Wealth Management


INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

Daniel Kelly, MBA, CIM, FCSI
Senior Portfolio Manager
Tel: 519-675-2528
daniel.kelly@rbc.com

Gary Gorham
Senior Associate Advisor
Tel: 519-661-2510
gary.gorham@rbc.com
Kelly-Gorham Private Wealth
Kelly-Gorham Private Wealth
Chris Alexander
Associate Investment Advisor
Tel: 519-675-2667
chris.alexander@rbc.com

Lauralee Bushan-Jazey, CIM, FCSI
Associate Wealth
& Investment Advisor
Tel: 519-661-2557
lauralee.bushan-jazey@rbc.com

Jessi da Silva-Couto
Associate
Tel: 519-675-2664
Kelly-Gorham Private Wealth
jessi.dasilva-couto@rbc.com

Kelly-Gorham Private Wealth
of RBC Dominion Securities
148 Fullarton St - Suite 1900
London, ON   N6A 5P3
Tel: 519-675-2000 | Fax: 519-675-2020
Toll free: 1 800-265-5911 ext.2528
www.danielfkelly.com

# Pension income splitting

**Many Canadian families may be able to reduce their total tax bill by having a higher income spouse allocate certain types of retirement income to a spouse who's taxed at a lower rate. This article summarizes these rules, as well as some of the key opportunities that you and your spouse may want to consider as part of your overall retirement income plan.**

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

## 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 to the other spouse. In order to lower your family's 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 who 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 may result in a tax refund.

### Who may 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's eligible depends on the age of the person who's the ***primary*** *recipient* of the income. While the age of the spouse who's being allocated the eligible pension income isn't relevant for the purposes of these rules, the spouse's age may be relevant for determining whether they qualify for a non-refundable pension tax credit (which is discussed later).

In most cases, if you're under age 65 during the entire tax year, you'll only be able to split the payments you directly receive from a registered pension plan or a Saskatchewan Pension Plan (SPP). If you're 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 age 65 or over during the year:**

1. A life annuity payment from a superannuation or pension plan (including the Saskatchewan Pension Plan).
2. In certain cases, a life annuity payment from a Retirement Compensation Arrangement (RCA)^.
3. An annuity payment from a Registered Retirement Savings Plan (RRSP), which is an old insurance product that is 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 U.S. Social Security).

**For primary recipients who are under age 65 during the year:**

1. A life annuity payment from a superannuation or pension plan (including the Saskatchewan Pension Plan)*.
2. A payment described in 3 to 7 from the previous list you receive as a consequence of the death of your spouse.
3. A payment from certain foreign pension plans (including U.S. Social Security).

^The ability to split RCA income is subject to certain conditions and limits. Please ask your RBC advisor for a copy of our article on "Retirement Compensation Arrangements" for more information.

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

> You and your spouse must file a joint election form together with your income tax returns in order to split your pension income.

### Income that doesn't qualify

The types of income that don't 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 not taxable in Canada;
- Income from a U.S. Individual Retirement Account (IRA); and
- Amounts received from a salary deferral arrangement.

## The election to split pension income

If pension income splitting is an appropriate strategy, both you and your spouse need to complete the proper election in order to split eligible pension income. There's 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. Also keep in mind that you don't 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 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 website.

In situations where an individual passes away during the tax year, they may still be able to split their pension income. The amount that can be split is pro-rated for the months they were alive, up to and including the month of death. For example, if the deceased had $20,000 of eligible pension income and passed away in June, they'd be eligible to split 50% of $20,000 multiplied by 6 out of 12 (6/12) months, or $5,000. The pension income splitting form must be filed with the deceased's final return in order to split the deceased's pension income.

## 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 or your spouse receive and the difference between you and your spouse's marginal tax rates.

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 numerical examples of what the potential savings can be.

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 is the same as the higher-income spouse's taxable income, there will generally be no further tax savings from allocating more income from the higher income spouse to the lower income spouse. For example, you may only need to allocate 20% of the higher income spouse's pension income to the lower income spouse to equalize their incomes. You do not need to allocate the full 50%. That being said, in some cases it may make sense to reallocate income even if the spouses have similar amounts of income.

## Spouses who already have similar amounts of income

There are a few instances where you may still benefit from reallocating pension income, even if you and your spouse have similar amounts of income. Below are some of the reasons you'd want to reallocate eligible pension income.

### To enable both spouses to receive the pension income tax credit

If you're currently receiving eligible pension income but your spouse is not, you may want to allocate $2,000 of your pension income to your spouse. This will allow you and your spouse to claim the federal pension tax credit. You and your spouse may also be entitled to a provincial/territorial pension income tax credit. The total is typically worth between $350 and $450 per year, depending on your province or territory of residence.

If you're currently receiving eligible pension income but your spouse is not, you may want to allocate $2,000 of your pension income to your spouse.

While the age of the recipient spouse doesn't 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'll 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 younger than 65 during the entire tax year, they'll only be able to claim the pension income tax credit on income that's eligible for income tax splitting where the individual is under age 65.

### To reduce or eliminate the clawback of OAS benefits

If you're receiving OAS benefits, you will be subject to a 15% OAS clawback for every dollar of your net income that 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.

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.

| | Net income and taxable income | Marginal tax rate excluding the effect of OAS clawback |
|---|---|---|
| James | $84,000 | 31.5% |
| Mary | $68,000 | 29.7% |

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, the reallocation of $5,000 under the pension income splitting rules will also result in an ***elimination of OAS clawback*** and, therefore, additional savings.

## 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 your and your spouse's total income, you can determine if and how you should split your eligible pension income.

Keep in mind that everyone's circumstances will be different. Whatever your situation is, it's important to discuss your needs with a qualified tax advisor in order to make the best decision possible for you and your family.

*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.*

Whatever your situation is, it's important to discuss your needs with a qualified tax advisor in order to 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 2019 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 may 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 | $15,769 | $8,060 | $7,709 |
| | Mary | $24,000 | $50,000 | $2,467 | $8,060 | ($5,593) |
| | **Total:** | **$100,000** | **$100,000** | **$18,236** | **$16,120** | **$2,116** |
| Example 2 | James | $90,000 | $50,000 | $20,205 | $8,060 | $12,145 |
| | Mary | $10,000 | $50,000 | $0 | $8,060 | ($8,060) |
| | **Total:** | **$100,000** | **$100,000** | **$20,205** | **$16,120** | **$4,085** |
| Example 3 | James | $200,000 | $100,000 | $69,972 | $24,213 | $45,759 |
| | Mary | $0 | $100,000 | $0 | $24,213 | ($24,213) |
| | **Total:** | **$200,000** | **$200,000** | **$69,972** | **$48,426** | **$21,546** |