Tax, Retirement & Estate Planning Services

TAX MANAGED STRATEGY #15

Opportunities for pension income splitting

Spouses[1] are allowed to split qualified retirement income with their spouse. This can result in a reduction of family taxes and can also minimize the impact on income-tested tax credits and benefits. If you have a spouse who is in a lower tax bracket, you and your spouse are able to elect to have up to 50 per cent of eligible income transferred to the lower income spouse. Eligible income is defined as income eligible for the pension income credit.

What types of income are eligible?

Under age 65, only income received directly from a pension plan or received from other registered plans or an annuity because of the death of your spouse qualifies for pension income splitting. Income from other registered plans such as Registered Retirement Income Funds (RRIFs), annuities purchased with your Registered Retirement Savings Plan (RRSP) and Deferred Profit Sharing Plans are only eligible for splitting if you are age 65 or older. Government plans such as Canada/Quebec Pension Plan (CPP/QPP) and Old Age Security (OAS) do not qualify under the federal pension income splitting rules. Generally, income from non-registered investments will also not qualify. One exception is when the income is received from an annuity, including a Guaranteed Interest Contract (GIC) provided by an insurance company. A GIC from a life insurance company reports the interest accrued as annuity income which qualifies for the pension income credit at age 65. The interest element of a non-registered annuity contract (prescribed & non-prescribed) also qualifies for those age 65 or older.

See Tax Managed Strategy #14: The Pension Income Tax Credit Using an Insurance Company GIC (MK2071E) for more information on the pension income credit and insurance company GICs.

[1] Includes a spouse or common-law partner as defined by the Income Tax Act (Canada).

Income Splitting Options

Eligible income

You can split up to 50 per cent of eligible income, described above, with a spouse. Because of income tested benefits such as age credits, medical expenses and clawbacks on OAS, the optimum transfer may be less than 50 per cent. The examples below demonstrate that some analysis will be necessary each year to determine the optimal amount to split with your spouse in order to maximize the reduction in taxes and minimize the impact on income tested tax credits and benefits.

Canada/Quebec Pension Plans

Although not part of the Federal initiative with respect to pension income splitting, these government plans already allow spouses who are at least 60 years of age to share up to 50 per cent of the benefits earned while you were living together.

Spousal RRSPs

Contributing to a spousal RRSP can also result in tax savings. Under the pension income splitting rules, eligible income can only be split at age 65 or older. However, spousal RRSPs provide income splitting at any age and are not restricted to 50 per cent. Also, if your spouse is younger, the income can be delayed until the year after your spouse reaches age 71.

Following are two examples taking into account tax credits for the basic personal exemption, age credit and pension income credit, where applicable.

Example 1:

Both spouses are age 65 or older. The maximum benefit occurs by splitting just enough income to fully utilize the lower tax brackets and avoid an OAS clawback for Spouse 2.

	NO SPLITTING ($)		WITH SPLITTING ($)		
	SPOUSE 1	SPOUSE 2	SPOUSE 1	SPOUSE 2	DIFFERENCE ($)
Company pension	90,000		45,000	45,000	
RRIF/Spousal RRIF	22,000	12,000	12,190	21,810	
CPP	13,370		13,370		
OAS	6,942	6,942	6,942	6,942	
Gross Income	132,312	18,942	77,502	73,752	
Tax[2]	(33,419)	(1,475)	(15,533)	(14,634)	
OAS Clawback	(6,942)		(562)		
Age Credit[3]		1,315	160	244	
Net Taxes Owing	(40,361)	(160)	(15,935)	(14,390)	Decrease 10,196
After Tax Income	**91,951**	**18,783**	**61,567**	**59,363**	**Increase 10,196**

For illustration purposes only.

Example 2:

Spouse 1 is 65 or older and spouse 2 is between age 60 and 65. A full 50 per cent split can maximize the tax benefits since no OAS clawbacks or age credits apply to spouse 2 and can eliminate the OAS clawback for spouse 1.

	NO SPLITTING ($)		WITH SPLITTING ($)		
	SPOUSE 1	SPOUSE 2	SPOUSE 1	SPOUSE 2	DIFFERENCE ($)
Company pension	90,000		45,000	45,000[4]	
RRIF/Spousal RRIF	22,000	12,000	11,000	23,000	
CPP	13,370		6,685	6,685	
OAS	6,942		6,942		
Gross Income	132,312	12,000	69,627	74,685	
Tax[2]	(33,419)	(145)	(13,470)	(14,897)	
OAS Clawback	(6,942)				
Age Credit[3]			337		
Net Taxes Owing	(40,361)	(145)	(13,133)	(14,897)	Decrease 12,477
After Tax Income	**91,951**	**11,855**	**56,494**	**59,788**	**Increase 12,477**

For illustration purposes only.

[2] Taxes owing are calculated using graduated rates for the province of British Columbia taking into account the Basic Personal Exemption and the Pension Income Credit ($351) if applicable. Generally others will also apply.

[3] The Age Credit is $1,315 less clawbacks.

[4] Even though under age 65, Spouse 2 now has a Pension Income Credit on the transferred Company pension income.

Ideal Candidates

- Those age 65 or who are currently receiving income directly from a pension plan
- Those who have a spouse in a lower tax bracket

Take Action

- Identify the income eligible for splitting
- Determine, with your tax preparer, the amount to be taxable to your spouse
- Make an election on your tax return

INVESTMENT OPTIONS AVAILABLE THROUGH MANULIFE

Mutual funds from Manulife Investments can help meet your specific financial needs, throughout your life. Whether you are just starting out, accumulating wealth or are nearing/in retirement, mutual funds offered by Manulife Investments, can provide you with solutions to help build a portfolio that meets your needs. Manulife utilizes four principal asset management firms to oversee its extensive fund family. Each firm is recognized for its strength and depth of experience in various asset classes and investment styles. Manulife is committed to providing superior investment products and services so you can enjoy life and worry less.

Manulife Segregated Fund Contracts combine the growth potential offered by a broad range of investment funds, with the unique wealth protection features of an insurance contract. Through Manulife segregated fund contracts, investors can help minimize their exposure to risk through income, death and maturity guarantees, potential creditor protection features, and estate planning benefits – all from a single product or insurance contract.

The Manulife Investments Guaranteed Interest Contract (GIC) offers competitive rates plus investment options that include Basic, Escalating Rate and Laddered GIC Accounts. Investors benefit from a guarantee on their principal investment and from several different investment options that can diversify and add flexibility to their portfolio.

Manulife Investments GIC can be an ideal solution for conservative investors looking to help grow their wealth but who are also concerned about minimizing risk.

Manulife Annuities are a popular choice for those who want a guaranteed income stream. In exchange for a single lump sum deposit, Manulife makes guaranteed regular income payments to a client that contain both interest and a return of principal. Annuity payments can continue for a chosen period of time or for the lifetime(s) of one or two people.

For more information about this innovative solution, speak to your advisor, or visit manulife.ca/investments

MK2070E 05/17