Pension Income Credit

What is the pension income credit and how is it calculated?

The pension income credit is a ***non-refundable tax credit*.** Your pension income amount is the lesser of your eligible pension income or the prescribed amount which, for 2012, is $2,000. The federal tax credit for the pension income amount is the product of the lowest federal tax rate and the pension income amount.

For example, in 2012:

- The federal credit for the pension income amount = 15% x the lesser of eligible pension income or $2,000.

The eligible pension income amount for deduction will vary at the provincial level. For example, in Ontario, the qualified pension income amount is $1,300 for 2012 and the credit is the product of the lowest provincial tax rate and the pension income amount.

For example, in 2012:

- The provincial credit for the pension income amount for an Ontario resident = 5.05% x the lesser of eligible pension income or $1,300.

Therefore, contrary to common belief, the pension income credit is NOT a dollar for dollar deduction. It only reduces tax payable on a prescribed amount of eligible pension income at the federal tax level and on the provincial level.

What is considered as qualified pension income?

The definition of qualified income varies depending on your age.

If you are **65 or older** in the current tax year, qualified pension incomes include the following:

- An annuity payment from a registered pension plan (RPP) or a superannuation plan;
- An annuity payment (but not a lump sum withdrawal) out of a registered retirement savings plan (RSP);
- An income payment out of a registered retirement income fund (RIF);
- An income payment out of a locked-in income fund (LIF) or a locked-in retirement income fund (LRIF)
- An annuity payment out of a deferred profit sharing plan (DPSP);

- Foreign pension that is not deductible under a tax treaty and is reported at line 256 (additional deductions) of the T1 General Tax form; and
- The income from an income-averaging annuity contract (IAAC) and from a non-prescribed annuity.

If you are **under 65** in the current tax year, qualified pension incomes include the following:

- An annuity payment from a registered pension plan (RPP) or a superannuation plan;
- An annuity payment arising from the death of your spouse or common-law spouse (hereinafter collectively referred to as the “Partner”) under a registered retirement savings plan (RSP), a registered retirement income fund (RIF), a deferred profit sharing plan (DPSP) and other foreign government pension plans; and
- The income portion of any annuity payment arising from the death of your Partner.

What is excluded from qualified pension income?

For the purpose of pension income credit calculation, the following incomes are always excluded:

- Canada Pension Plan (CPP), Quebec Pension Plan (QPP), or Saskatchewan Pension Plan (SPP);
- Old Age Security (OAS) pension or any similar payment from a province;
- A payment received out of or under a salary deferral arrangement, a retirement compensation arrangement (RCA), an employee trust, or an employee benefit plan;
- Gross death benefit payable to a Partner or other beneficiary in recognition of the deceased’s service in an office or employment;
- Amount from a foreign pension which is not taxable in Canada due to the tax treaty; and
- Incomes from a United States individual retirement account (IRA).

What are some tax planning strategies using the pension income credit?

- If one Partner is not able to utilize the pension income credit because the tax payable has been reduced to nil by other tax credits or deductions, the Partner can transfer the unused portion of the pension income credit to the other Partner.
- If you are age 65 and over and you do not have any qualified pension income and you only have non-registered assets, you could consider purchasing a non-registered Guaranteed Income Annuity (GIA) from a life insurance company to generate some annuity income. The annuity income will be considered as eligible pension income. However, the income is reported based on the “policy year” rather than “calendar year”, therefore it is important to plan when the purchase should be made.
- If you are age 65 and over you do not need to convert your RSP until age 71 however you can nevertheless transfer some of your RSP money to a RIF in order to take advantage of this pension income credit. You may wish to perform a tax benefit analysis (or consult your advisor to discuss your particular situation) to determine if this strategy makes sense given your current tax situation. Although this strategy will enable you to qualify for the pension income credit, the additional income received could (i) drive you into a higher tax bracket resulting in more taxes payable or (ii) result in an OAS clawback.

- If one Partner has eligible pension income well in excess of $2,000 but the other Partner has none, it may be possible to take advantage of the recently adopted pension income splitting rules so that both Partners will receive the pension income credit.

Note: if the RIF annuitant dies prior to receiving any RIF income, the pension income credit is not available on the deemed receipt of the fair market value of the RIF immediately before death.

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