

Reduce your taxes using Pension Splitting

Taxation



Many seniors face challenges in planning and managing their retirement income. If you or members of your family receive pension income, the pension splitting income rules may be good news.

Beginning with the 2007 taxation year, Canadian residents who receive income that qualifies for the existing pension income tax credit will be permitted to allocate up to one-half of that income to their resident spouse (or common-law partner).

The amount allocated is deducted when determining the net income of the person who actually received the pension income, and it is included in computing the net income of the spouse or common-law partner. Since, in many cases, this will increase the transferee's tax payable, a joint election must be included in their tax returns for the year in question.

What is Income Splitting?

The term "income splitting" refers to strategies for shifting income from a higher tax bracket family member to a family member in a lower tax bracket. The resulting savings in tax provide a

higher level of after-tax income for the family member with the lower income. Generally, the federal government has a number of "attribution" rules to prevent the tax-advantaged shifting of assets; however, this recent amendment could provide tax relief for seniors, particularly those whose only source of income during retirement is pensions.

What is Eligible Pension Income?

Under the new rules, eligible pension income generally includes the following amounts received by the pensioner in the year (these amounts also qualify for the pension income tax credit):

- Annuity payments from a superannuation or pension fund or plan; and If received as a result of the death of a spouse or common-law partner, or if the pensioner is age 65 or older at the end of the year:
- Annuity and Registered Retirement Income Fund (RRIF) (including Life Income Fund) payments; and
- Registered Retirement Savings Plan (RRSP) annuity payments.

How does Pension Income Splitting Work?

Here are a few general highlights of these amendments:

- Married and common-law partners are permitted to pension split provided that they are residents of Canada and living together at the end of the year.



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The rules still apply if a couple is not living together at the end of the year because of medical, educational or business reasons. If the couple is married in the year or one of them dies in the year, pension splitting is only available for the period they were together in the year.

- There is no age restriction for the spouse or common-law partner who receives the income allocation. However, the income received by the individual who is under the age of 65 will not be eligible for the pension income tax credit unless it was pension income or certain RRSP or RRIF payments received as a consequence of the death of a spouse. If the transferee spouse is over age 65, all of the income will be eligible for the pension income tax credit (to a maximum of \$2,000). This means that some couples may receive a second pension income tax credit where previously only one was available.
- For individuals under 65 years of age, the major type of qualifying income that can be allocated to a spouse or common-law partner is income from a pension from a registered pension plan (RPP). RPPs are pension plans for employees sponsored by employers or unions and usually funded through contributions by both employees and employers.
- Some types of income that you consider to be pension income do not qualify for the pension income credit. For example, Old Age Security payments, Canada or Québec Pension Plan payments and payments from certain supplemental retirement compensations arrangements (RCAs) do not qualify.
- While the ability to split income may impact the tax return for the spouse or partner, the individual registered with the pension plan will still receive the pension payments.
- Benefits and tax credits that are calculated based on the total of the net incomes of both spouses (or common-law partners) — such as the GST/HST credit, Canada Child Tax Benefit, and related provincial or territorial benefits — will not change as a result of pension splitting.
- Any tax credits and benefits that are calculated using one individual's net income, such as the age amount, the spouse or common-law partner amount, medical expenses and the repayment of Old Age Security benefits, will be affected. In addition, splitting pension income could mean higher Old Age Security entitlements for some couples.
- Individuals that split pension income with their spouse must also split the income tax withheld at the source in proportion to the split of the pension income.
- The election to pension split is an annual election. The decision to pension split is made each year based on your circumstances for that year.

Tax Instalments

If you are required to pay tax by instalments, the CRA issues instalment reminders indicating the amounts to be paid by each instalment due



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date. However, as an alternative to paying the amounts shown on the reminders, instalment payments can be made based on either the individual's prior-year net tax owing and CPP payable, or his or her estimated current year net tax owing and CPP payable.

If you are eligible for pension splitting, your current year's tax liability may be lower and, therefore, you can reduce your instalments.

Talk to us

The election to split income must be made using a prescribed form accompanying income tax returns for 2007 and following years. The form will be available beginning in January 2008. Be sure to consult with us to determine whether pension splitting could result in tax savings for you and your spouse or senior members of your family. Also discuss the possibility of reducing your tax instalments.