

Pension Income Splitting

In Canada, we have a graduated income tax system, which means that taxpayers who earn more income are subject to progressively higher rates of tax on incremental dollars earned. To minimize the overall tax liability for a couple, spouses may elect to split their pension income by allocating certain pension income from a higher-income spouse to a lower-income spouse.

In this article, the term "spouse" will be used to refer to spouses or common-law partners.

How does it work?

In splitting pension income, you may allocate up to 50% of your "eligible pension income" to your spouse. Eligible pension income generally includes sources of income such as payments under Registered Retirement Income Funds (RRIFs) and lifetime annuity payments under pension plans. A taxpayer who reports eligible pension income may claim a pension income amount as a non-refundable tax credit to reduce tax payable. By splitting eligible pension income with your spouse, you may potentially double the pension credit for the family if your spouse does not otherwise have their own pension.

To be able to split pension income, you and your spouse must make a joint election using the prescribed Form T1032, *Joint Election to Split Pension Income*. When completing your tax return, the transferring spouse will deduct the amount of pension income allocated to the receiving spouse who will in turn include it in income. Any tax withheld at source from the transferring spouse's eligible pension income will also have to be allocated proportionately to the receiving spouse.

Who qualifies for pension income splitting?

Pension income splitting is limited to spouses. For purposes of pension income splitting, spouses are defined as those who are either married or in a common-law partnership at any time in the taxation year and are not, because of a breakdown in the marriage or common-law partnership, living separately and apart from each other at the end of the year and for a period of 90 days or more commencing in the year. In addition, both spouses must be Canadian residents for tax purposes at the end of the year, and at least one spouse must be receiving pension income eligible for the pension income amount.

What income qualifies for pension income splitting?

Pension income that qualifies for pension income splitting generally includes:

- The taxable portion of a life annuity that derived from a superannuation or pension fund or plan
- If either the transferring spouse is at least 65 years old at the end of the year, or if the amount is received as a result of the death of a spouse:
 - A payment out of a RRIF / Life Income Fund (LIF) / Locked-in Retirement Income Fund (LRIF) / Prescribed Registered Retirement Income Fund (PPRIF)
 - Registered Retirement Savings Plan (RRSP) annuity payments

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- Certain payments out of or under a Retirement Compensation Arrangement (RCA)

The following are not eligible for pension income splitting:

- Old Age Security (OAS) payments
- Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) payments
- Guaranteed Income Supplement (GIS) payments
- Withdrawals made from an RRSP (other than annuity payments)

You should note that if you meet certain criteria under the CPP or QPP legislation, you may be able to share your CPP and QPP pension with your spouse. These rules are different from the pension income splitting rules described here for income tax purposes.

How will pension income splitting affect the pension income amount?

If you have allocated eligible pension income to your spouse, the pension income amount you may claim on your tax return will be limited to the lesser of (a) \$2,000, and (b) the amount of your eligible pension income after excluding amounts allocated to your spouse. Your spouse will be able to claim as pension income amount the lesser of (a) \$2,000, and (b) the amount of their eligible pension income, which includes the amounts allocated from you.

It is important to note that eligible pension income is defined differently in the *Income Tax Act* (Canada) for a taxpayer who has attained age 65 before the end of the year and for a taxpayer who has not. While a couple may still benefit from pension income splitting when one spouse is under age 65, an amount that qualifies for the pension income amount in your hands will only qualify for the pension income amount in the hands of your spouse if they are age 65 or older.

For example, Logan is 66 years old and receives RRIF income. He may take advantage of the pension income splitting rules to allocate up to 50% of his RRIF income to his spouse Ali, age 63. However, while the income would qualify for the pension income amount in the hands of Logan, it would not qualify as such in the hands of Ali, because Ali is not yet 65 years old. On the other hand, it would qualify if Ali were to receive the RRIF income as a consequence of Logan's death, even if Ali were under age 65.

Planning Opportunities

1. RRSP conversion age

Based on your retirement income needs, you should consider whether it is advantageous to convert your RRSPs to a RRIF or annuity at age 65 rather than waiting until you reach age 71. Under some circumstances, spreading the income inclusion over a longer term may minimize the overall tax liability over the course of your retirement years.

2. Are spousal RRSPs still relevant?

Spousal RRSPs are generally the main income splitting tool for couples who are in different tax brackets pre- and post-retirement. Notwithstanding the rules on pension income splitting, a spousal RRSP may still play an important role in retirement planning in the following situations:

- It may facilitate income splitting prior to age 65 if you do not have a Registered Pension Plan (RPP).

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- You may effectively allocate more than 50% of your retirement income to your spouse.
- RRSP contributions may be made to a spousal RRSP beyond age 71, as long as the contributor has contribution room available and the annuitant spouse has not reached age 71 by the end of the year.

3. OAS clawback

For high-income seniors who are normally subject to the OAS clawback, reducing the amount of income reported on your tax return through pension income splitting may mean that your OAS payments are not clawed back, or clawed back to a lesser degree. However, this must be balanced with the possibility that your spouse being allocated pension income may be subject to the OAS clawback if their increased income exceeds the threshold.

Should you have any additional questions or require more information about pension income splitting, please contact your TD representative.



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