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The nuts and bolts of pension splitting

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The 2007 federal budget that passed into law on June 22 allows pensioners to split 50 per cent of their pension income with their spouse. The benefit is, if you can keep each spouse's personal income close to even, your household will pay less tax in aggregate per year. Let's take a look at some of the specifics.

Only "eligible pension income" qualifies for income splitting. This is defined as pension income from a registered pension plan (RPP), regardless of the recipient's age. Also, if the recipient is at least 65 years old, payments from a retirement income fund (including life income fund), annuities, and retirement savings plans that have been converted to an annuity, qualify. Amounts that do not qualify under the new law include lump sum withdrawals from a retirement savings plan (RSP), Old Age Security (OAS), Guaranteed Income Supplement (GIS), and Canada Pension Plan (CPP) benefits. It should be noted here that under another plan, CPP benefits can be split with your spouse provided both of you are over age 60.

Given these new rules, let's review a few planning opportunities you may want to consider.

First, if you do not have a RPP, you may want to convert your RSPs to retirement income funds (RIFs) at age 65 rather than 71 to benefit from the new pension income splitting opportunity for a longer period of time.

Second, spousal RSPs are still an important tool as they allow income splitting before age 65 and can provide allocations of more than 50 per cent of your retirement income to your spouse. You can also make RSP contributions beyond age 71 as long as you have a spouse younger than 71 years old.

The third planning opportunity relates to OAS clawbacks. By getting income onto your spouse's tax return and off yours, you may be able to lower or stop an OAS clawback if it's being applied.

The benefits of pension income splitting are simple to realize by completing a new form, T1032 -- Joint Election to Split Pension Income -- that will be available in January 2008. On your 2007 income tax return, there will be a new line for pensioners to deduct the amount of pension allocated to the spouse and a new line for the spouse to add this income.

Discuss with your tax or investment adviser any rearranging of your plans to benefit from this new legislation change.

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