

Biased Income Splits

COURT REPORT

BY JAMIE GOLOMBEK



One of the most significant tax changes for 2007 was the announcement last fall by the Conservatives to permit pension income splitting.

The rules governing the type of income that can be split mirror the rules for definition of "pension income" in the *Income Tax Act* and, as currently drafted, tend to

discriminate based on both plan type and age.

Specifically, registered pension plan recipients can split their pension income at any age whereas registered retirement savings plan pensioners are forced to wait until age 65 and either annuitize their RRSP or convert it to a registered retirement income fund in order to split their pension income or qualify for the recently doubled \$2,000 pension income credit.

This discrimination has always been the source of resentment by

taxpayers.

There are several cases specifically on this point, but one of the most recent ones was the decision in *Letarte v The Queen* (2005 TCC 420).

In 2004, the tax year in question, André Letarte was 58 years old and reported nearly \$3,000 of pension income on his tax return. He attempted to claim the pension income credit, which was denied by the Canada Revenue Agency on the grounds that it was RRIF income, and since Letarte wasn't yet 65, the RRIF income didn't qualify for the

pension income credit.

Naturally, Letarte objected and explained to the judge that, in fact, the amount came not from an ordinary RRIF but rather from a Life Income Fund or LIF.

As Letarte said: "the Quebec act requires us to transfer [the funds] to a LIF... Since that money came directly and solely from my former employer, it therefore constitutes retirement income... The friends with whom I worked for many years and who elected to leave their pensions with the employer receive a T4A, which gives them a \$1,000 pension income [credit]." Letarte therefore requested that his claim for the pension credit be

allowed.

The judge reviewed multiple definitions of what a LIF was and clearly concluded that a LIF was nothing more than a RRIF, which not only met the requirements of the *Income Tax Act* but also met the provincial locking-in requirements of the various provincial pension plan legislation.

Since Letarte wasn't 65, he could not avail himself of the pension credit on his LIF income. Quoting an earlier case, the judge concluded: "The law is clear that payments out of a RRIF do not entitle recipients under age 65 to the... pension credit. It is true that had the payments come directly from the [company's] pension plan, the credit would be available. Payments under a RRIF are not the same as direct pension payments."

Responding to the age 65 requirement for pension-splitting of RRSP annuity, RRIF and LIF income, the government reiterated that the purpose was to "target the pension income credit to retired individuals." It explained that since individuals have much greater personal control over the timing of withdrawals under RRSPs, RRIFs and LIFs, compared to RPPs, without the age 65 eligibility rule many individuals who are not retired could gain significant tax advantages well before they reach age 65, by arranging to withdraw money each year as RRSP annuity or RRIF income while still saving for retirement. Individuals receiving RPP income are usually only paid out when they are retired.

That being said, one could easily envisage a situation where someone in a defined benefit RPP decides to take "early retirement" at age 55 for the sole purpose of splitting his pension income with a non-working spouse and then starts working with a new employer.

An RRSP contributor could not do likewise as she must wait until 65 to split her income with the result that she is being discriminated against, both on account of her age, in addition to the type of retirement vehicle in which she has participated.

Last month, the Investment Funds Institute of Canada's Tax Working Group sent a submission to the Department of Finance asking for this discrimination to be removed from the final legislation before it is formally introduced in the House of Commons later this year. **AER**

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