

The pension splitting rules that were first announced on October 31, 2006 were enacted on June 22, 2007. The good news is that starting with the 2007 taxation year many couples will enjoy significant tax savings. Couples who do not already have income qualifying for splitting will want to meet with their financial advisors to see if a “source” can be created. There are opportunities here, especially for the age 65+ group.

The rules are really very simple. We will look at who can split income and how this gives rise to potential tax savings. We will then take a closer look at what sources qualify and will also cover the mechanics of the splitting. Finally, we will alert you to some planning that can be done in this area.

Who qualifies?

The legislation contains two important definitions:

1. “Pensioners” can split income. These are individuals resident in Canada on December 31 (or if they died in the year, immediately before their death). They must also receive income that meets the “eligible pension income” definition.
2. “Pension transferee” is the person to whom the pension income is allocated for tax purposes. This individual must also be resident of Canada on December 31 and must at any time in the taxation year be married to or be a common-law partner of the pensioner. (Living separate at the end of the taxation year for a period of at least 90 days will disqualify them as a pension transferee.)

There is no requirement that the “pensioner” be truly retired. They may in fact continue to be employed or to consult. From a practical perspective, most pensioners will be age 65 although it is possible to be a “pensioner” at an earlier age. This is because life annuity benefits from a pension plan generally qualify regardless of age.

There are no age requirements for the person being allocated the income. However, their age determines whether they can claim the Pension Credit for the allocated income.

Pension Splitting - what’s in it for you?

A couple splitting income will realize savings through any or all of the following:

- Potential tax savings where the spouse (or common-law partner) being allocated the income is in a lower tax bracket.
- Reinstatement of Old Age Security (OAS) benefits through a reduction or elimination the clawback (repayment).
- Reinstatement of Age Amount Credit through reduction or elimination of its clawback (reduction).
- Potential for doubling access to the Pension Tax Credit.

What “eligible pension income” qualifies for splitting?

“Eligible pension income” can be split. This represents amounts qualifying for the non-refundable Pension Credit. The table below shows the more common sources.

Some common sources	If Pensioner is age 65 on Dec. 31	If Pensioner is younger than age 65 on Dec. 31
Life annuity payments out of or under a pension plan (generally excluding amounts from certain unfunded plans but including amounts from foreign private and government plans) (Box 16 of T4A slip)	X	X (Note 1)
Annuity payments under a Registered Retirement Savings Plan (RRSP) (Box 16 of T4RSP)	X	Amount must be received as the consequence of the death of the spouse
Annuity purchased from a Registered Retirement Income Fund (RRIF) (Box 16 of T4RSP slip)	X	
Annuity purchased from a Life Income Fund (LIF) (Box 24 of T4A slip)	X	
“Taxable Amounts” from a RRIF/LIF (Box 16 of T4RIF)	X	
Certain instalment and annuity payments under a Deferred Profit Sharing Plan (DPSP) (Box 24 of T4A slip)	X	
The income portion of certain annuities (including prescribed annuities offered by insurers) (Box 24 of T4A slip)	X	
The policy year accrual for non-prescribed annuities offered by insurers (Box 19 of T5 slip)	X	

Note 1: Bridging benefits are also included

Certain types of income do not qualify for splitting, including:

- Pensions or supplements under the OAS
- Payments from most supplemental pension plans (including Salary Deferral Arrangements (SDAs) or Retirement Compensation Arrangements (RCAs), or plans that would have been SDAs or RCAs, had they been funded).

Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) benefits do not qualify for splitting under these rules, but may be shared under a different set of rules.

What are the mechanics of the split?

- The splitting of the income is done on the tax returns, with the actual payment of the full pension continuing to the “pensioner”. (This is very different from what happens when CPP/QPP is shared.)

- Up to 50% of the “eligible pension income” can be reallocated¹. This amount is added to the “pensioner transferee’s” net income and deducted from the “pensioner’s” net income.
- Canada Revenue Agency (CRA) is introducing a new form – *Form T1032 – Joint Election to Split Pension Income*, which both parties will need to complete and file with their tax returns (by April 30th for most taxpayers, but June 15th for couples where one is self-employed.)
- The payor cannot reduce the taxes withheld at source. (CRA has stated that taxes withheld at source must be “reallocated” on a proportional basis as part of the tax filing process.)
- A different election can be made each year, depending upon the taxpayers’ circumstances. (Where both reside in Quebec, a different election will be permitted for Quebec tax purposes.)

¹ Proration rules apply if “pensioner’s” marital status changes in the year or if he or she dies in the year.

Can the Pension Credit really be doubled?

Pensioners can claim this credit on the first \$2,000 of qualifying income. For federal tax purposes, this results in savings of approximately \$300. (For 2007, a 15.5% rate is applied to the qualifying income. On \$2,000 this works out to \$310.)

Additional savings are available at the provincial level. (The provinces determine the tax rate as well as the amount of the qualifying income that is to be used to calculate the credit. Currently, only Yukon uses \$2,000 for calculating its credit.)

Let's assume that Susan is age 66 and receives \$4,500 from a RRIF. Her husband Robert is age 68 and currently does not have a source qualifying for the pension credit. She only needs to have \$2,000 of qualifying income to maximize her claim. As a couple they will be able to double their access to the pension credit where she allocates \$2,000 to Robert.

Of course, if Robert were only age 64, this would not happen. What the new rules provide is that the person being allocated the income will only be able to claim the pension credit if the amount would have qualified had they been paid the amount directly. Robert at age 64 would not be able to claim the pension credit for taxable amounts paid from his own RRIF. Thus, an allocation of this income to him will not result in this couple's being able to double their access to the pension credit.

Are there some other things that need to be considered?

Many taxpayers are required to make quarterly tax instalments. Taxpayers will need to speak to their financial advisors or tax accountants in order to determine how pension splitting affects their instalment obligations. Take care here since late or underpaid instalments are subject to interest charges.

What if there isn't any qualifying income or the amount is minimal?

Taxpayers will want flexibility when it comes to making the election at tax filing time. As a general rule, taxpayers will want to maximize the income qualifying for the split.

Insurers offer many products that can be used for this purpose. Remember that insured products also offer the potential for probate fee savings and creditor proofing.

Taxpayers who do not have a source qualifying for pension splitting (or who want to increase the amount qualifying for splitting) will want to consider the following:

- RRIFs, LIFs, prescribed RRIF and LRIF income
- Registered annuities (both term certain and life annuities)
- Prescribed annuities (both term certain and life annuities)
- Non-prescribed annuities (including our Performance Annuity)
- Guaranteed Term Fund Policies

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