Aging and taxation

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 by idly and simply 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 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.

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
- payment 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.

Income in retirement (continued)

Non-registered savings

The tax treatment of non-registered savings will depend on investment choices and the type of income derived from each. Non-registered savings income includes:

- fully taxable interest income;
- fully taxable foreign income;
- capital gains, 50% of which is taxable as income;
- dividend income which has a net tax cost higher than capital gains at the top tax bracket, but can be significantly less at lower income levels; and
- non-taxable return of capital or drawdown of capital.

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

Canada/Quebec Pension Plan

The Canada/Quebec Pension Plan provides monthly retirement benefits to pensioners based on credits accumulated during their working years.

A pensioner may draw his or her full pension entitlement at 65, elect to receive an earlier, reduced base pension or delay payments to obtain a higher monthly amount later in life. Clients who elect to commence their CPP pension as early as age 60 will incur a discount for each month prior to age 65 the pension begins. Conversely, a premium is added for each month the pension is delayed after age 65, but no later than age 70. The amounts can be strategically coordinated with the timing and tax treatment of other income sources.

Old Age Security (OAS)

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.

Interestingly, tax on an OAS pension may be paid monthly, whereas the CRA withholds taxes payable from each pension payment (electable) quarterly, which may be required by law in some circumstances, or annually. (Many people calculate their tax owing when filing their annual tax return.)

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

- Guaranteed Income Supplement (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, which is a payment to low-income widowed spouses (age 60 to 64) who are not yet eligible for OAS.

Handy facts 2011

CPP	Maximum CPP payment	$960.00 monthly
	Maximum pension premiums	$2,217.60 (employee portion)
	Maximum death benefit	$2,500 (one-time payment)
OAS	Monthly maximum	$537.97* (As of July 1, 2011)
	Payback range 15% on net income over	$67,668
	Full OAS payback when net income is on or above	$110,123
Pension income amount (Federal)		$2,000
Age amount (Federal)		
	Maximum claim	$6,537+
	Phase out of credit begins	$32,961
	Age amount credit eliminated	$76,541++

* The maximum amount includes the GIS top-up amount announced in Budget 2011.
\+ The credit is calculated at the lowest marginal tax bracket (15%) for a maximum $981 non-refundable tax credit.
++ The age credit claimable amount is reduced by 15% of the amount of net income in excess of the base threshold of $32,961.

Tax credits

Age amount

A person may claim the age amount beginning in the year he or she turns 65. The federal credit is determined by applying the lowest-bracket federal tax rate to a prescribed amount. Similar calculations are used to determine provincial credits, which, in round terms, range from $200 to $400 in value.

There is a 15% 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.

Pension income amount

This pension credit is determined by applying the lowest-bracket federal tax rate of 15% to the actual eligible pension income received, up to $2,000, resulting in a maximum possible credit of $300. In contrast to the age amount, the prescribed $2,000 amount is not indexed. Once again, similar calculations are used when calculating provincial credits, some of them indexed, with credit values ranging roughly between $50 and $400.

For someone 65 or older, common income types that qualify for this credit include:

- Life annuity from a RPP
- Annuity payment from a RRSP or DPSP
- Payment from a RRIF
- Income component of certain annuities

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

- life annuity from a RPP, or
- income from RRSP, DPSP or RRIF sources described above if the income comes from the death of a spouse or common-law partner.

Disability amount and medical expenses

While these credits are not age-specific, it is more likely they can be claimed as the client ages and feels the effect of his/her accumulated years.

Amounts transferred from your 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 has disability or medical issues.

Pension income-splitting

Announced in the 2007 Federal Budget, pension income-splitting is now a reality. At tax reporting time, a qualified pensioner and his or her spouse can report up to 50% of eligible pension income received on a spousal return.

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
- **OAS**. Shifting reduces income for pensioners who are in the clawback range
- **Age amount**. Like OAS, the shift reduces income for pensioners over 65 who are in the clawback range
- **Pension amount**. Where the spouse does not otherwise have eligible pension income, this tax credit may be accessed

Bear in mind that reducing the pensioner's income will obviously increase the transferee spouse's income, potentially triggering clawbacks or "bracket creep," which could offset the benefits of transferring amounts in the first place.

TFSAs

The 2008 Federal Budget put in place the Tax-Free Savings Account, or TFSA. Since 2009, each person 18 and older has been entitled to use $5,000 of TFSA contribution room, cumulative each year, with that figure indexed upward over time.

The simplest way to understand the tax characteristics of the TFSA is to compare it to 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, no tax is paid within the account and withdrawals are 100% non-taxable coming out

The TFSA could have great value for those past their income-earning years; i.e., who are no longer accumulating RRSP room, especially for those past age 71 when RRIF minimum payouts force the depletion of other tax-sheltered funds.

Testamentary trusts

Testamentary trusts can be created for your spouse or any other beneficiary using your Will. The key tax benefit of this type of trust is that it is a separate taxable entity entitled to graduated tax-bracket treatment. This allows and facilitates income-splitting opportunities between the trust and its beneficiaries, especially wealthy beneficiaries. In effect, you are lending a part of your legal personality to an ongoing trust that may last for years or even decades into the future.

That's one way that you may be gone but not forgotten – at least in a tax sense.

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

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