

Pension Income Credit

Do you know how the Federal Pension Income Tax Credit is calculated? Did you know that 'pension income' is calculated differently depending on your age? Do you know what is excluded from 'pension income'? Are you aware of tax planning strategies using the pension income credit?

This article will help you understand the pension income credit!

How is the Pension Income Credit calculated?

The federal pension income credit is calculated using the following formula:

$$16\% * \text{the lessor of your 'pension income' or } \$1,000$$

This means that the maximum pension income credit is \$160 (16% * \$1,000). Any provincial taxes will increase the effect of this credit.

What Qualifies as 'Pension Income'?

The definition of 'pension income' differs depending on your age.

If you were 65 or older in the year: Pension income includes:

- an annuity (not lump sum) payment out of or under a superannuation or pension fund or plan,
- an annuity payment out of a Registered Retirement Savings Plan ("RRSP") or a Deferred Profit Sharing Plan ("DPSP")
- a payment out of or under a Registered Retirement Income Fund ("RRIF")
- the interest element from a prescribed annuity
- accrual income included in respect of non-exempt life insurance policies and non-prescribed annuities.

If you are younger than 65 for the entire year: Pension income includes:

- payments from superannuation or pension plans (provided they are life annuity and not lump sum payments) and
- annuity payments arising from the death of your spouse under a RRSP, RRIF, DPSP and other specified plans.

What is Excluded from ‘Pension Income’?

The following sources of income are always excluded from the definition of ‘pension income’:

- Old Age Security ("OAS") pension or supplement or of any similar payment from a province,
- Canada Pension Plan ("CPP"), Quebec Pension Plan ("QPP") or Saskatchewan Pension Plan ("SPP") payments,
- payments received out of or under a salary deferral arrangement, a retirement compensation arrangement, an
- employee benefit plan or an employee trust and
- death benefits.

Is there any tax planning strategies involving the pension income credit?

To get the maximum pension credit your goal should be to have at least \$1,000 of ‘pension income’ for both you and your spouse.

If your spouse is younger than 69, you may be able to create ‘pension income’. This can be achieved by creating a spousal RRSP and contributing your RRSP contributions to the spousal RRSP. When this income is withdrawn as an annuity payment, the ‘pension income’ created will be eligible for the pension income credit.

Although there are restrictions that may apply, if your spouse has eligible ‘pension income’ but is not able to utilize the pension credit because their tax payable has been reduced to nil by using other tax credits, you should transfer the unused portion of their pension income credit to you.

If you do not have any qualifying pension income, are age 65 or over, and do not want to draw down your registered assets at this time, you could consider purchasing a non-registered Guaranteed Income Annuity ("GIA") (very similar to a GIC) from a life insurance company. The deposit should be enough to produce \$1,000 of interest income and this income will qualify for the pension income credit. Note that the reporting of the income is done on a "policy year" basis rather than "calendar year" so it is important to calculate when to purchase these.

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