Pension Income Splitting

As a result of the 2007 Federal Budget, Canadian residents now have the opportunity to split 50% of their pension income with their Canadian resident spouse or common-law partner in order to lessen their tax burden.

In this article, the terms spouse or common law partner collectively will be referred to as the “Partner”.

How does it work?

To split pension income, you can allocate in your income tax return up to 50% of your income that qualifies for the pension income tax credit to your resident Partner.

You and your Partner must make a joint election using prescribed Form T1032, *Joint Election to Split Pension Income*. Since 2007, income tax returns now include a new line for the pensioner to deduct the amount of pension allocated to the Partner and also a new line for the latter to report the pension income allocated to him or her.

The tax withheld at source from the eligible pension income will also have to be allocated from the pensioner to the Partner in the same proportion as the pension income is allocated.

Who qualifies for pension income splitting?

If you receive pension income in the year, you can elect to split your “eligible pension income” with your Partner if you are either married or in a common-law partnership in the year and are not, because of a breakdown in the marriage or common-law partnership, living separate and apart from each other at the end of the year and for a period of no less than 90 days commencing in the year.

To qualify, both the pension recipient and the Partner must be Canadian residents.

What income qualifies for pension splitting?

Eligible pension income is the total of the following amounts, which also qualify for the pension income tax credit:

- Regardless of the recipient’s age, pension income from a registered pension plan (RPP), whether defined benefit (DB) or defined contribution (DC).
- Provided that the recipient is at least 65 years old, or if received as a result of the death of a Partner, income from:
  - a RIF (including a LIF or LRIF).
  - a RSP annuity (i.e. an RSP that has been converted to an annuity).

Note that the following incomes are NOT eligible for income splitting:

- Old Age Security (OAS)
- Guaranteed Income Supplement (GIS)
- Canada Pension Plan / Quebec Pension Plan (CPP/QPP).

Note: existing rules already allow CPP/QPP pensioners to split their CPP/QPP retirement benefit based on the number of years a couple lived together during the period they were required to contribute to CPP/QPP.

- RSP withdrawals (not from an annuity)
- Income from a retirement compensation arrangement (RCA).

How will pension income splitting affect the pension income amount?

By splitting pension income with your Partner, you can potentially double the pension income credit for the household, if both Partners are able to take advantage of the pension income credit. However, note that an amount that qualifies as a pension income amount in your hands does not necessarily qualify for the pension income amount in the hands of your Partner. Whether it does still depends on the eligibility test set out in the section "What income qualifies for pension splitting?".

For example, if Logan is 66 years old and is in receipt of RIF income, he can make use of the new pension income splitting rules to allocate up to half of his RIF income to his Partner Ali (age 63) on their tax return. However, while the income would qualify as a pension income amount in the hands of Logan, it will not qualify as such in the hands of Ali, because Ali is not yet 65 years old.

If you have allocated pension income to your Partner, the pension income amount you can claim in 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 Partner. Your Partner will then be able to claim as pension income amount whatever is the lesser of (a) $2,000, and (b) the amount of his or her eligible pension income, including the amounts allocated from you.

Planning Opportunities

1. RSP conversion age

If you do not have a RPP, you should consider whether it is advantageous to convert your RSPs to RIFs at age 65 rather than waiting till you are 71, to maximize the benefit from pension income splitting.

2. Are spousal RSPs still relevant?

Currently, the spousal RSP is the main income splitting tool for retired couples who are in different tax brackets. Notwithstanding the new rules on pension income splitting, a spousal RSP still has an important role in retirement planning in the following situations:

- Facilitates income splitting prior to age 65 if you do not have an RPP.
- Allocation of more than 50% of your retirement income to your Partner.
- Enables you to make RSP contributions beyond age 71 so long as you have a Partner who is younger than 71 years old.
- Doubling Home Buyers Plan Withdrawals.

3. OAS clawback

For high-income seniors who are normally subject to the OAS clawback, the possibility of being able to split pension income with their lower-income Partner may mean that their OAS payments can be preserved. However, this must be balanced with the possibility that the Partner being allocated pension income may be brought into OAS clawback zone as a result of the allocated pension income.

Revised 04/01/2012