

Lifetime Pension at Age 55 vs. Lump Sum Option at age 54/11

Income splitting announced by Federal Government on October 31, 2006

When Finance Minister Flaherty dropped his income trust bombshell on Halloween, he also announced the Federal Government's intention to introduce a couple of Income Tax Act amendments that would benefit pensioners and seniors. One of these - pension income splitting - is the subject of this memo.

Under the proposed income tax amendments, taxpayers would be able to split with their spouses up to 50% of their "eligible pension income" for income tax purposes. Where a taxpayer with "eligible pension income" has a spouse who is in a lower tax bracket, this income splitting can potentially reduce the couple's combined income tax payments significantly.

Under the proposed pension income splitting amendment to the Income Tax Act, "eligible pension income" would include the following:

- For individuals age 65 and older: lifetime pension payments from a registered pension plan (such as the CPR pension plan), a registered retirement income plan (RRSP) and a registered retirement income fund (RRIF).
- For individuals under age 65: lifetime pension payments from a registered pension plan, but NOT RRSP/RRIF payments.

A CPR employee who retires at age 55 would be able to income split up to 50% of his/her CPR pension with his/her spouse starting at his/her retirement date. However, if the employee chooses to terminate employment shortly before age 55 in order to receive a lump sum transfer from the CPR pension plan, he/she would not be able to benefit from the income splitting option until reaching age 65, thereby foregoing potential income tax savings for the next 10 years.

The Fine Print: Lump sum payments from a pension plan are transferred to a locked-in version of an RRSP or RRIF. Although Flaherty's announcement did not mention the locked-in versions of these vehicles, it is expected that these locked-in versions would also be excluded from income splitting whenever RRSPs or RRIFs are excluded (i.e., before age 65).

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