

New Tax rules allow spouses to split pension income

Individuals who earn income eligible for the pension income tax credit may reduce their overall household tax bill through the new pension income splitting measure introduced by the federal government in October 2006.

Previously, the only pension that couples, including common law partners, were able to split was CPP/QPP payments. However, with this new initiative the types of pension income eligible for income splitting will vary depending on age:

- **For people age 65 and older**, eligible pension income includes payments from a registered pension plan (RPP – a pension from an employer-sponsored defined benefit plan or a defined contribution plan), income from a registered retirement savings plan (RRSP) annuity, a registered retirement income fund (RRIF), a LIF (a locked-in RRIF), or a deferred profit sharing plan (DPSP) annuity.
- **For individuals younger than 65**, eligible pension income includes only payments from a registered pension plan (RPP – defined benefit or defined contribution).
- **Ineligible income includes**, guaranteed income supplement (GIS), old age security (OAS), RRSP withdrawals and income from retirement compensation agreements (RCAs).

Therefore, when it comes time to prepare personal tax returns in April the higher income earning spouse can allocate up to 50% of their eligible pension income to their lower income earning spouse, where it will be taxed at their lower marginal rate.


Example:

Assume in 2007 you earn \$140,000 in taxable income: \$80,000 in investment and other income and \$60,000 in pension income. Assume your spouse earns \$30,000 in income, including \$5,000 in pension income from a spousal RRSP. When preparing your 2007 tax returns, you and your spouse jointly elect to report half of your pension income, or \$30,000, on your spouse's return.

In this case, you would save about \$13,600 in combined federal and provincial income tax while your spouse's tax bill would rise by about \$9,600. Tax savings would be about \$4,000 in total.¹ The actual amount would vary depending on the province.

It is advised however, that a couple use caution when implementing this income splitting strategy as the increase in taxable income of a lower earning spouse may reduce or eliminate the amounts of personal tax credits they can otherwise claim or transfer to you. This would include personal tax credits, such as the spousal credit, the age credit and medical expense credit. Moreover, pension income splitting may also trigger a claw back in Old Age Security benefits.





Lastly, many may question the need for a Spousal RRSP in light of this new tax rule. There is still a need for spousal RRSPs especially for individuals who plan to retire before age 65 when the pension income eligible for income splitting covers only RPPS and payments received upon the death of a spouse.

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