Tax & Estate

Aging and taxation: Retirement income and age-related tax issues

We all know the over-worn adage about the inevitability of death and taxes, but just because we recite it doesn't mean we have to stand idly by and just let it happen. In fact, for those who take the time to understand and manage their income sources as they age, tax burdens may be reduced or at least delayed. For those who take further advantage of options when planning their estate, surviving spouses and other beneficiaries may be delivered a gift of ongoing tax relief all at the expense of the tax collector along the way.

Income in retirement

Registered money

For most of us, our principal income source will be a draw from a registered plan of some sort. The most common types of such registered income plans are

- life annuities from a registered pension plan (RPP),
- annuity payments from a registered retirement savings plan (RRSP) or deferred profit sharing plan (DPSP), or
- payments from a registered retirement income fund (RRIF).

While terms and investment performance will dictate how much income will actually be received, in all cases the income is fully taxable.

Registered money – Handy facts 2019	
RRSP maximum contribution limit	■ $26,500 (or 18% of 2018 net income)
RRIF minimum withdrawal (self or spouse)	■ [1 divided by (90-age)]% under age 71 ■ 5.28% at 71, increasing to 20% at 95+
Money purchase pension plan limit	■ $27,230
Defined benefit pension plan limit	■ $3,025.56 (credit per year of service)

Non-registered savings

The tax treatment of non-registered savings will depend on investment choices and how the Canada Revenue Agency characterizes the income derived from each. Non-registered savings income includes

- fully taxable interest and foreign-dividend income;
- capital gains, 50% of which is taxable as income;
- Canadian dividend income with net tax cost less than capital gains at low tax brackets, equaling or exceeding capital gains at top brackets, but always below fully taxable income levels; and
- non-taxable return of capital or drawdown of capital.

The ability to choose the type of investment return and manage its timing can be a valuable tool for balancing a person's tax bill over time.

Canada Pension Plan/Quebec Pension Plan (CPP/QPP)

The CPP/QPP provides monthly retirement benefits to pensioners based on credits accumulated during their working years.

A pensioner may commence a pension at 65, elect an earlier reduced pension, or delay payments to obtain a higher monthly amount later in life. The monthly penalty for early commencement is 0.6% (7.2% per year) as of 2019, and the monthly deferral premium is 0.7% per month delayed (8.4% per year). Accordingly, an individual beginning at age 60 would receive 64% of the otherwise fully calculated amount or as much as 142%, if deferred until age 70. The amounts can be strategically coordinated with the timing and tax treatment of other income sources.

A disability pension is available for those who have contributed to the CPP and are unable to work due to a qualifying disability. Support may also be available to a surviving spouse of a deceased contributor and for children of a disabled or deceased contributor.

CPP – Handy facts 2019

Maximum retirement pension – annualized	■ $13,854.96, beginning at age 65
Maximum annual pension premiums	■ $2,748.90 (employee portion) ■ $5,497.80 (self-employed)
Maximum death benefit	■ $2,500 (one-time payment)
Maximum disability benefit – annualized	■ $16,347.60

Old Age Security (OAS)/Guaranteed Income Supplement (GIS)

OAS entitlement is based on years of residence in Canada after age 18. It becomes payable upon reaching age 65, but is subject to a 15% clawback for those earning income above a minimum threshold.

There are also a number of non-taxable benefit programs related to OAS, the full details of which are beyond the scope of this article. Some of these include

- GIS for low-income OAS recipients;
- allowance for low-income seniors (age 60 to 64) whose spouse or common-law partner is eligible for, or currently receiving, OAS and GIS; and
- allowance for the survivor – for low-income widowed spouses (age 60 to 64) not yet eligible for OAS.

OAS/GIS – Handy facts 2019

Maximum OAS pension – annualized	■ $7,217.40[1] (second quarter of 2019)
OAS recovery on 15% of net income from	■ $75,910 to $123,386[2] (for period between July 2019 and June 2020 based on 2018 income)
Maximum GIS pension – annualized	■ $10,779.84[1] (second quarter of 2019) single person
Maximum annual income to receive GIS (recovery equals 50% of net income)	■ $18,240[1] (second quarter of 2019) single person

[1] Includes GIS top-up amount and allowances.
[2] Upper threshold effectively indexed quarterly.

Tax credits

Age amount

The age amount may be claimed beginning in the year the person turns 65. The federal credit is determined by applying the lowest-bracket federal tax rate to a prescribed amount. A similar calculation is used to determine respective provincial credits.

There is a 15% repayment or clawback of the federal credit for income over a prescribed threshold that applies until the credit is fully clawed back. Similar clawbacks apply for provincial credits, but the threshold and clawback rates vary.

Both the prescribed amount and the clawback income thresholds are indexed annually.

Age amount – Handy facts 2019

	Credit value	Repayment range
Federal	$1,124	$37,790 – $87,750
AB	$540	$40,179 – $76,159
BC	$242	$35,660 – $67,600
MB	$403	$27,749 – $52,602
NB	$485	$37,311 – $70,725
NL	$523	$32,930 – $72,990
NS	$364[3]	$30,828 – $58,435
ON	$261	$38,463 – $72,903
PE	$369	$28,019 – $53,112
QC	$482	Depends[4]
SK	$514[5]	$36,430 – $69,057

[3] The enhanced supplemental age credit (worth $129) is available for individuals with taxable income under $25,000, and is gradually reduced when taxable income reaches $75,000.

[4] Quebec clawbacks apply to a pool of credits (not for the age amount alone), taking into consideration net family income.

[5] A senior supplement (worth $136) applies to all individuals ages 65 and older.

Pension income splitting is briefly discussed below. For more information on eligible pension income and strategies on splitting pension income with a spouse, please refer to our *Tax & Estate InfoPage* titled *Pension Income Splitting*.

