like to structure your retirement holdings to take advantage of this credit.

Any reference to a spouse in this article also includes a common-law partner.

What is the pension income tax credit?

If you receive income from sources such as an employer pension plan, certain annuities or a registered retirement income fund (RRIF), you may be able to claim a tax credit on 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, which means you only benefit from 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. Any unused amount cannot be carried forward or back to other tax years.

What types of income qualifies for the credit?

65 years of age or over during the year

If you are 65 years of age or over at any point during the year, you can claim the pension income tax credit if you receive the following types of income:

1. Life annuity payments from a superannuation or employer pension plan (including the Saskatchewan Pension Plan);
2. Certain life annuity payments from a retirement compensation arrangement (RCA);

3. Annuity payments from a registered retirement savings plan (RRSP), which is an old insurance product no longer available;
4. Payments from a pooled registered pension plan (PRPP);
5. Payments from a RRIF, LIF, RLIF, LRIF or prescribed RRIF;
6. Annuity payments from a deferred profit sharing plan (DPSP);
7. Payments (including the income portion) from a regular annuity or an income averaging annuity contract;
8. Payments from certain foreign pension plans (including the taxable portion of the U.S. Social Security); or
9. Elected split pension income reported on your tax return.

Under 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. Life annuity payments from a superannuation or employer pension plan (including the Saskatchewan Pension Plan);
2. Payments described in points 3 to 7 in the previous section you received as a consequence of the death of your spouse;
3. Payments from certain foreign pension plans (including the taxable portion of the U.S. Social Security); or
4. Elected split pension income reported on your tax return that your spouse received from a life annuity payment from a superannuation or employer pension plan.*

* 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 over.

What types of income does not qualify for the credit?

The following are some types of income you may receive at retirement that do not qualify as eligible pension income for the purposes of the pension income tax credit:

- Old age security (OAS) benefits;
- Canada Pension Plan (CPP) benefits;
- Quebec Pension Plan (QPP) 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;
- RCA withdrawals other than certain life annuity payments;

> If you're in the lowest federal marginal tax bracket, you can essentially receive the first $2,000 of eligible pension income tax-free for federal tax purposes.

- 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 do you save with this credit?

If you're in the lowest federal marginal tax bracket, you can essentially receive the first $2,000 of eligible pension income tax-free for federal tax purposes. This is because the federal tax credit and the lowest federal marginal tax rate on personal income are both 15%. If you're in a higher tax bracket, you will pay tax on the first $2,000 of eligible pension income, but at a reduced rate.

The pension income amount that is eligible for the provincial/territorial tax credit varies by jurisdiction. The rate that is used to calculate the tax credit also varies by jurisdiction. The rate mirrors the tax rate of the lowest marginal tax bracket. Therefore, the actual tax benefit of the pension income tax credit differs across all provinces/territories. For example, the maximum pension income amount in British Columbia is $1,000 with the tax credit at a rate of 5.06%, while the maximum pension income amount in Ontario is $1,491 with the tax credit at a rate of 5.05%.

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

Federal marginal tax rate	15%	20.5%	26%	29%	33%
Eligible pension income	$2,000	$2,000	$2,000	$2,000	$2,000
Federal tax before credit ($2,000 x respective tax rate) (A)	$300	$410	$520	$580	$660
Pension tax credit ($2,000 x 15%) (B)	$300	$300	$300	$300	$300
Net federal tax (A)-(B)	0	$110	$220	$280	$360

Should you structure your retirement holdings to qualify for the credit?

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

- 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;
- Depending on your province/territory of residence, it may be the case that you will owe provincial/territorial taxes since the provincial/territorial pension income tax credit amount may be less than the federal amount of $2,000; and
- 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 potential benefit 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.

If you're between the ages of 65 and 71 with no pension income, you might want to consider converting a portion or all of your RRSP funds to a RRIF and drawing $2,000 per year from the RRIF, subject to RRIF minimum payment requirements.

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.

This article may contain several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance 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, legal and/or insurance advisor before acting on any of the information in this article.