



New for 2007 Tax Returns – Pension Splitting

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In completing 2007 tax returns, up to 50% of certain pension income can be “split”, “shifted” or “allocated” from a higher tax bracket spouse to a lower tax bracket spouse.

This results in a couple paying less tax. The tax paid by the lower tax bracket spouse will be less than the tax saved by the higher income tax bracket spouse – therefore, a net tax savings for the couple.

Let’s take a look at a simple example to make this a little clearer. Assume a senior’s income is about \$175,000, including \$50,000 of pension income from a former employer. At \$175,000 of income the senior is in the top tax bracket. (The top 2007 tax bracket in Ontario, 46%, begins at taxable income of \$120,887). Further assume that the senior’s spouse makes \$10,000. At this level of income, the tax rate is 22 percent. (The lowest tax bracket ends at \$37,178.)

	Senior	Senior’s Spouse	Total
Retirement pension <i>without</i> pension splitting	\$50,000	\$-----	\$50,000
Tax rate	46%	-----	
Tax	\$23,000	\$-----	\$23,000

Let’s improve the situation. The senior and the spouse agree to “pension split” when completing their 2007 tax returns. They wish to shift the maximum of \$25,000 (maximum is 50% of \$50,000) from the senior’s tax return to the spouse’s tax return. In other words, rather than \$25,000 being subject to tax at the top tax rate it is being taxed at the lowest rate.

The tables highlight the tax is reduced to \$17,000 from \$23,000 – a \$6,000 saving!

	Senior	Senior’s Spouse	Total
Retirement pension <i>with</i> pension splitting	\$25,000	\$25,000	\$50,000
Tax rate	46%	22%	
Tax	\$11,500	\$5,500	\$17,000

This pension splitting result is optimal when one spouse is in the highest tax bracket and the other spouse is in the lowest tax bracket.

Some additional rewards and cautions

- Reward - The decrease in the higher tax bracket spouse’s income can cause his or her OAS clawback to be reduced or eliminated.
- Caution - The increase in the lower tax bracket spouse’s income can cause him or her to have an OAS clawback or an increase in the current OAS clawback.
- Reward - The lower tax bracket spouse may be able to claim a pension income credit of up to \$2,000 if not able to do so already. The pension income credit can be claimed by an individual on income allocated under the new pension splitting rules subject to the type of pension allocated and the age of the spouse receiving the allocation.
- Caution - As the lower tax bracket spouse will report a higher net income as a result of pension splitting, the age credit available prior to pension splitting can be reduced or eliminated. The age credit decreases in 2007 as income begins to exceed \$30,396.
- Caution - With pension splitting, the lower tax bracket spouse will report a higher net income which can cause the higher tax bracket spouse’s claim for the married or common-law partner tax credit to be reduced or eliminated.
- Reward - If the higher tax bracket spouse makes tax instalments, he or she may be able to reduce them in 2008.
- Caution - The lower tax bracket spouse may need to begin making or increase tax instalments in 2008.

How to pension split

The process is simple! The steps are:

1 The amount to be split is deducted on the tax return of the spouse that actually received the pension – the high tax bracket spouse. There is a new line on the 2007 tax return to enter the amount being deducted in computing the taxable income of the high tax bracket spouse.

2 The amount is added to the income reported on the tax return of the other spouse – the low tax bracket spouse. Again, there is another new line on the 2007 tax return. At this new line the amount being added to the income of the low tax bracket spouse is entered.

3 The tax withheld on the actual pension payments to the high tax bracket spouse is allocated to the low tax bracket spouse on the same basis as the pension income was split. This will remove the cash flow burden of the low tax bracket spouse needing to come up with a significant amount of money on April 30th.

4 Both spouses must agree to pension split and the amount to be split. Form T1032, Joint Election to Split Pension Income, is completed and signed by both spouses. It is an annual election. Spouses can elect to pension split one year and not the next and vice versa.

Unlike CPP splitting, there is no need to contact the payer of the pension income. The pension can continue to be paid to one spouse and the tax information slip (e.g., T4A, T4RIF) issued solely to the actual recipient of the pension (i.e., the high tax bracket spouse). No actual payment needs to be made to the other spouse. In other words, nothing new needs to be done except making a few new notations on tax returns and completing the form T1032 election.

What type of pension income qualifies for pension splitting?

To make use of these new rules the pension recipient (i.e., the high tax bracket spouse) must receive “eligible” pension income. To figure out what is eligible pension income it is easiest first to look at what is “ineligible” pension income for purposes of pension splitting.

“Ineligible” Pension Income for Pension Splitting

- Old Age Security (OAS),
- Canada Pension Plan (CPP), but other rules exist to split or share this type of income,
- non-annuity registered retirement savings plan (RRSP) withdrawals, and
- withdrawals from a retirement compensation agreement (RCA).

“Eligible” Pension Income for Pension Splitting

When the actual pension recipient is 65 or over at the end of a year the pension income eligible for “splitting” includes:

- annuity payments from a registered pension plan (RPP),
- annuity payments from a deferred profit sharing plan (DPSP), and
- registered retirement income fund (RRIF) and life income fund (LIF) withdrawals.

When the actual pension recipient is under 65 at the end of a year, the pension income eligible for “splitting” includes:

- annuity payments from an RPP plus
- amounts noted above under “eligible”, if received by virtue of the death of a spouse.

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