Pension amount

The pension credit is available on eligible pension income received to a prescribed maximum amount. Like the age credit, the amount is multiplied by the respective federal or provincial credit rate. The federal amount is not automatically indexed, although some provinces do index.

For someone 65 or older, common qualifying income types include

- RPP life annuity payment,
- RRSP or DPSP annuity payment,
- RRIF payment, and
- the income component of certain annuities.

For those under age 65 the definition is more restrictive, being limited to

- life annuity from an RPP; or
- RRSP, DPSP or RRIF sources, if the income arises out of the death of a spouse or common-law partner.

Pension amount – Handy facts 2019

	Prescribed amount	Credit value
Federal	$2,000	$300
AB	$1,491	$149
BC	$1,000	$51
MB	$1,000	$108
NB	$1,000	$97
NL	$1,000	$87
NS	$1,173	$103
ON	$1,463	$74
PE	$1,000	$98
QC	$2,853	$428
SK	$1,000	$105

Disability amount, medical expenses

While these credits are not age-specific, it is more likely they can be claimed as a person ages and feels the effect of those accumulated years. For someone recently diagnosed with a qualifying disability that may have persisted from previous years, it may be possible to re-file some recent years' tax returns to obtain retroactive tax relief.

Amounts transferred from a spouse or common-law partner

If a taxpayer has reduced taxable income to zero but still has unused tax credits, those may be transferable to a spouse. Again, this is not necessarily an age-specific issue, but may be more likely to arise for retired couples if, for example, retirement income is earned by one spouse, while the other spouse has disability or medical issues.

Pension income splitting

Pension income splitting has been available since 2007. At tax reporting time, a qualified pensioner can split up to 50% of eligible pension income. The split is effected through a joint election by the two spouses to report the split portion on the spouse's tax return. The election has no effect on the receipt of payments from the pension source during the course of the year.

The qualifying income sources are the same as detailed under the "Pension amount" section above, including the age 65 constraints.

There are four principal benefits:

- **Bracket management** – Shifting income from a high-tax-bracket pensioner to a lower-tax-bracket spouse can reduce net taxes paid. Bear in mind that this will obviously increase the transferee spouse's income, potentially triggering clawbacks or "bracket creep"
- **OAS** – Shifting may reduce income of a pensioner who is in the clawback range
- **Age amount** – Like OAS, the shift reduces income for a pensioner over 65 who is in the clawback range for the age amount, but may also cause a clawback of the receiving spouse's age amount
- **Pension amount** – This would allow the receiving spouse (over age 65) to access or increase the claim for the pension amount

Tax-free savings account (TFSA)

Since 2009, Canadian residents ages 18 and older have been entitled to make use of a TFSA. The simplest way to understand the tax characteristics of the TFSA is to compare it with the commonly known RRSP/RRIF arrangement:

- **RRSP/RRIF**: Pre-tax money goes into the plan, no tax is paid on income earned in the registered account and all assets are fully taxable when withdrawn
- **TFSA**: After-tax money is invested, and no tax is paid within the account. Withdrawals, including gains, are 100% non-taxable coming out

The original allotment of annual contribution room was set at $5,000. If a person does not use the available contribution room in a year, it is carried forward indefinitely. A background indexing formula based on the Consumer Price Index causes the contribution room to increase by $500 increments every few years. The first such increment moved the annual contribution room to $5,500 for 2013 and following years. In the 2015 Federal Budget, the federal government increased the annual TFSA dollar limit to $10,000 and removed the annual indexation methodology. Subsequent changes by the federal government reinstated the annual TFSA dollar limit back to the original $5,000 and restored the indexation methodology. The reinstatement commenced in 2016, meaning for 2015, all eligible individuals have access to the fixed $10,000 in annual TFSA dollar limit. The annual TFSA contribution room for 2019 is $6,000, increased from $5,500 as a result of indexation.

Withdrawals from a TFSA in a year give rise to dollar-for-dollar recovery of contribution room the following year. In this way, the TFSA can be used and reused over a lifetime.

There is no required age when a TFSA must be depleted, making it especially useful for those past age 71, when RRIF minimum payouts force the depletion of those other tax-sheltered funds.

For more information on use of trusts, please refer to our *Tax & Estate InfoPages* titled *Trusts – Legal principles and common uses* and *Trusts – Tax features and strategic management*.

Testamentary trusts

Testamentary trusts can be created for a spouse or any other beneficiary using a Will. In the past, such a trust could be expected to be entitled to graduated tax bracket treatment for the life of the beneficiary. Changes were enacted in the 2014 Federal Budget to significantly restrict this treatment.

Effective January 1, 2016, estates are entitled to graduated bracket treatment for 36 months after the deceased individual's date of death, after which they will be subject to the top personal tax rate in the province. Existing testamentary trusts had a deemed year-end on December 31, 2015 and thereafter are also subject to the top personal tax rate in the province.

Graduated bracket treatment continues to be available for qualified disability trusts, which are testamentary trusts where the beneficiary is entitled to claim the disability tax credit.

For more information on alter ego and joint partner trusts, please refer to our *Tax & Estate InfoPage* titled *Tax planning using alter ego and joint partner trusts*.

Alter ego and joint partner trusts

A person over the age of 65 may settle one of these trusts either for him/herself as sole beneficiary or with both spouses as beneficiaries.

Capital property may be transferred into such a trust on a tax-deferred rollover basis, and all trust income is attributed to the settlor while living. On death, the trust assets would not be included in calculating provincial probate taxes.

With the elimination of graduated bracket treatment for testamentary trusts, this planning strategy may become more popular.

For more information about this topic, contact your advisor, call us at 1.800.874.6275 or visit our website at invesco.ca.

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