Financial Planning

Pension Income Splitting

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This Valentine's Day, skip the flowers and talk about money instead

If you are a retiree looking for a way to significantly reduce your overall taxes, and you have a partner in a lower income bracket, look no more. Pension splitting is an appealing tax strategy.

Transferring pension income from the higher-earning spouse to one in a lower tax bracket could result in thousands of dollars in tax savings. Pension splitting allows higher-income spouses to lower their payable tax by sharing up to 50% of eligible pension income with a spouse. Eligible pension income is defined as a pension plan or annuity payments. The payments are not actually split between the partners; the transfer in on paper for the purpose of tax calculations.

NOTE: Sharing CPP or QPP is available to spouses receiving these pensions. Eligible pensioners must apply for CPP sharing. This is not the same as pension income splitting, yet a pensioner is able to assign a portion to a spouse or partner through CPP or QPP Sharing.

Eligibility

To qualify for pension splitting in Canada, a retiree must:

- Be married or in a common-law partnership in the tax year. You also must be living together in that tax year for a period of at least 90 days.
- Be a Canadian resident in that filing period, as must the partner.
  - If deceased, have been a resident in Canada on the date of death.
  - If bankrupt, have been a resident in Canada in the tax year.
- Receive qualifying pension income in the year.

What qualifies as eligible pension income?

- For those under age 65, the most common form of eligible income is from a registered company pension plan, whether defined benefit or defined contribution. Individuals who are age 55 or older are eligible to split pension income with their spouses.
- Individuals without a registered pension plan can also take advantage of this tax strategy by converting their Registered Retirement Savings Plans (RRSPs) or deferred profit-sharing plans (DPSPs) into income through a life annuity or a Registered Retirement Income Fund (RRIF). It's important to note, however, that this income doesn't qualify for splitting until after age 65.

What payments are not eligible for pension splitting?

- Canada Pension Plan (CPP) payments
- Québec Pension Plan (QPP) payments
- Old Age Security payments
- Earnings from a United States individual retirement account (IRA)

What are the benefits?

- Reduces the taxpayers' marginal tax rate: By transferring income, you decrease your net income and increase the income of a spouse with a lower income.
- Reduces or eliminates OAS claw-back: If your claw-back reaches the annual limit for the tax year, consider splitting pension income or sharing CPP to reduce your net income level.
- Creates a pension tax credit: Under the Pension Income Tax credit, taxpayers can deduct pension or annuity income of up to $2,000.00. Further savings are possible if both spouses can claim the $2,000.

How do you become eligible?

Both spouses must opt for pension income splitting by completing the T1032 tax form. This form must be completed each year. If both spouses have eligible pension income, only one can allocate funds to a spouse or partner in each tax year. Both must file a tax return that includes the elected split-pension amount.

What if you forgot to split pension income?

No need to worry, you can request a change to a return for a tax year ending in any of the 10 previous calendar years. Complete a Form TD1-Adjustment Request or you can do it online.

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