

Pension income splitting (April 2011)

Unlike contributing to an RRSP or a tax-free savings account (TFSA), the idea of splitting pension income as a tax-planning strategy doesn't get a lot of attention in the media. That's unfortunate for a couple of reasons. First, the splitting of pension income can provide significant tax savings to those able to utilize it—generally older taxpayers who in many cases are living on a fixed income and can really benefit from the tax savings received—especially in the current low interest rate environment. Second, unless you're getting good tax-planning advice, it's very easy to overlook pension income splitting as a way of reducing your tax burden. The only references to pension income splitting on the annual return are two entries, one on line 116 and the other on line 210 and, unless you are already aware of the significance of those entries, there's really nothing to alert you to it. The Income Tax and Benefit Guide provides very little in the way of explanation and no indication at all of the benefits which may be obtained. In addition, the form which must be filed to effect a pension income splitting strategy isn't part of the standard tax return package provided to taxpayers by the Canada Revenue Agency (CRA)—taxpayers must ask for it and obtain it separately.

The general rule is that taxpayers receiving private pension income (including a pension received from former employer and, where the recipient taxpayer is over the age of 65, payments from a registered retirement savings plan or a registered retirement income fund) are entitled to split up to half that income with a spouse for tax purposes. (Government source pension income, like payments from the Canada Pension Plan or Old Age Security payments do not qualify for pension income splitting.) A number of the provinces have also indicated that they will adopt the federal rules for provincial tax purposes.

While the concept and general rules governing pension income splitting aren't particularly complex, the splitting of pension income has some fairly wide-ranging, beneficial tax consequences for the taxpayer and his or her spouse.

The mechanics of pension income splitting are relatively simple. There is no need to make any change in the actual payment or receipt of qualifying pension amounts, and no need to notify the pension plan administrator. In addition, the decision of whether and to what extent to split pension income for tax purposes does not have to be made until the return for the year is being completed. Taxpayers who wish to split eligible pension income received by either of them must each file Form T1032, *Joint Election to Split Pension Income*, with their annual tax return, and the form is available on the CRA Web site at <http://www.cra-arc.gc.ca/E/pbg/tf/t1032/t1032-10e.pdf>.

On the T1032, the taxpayer receiving the private pension income and the spouse with whom that income is to be split must make a joint election to be filed with their respective tax returns for the particular tax year. Since the splitting of pension income affects both the income and the tax liability of both spouses, the election must be made and the form filed by both spouses—an election filed by only one spouse or the other won't do.

In addition to filing the T1032, the spouse who actually receives the pension income must deduct from income the pension income amount allocated to his or her spouse, on line 210 of his or her

return for the year. And, conversely, the spouse to whom the pension income is being allocated is required to add that amount to his or her income on the return, this time on line 116.

As well as reporting the pension income “received” and claiming the corresponding deduction on lines 116 and 210, there’s a requirement that, where tax has been withheld from the income to be split, that tax must be allocated on the return for the year in the same proportion as the pension income is allocated. The formula for doing so is outlined in Part 5 of Form 1213.

Finally, taxpayers receiving private pension income can claim a non-refundable federal tax credit of up to \$2,000 on their returns for the year. The actual credit claimable is equal to the amount of qualifying pension income earned or \$2,000, whichever is less. The CRA has confirmed that where pension income is split, the amount of such income reported for tax purposes by each spouse will be used to determine eligibility for and the amount of any pension income credit. For example, where a taxpayer who receives \$10,000 in eligible pension income for the year allocates 50% of that amount, or \$5,000, to a spouse, each spouse will be able to claim the full \$2,000 pension tax credit on his or her return for the year the income is reported, thereby saving an additional \$300 in federal income taxes.

The ability to split pension income between spouses has the potential to achieve real and permanent tax savings and to enhance eligibility for certain federal tax credits and benefits. And, as long as the administrative requirements outlined above are followed, pension income splitting is a win-win strategy for eligible taxpayers.