Pension income splitting for tax purposes

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Jamie Golombek
Managing Director, Tax and Estate Planning, CIBC Private Wealth

Since the notion of pension splitting was first introduced, the Canada Revenue Agency (CRA) has responded to a number of technical questions on the rules. Here's a brief summary of some of the more interesting ones.

What is pension splitting for tax purposes?

Canadian residents can split up to half of their pension income for tax purposes by allocating an amount to a spouse or partner[1]. The amount allocated is then deducted by the person who received the pension and is taxed in the hands of the spouse or partner on their own personal return. Naturally, both spouses or partners must elect the allocation in writing, which is to be done on an annual basis, as desired. Any pension income that qualifies for the $2,000 federal pension income credit also qualifies to be split. Specifically, this would include annuity-type payments from a pension plan (regardless of age[2]) and can also include RRIF or Life Income Fund (LIF) withdrawals upon reaching age 65. Under the legislation, Old Age Security (OAS) payments and Canada or Quebec Pension Plan (CPP / QPP) payments do not qualify (CPP / QPP can already be split under separate legislation).

Who should do it?

If one partner is in a lower tax bracket, pension splitting is a way to notionally transfer income from the higher earning partner, who pays higher taxes. Other potential benefits include doubling the pension income credit, preserving some (or all) of the age amount and avoiding or even entirely eliminating the recovery tax (clawback) of OAS benefits (which are reduced by 15% once income is over $86,912 in 2023 and are fully recovered once income hits $142,609 ($148,179 for those aged 75 and over) for 2023.

Do I have to contact my pension provider to ask them to split the income?

No. The fact that you will be splitting pension income with a spouse or partner has no effect whatsoever on the actual payment of the pension income to the recipient. Who actually gets the payment doesn't change. The recipient spouse or partner will continue to receive an information slip reporting the pension received, and the pension income for tax purposes would then be split on the tax return.

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1 In this article, spouse refers to someone to whom you are legally married. Partner refers to a common-law partner under the Income Tax Act, which means someone who cohabits with you in a conjugal relationship, provided the two of you have cohabited for the past 12 months or are jointly parents of a child.

2 For Quebec income tax purposes, the ability to split pension income starts only at age 65, regardless of the type of pension income.

Will the attribution rules still apply on split pension income?

Since it's a notional allocation only and not an actual transfer of funds from one spouse or partner to the other, attribution does not apply. For example, even though some of a husband's pension income may be taxed in his wife's hands (through the election), the actual money does not become hers for subsequent investment purposes. However, if the husband actually transfers pension income he receives to his wife, the normal attribution rules still apply for any income that his wife earns upon subsequent investment of that pension income.

Tell me more about the "election" to split pension income.

To be able to split pension income, pensioners and their spouses or partners must make a joint election on their annual tax returns using the CRA form T1032, "Joint Election to Split Pension Income". The income tax return includes a line for the pensioner to deduct the amount of pension allocated to their spouse or partner. Similarly, the spouse or partner reports the allocated pension income as income on another line on their return.

What about the tax withheld — who claims this?

The CRA has stated that any tax withheld at source from the pension income must be allocated in exactly the same proportion as the pension income is allocated, as per the election.

Who claims the $2,000 pension income amount?

Both the recipient and spouse or partner each may potentially claim the $2,000 pension credit. While the recipient of the pension will certainly qualify for the credit (as it's a prerequisite for splitting pension income in the first place), the spouse or partner may not qualify. That's because eligibility for the credit may depend on the age of the recipient and the character of the “pension” income.

For example, say Sharma, age 65, decides to split her RRIF withdrawals with her partner, Lee, who is only 62. While the RRIF income certainly qualifies in Sharma's hands for the pension income credit (and thus permits her to split up to 50% of it with Lee), Lee is not yet 65 years of age and won't be able to claim the $2,000 credit. On the other hand, if Sharma had a defined benefit pension plan instead of a RRIF and began receiving her monthly pension, the income would qualify for the pension credit in both Sharma's and Lee's hands. This example assumes Sharma and Lee live in a province other than Quebec.

Can pension income be split if one spouse or partner dies during the year?

Let’s use an example to illustrate this scenario. Arya received pension income during the taxation year in which her husband, Idris, died. Idris’ executor and Arya would like to split the pension income received by Arya between her and her late husband for tax purposes.

In this case, it is possible to split the income, but the maximum amount that can be split is 50% of the eligible pension income pro-rated by the number of months of the year during which Arya was married to Idris. So, if Idris died in February 203, the maximum amount eligible to be split would be 2/12 of 50% of the eligible pension income (since Idris and Arya were only married in two months of 2023).

The split income must be included in Idris’ final tax return and Idris’ executor and Arya would have to complete and sign form T1032 to elect to split the eligible pension income and file that form with each of Idris’ and Arya’s tax returns for 2023.

How will pension splitting affect income-tested benefits, such as the Goods and Services Tax / Harmonized Sales Tax (GST / HST) Credit, Canada Child Benefit (CCB), and other benefits, such as OAS?

Since allocating pension income to a spouse or partner merely reduces one spouse's or partner's net income while simultaneously increasing the other's net income, benefits and credits that are income-tested based on the combined income of both spouses or partners will not be affected. Such credits include the Goods and Services Tax / Harmonized Sales Tax credit, the Canada Child Benefit and related provincial or territorial benefits. Pension splitting, however, does have the ability to affect other credits and benefits that are solely based on one spouse or partner's net income, such as the age amount, and any OAS recovery. Consequently, transferring pension income from a high-income spouse or partner who is subject to the OAS recovery (with net income over $86,912 in 2023) to a spouse or partner whose income remains below the OAS threshold can provide a way to preserve otherwise recovered benefits.

Jamie Golombek, FCPA, FCA, CFP, CLU, TEP is the Managing Director, Tax & Estate Planning with CIBC Private Wealth in Toronto.

jamie.golombek@cibc.com