

Turning Interest Income into Pension Income

A little planning and our Ideal Term Fund policy works like magic

Halloween 2006 was more than just “trick or treat” for most. The Federal Government introduced the Tax Fairness Plan and it will have a profound impact on the pocketbook of many pensioners beginning with the 2007 taxation year. Most importantly, the Tax Fairness Plan also introduced the concept of pension splitting (also covered in the Federal Budget of March 17, 2007).

Pension Splitting, when it is enacted, will change the way we look at pension income and most particularly, the way we plan for retirement. Pension Splitting is the ability to “allocate” income to a spouse (or common-law partner), with the potential advantage of allowing the spouse (or common-law partner) to also claim the Pension Tax Credit, which will in many cases reduce the overall taxes payable on the family’s income. To see how this can benefit you, consult our document **“How to win under the proposed pension splitting rules”**.

To qualify for Pension Splitting the individual must first receive “eligible pension income”. How do we do this? Care needs to be taken in ensuring that the person has income from an eligible source, taking into account their age at time of receipt, as this has an impact on eligibility. We will cover this topic in greater detail in a separate bulletin.

Interest income, such as that earned on Guaranteed Investment Certificates (GICs), is reported as “Interest from Canadian Sources” in Box 13 of the T5 slip (RL-3, Box D in Quebec), and this is not a qualifying source of income. However, term fund policies are subject to special rules under the Income Tax Act.

Section 12.2 addresses the annual policy accrual rules for annuity policies. Specifically, amounts reported pursuant to that section qualify as “pension income” for taxpayers who are age 65 or older at the end of the year, making them eligible for the Pension Tax Credit, with the spin-off benefit that this income can be split under the proposed legislation. Insurers report this annual policy accrual income as “Accrued Income: Annuities” in Box 19 of the T5 (RL-3, Box J in Quebec). This is how interest income becomes “pension income” once an individual turns age 65¹.

Using a case study we will see how we can turn interest income earned from a typical bond or GIC into pension income.

Meet our clients

- ✓ Mary age 64 and Henry age 72, are retired.
- ✓ No pension income other than Government Benefits (OAS & C/QPP)
- ✓ Henry has \$200,000 in GICs – average interest rate 4.5%. He draws interest annually.

¹ Quebec has proposed that amounts qualifying for the Pension Tax Credit for federal purposes will qualify for Pension Splitting.

Our examples assume an initial premium of \$100,000 deposited into an Ideal Term Fund *Plus* Policy – 5-year term fund at 4.85% for the annual income scenario and 4.60% for the Monthly Income scenario. (Rates at June 11, 2007). To view our current rates, please visit our website at www.standardlife.ca

Payments annually Policy anniversary: June 11 th of each year	Annual Interest Income Payment	Income Reported T5 – Box 13 (Interest Income)	Income Reported T5 – Box 19 (Pension Income)
June 11, 2008	\$4,850	0	\$4,850
June 11, 2009	\$4,850	0	\$4,850
June 11, 2010	\$4,850	0	\$4,850
June 11, 2011	\$4,850	0	\$4,850
June 11, 2012	\$4,850	0	\$4,850

Payments monthly Policy anniversary: June 11 th of each year	Monthly Interest Income Payment	Income Reported T5 – Box 13 (Interest Income)	Income Reported T5 – Box 19 (Pension Income)
July 11, 2007	\$383.33	\$1.46	0
August 11, 2007	\$383.33	\$2.92	0
September 11, 2007	\$383.33	\$4.37	0
October 11, 2007	\$383.33	\$5.82	0
November 11, 2007	\$383.33	\$7.26	0
December 11, 2007	\$383.33	\$8.70	0
2007 – T5 Slip		\$30.53	0.00
January 11, 2008	\$383.33	\$10.13	0
February 11, 2008	\$383.33	\$11.56	0
March 11, 2008	\$383.33	\$12.98	0
April 11, 2008	\$383.33	\$14.39	0
May 11, 2008	\$383.33	\$15.80	0
June 11, 2008	\$383.33	0	\$4,504.61
July 11, 2008	\$383.33	\$1.46	0
August 11, 2008	\$383.33	\$2.92	0
September 11, 2008	\$383.33	\$4.37	0
October 11, 2008	\$383.33	\$5.82	0
November 11, 2008	\$383.33	\$7.26	0
December 11, 2008	\$383.33	\$8.70	0
2008 – T5 slip		\$95.39	\$4,504.61

Also, note that since all or a portion of the interest would become “pension income” for Henry, he can allocate up to 50% of the amount in Box 19 to Mary. She will be able to claim the Pension Tax Credit on this amount in 2008 when she has also attained age 65. Thus, this couple gains double access to the Pension Tax Credit.

Standard Life's Ideal Term Fund policies offer an all-star line-up of features to help you achieve your retirement income goals! Consult the chart below for a short summary.

	Ideal Term Fund Policy	Bank GICs
Guaranteed Interest Income	★	★
Beneficiary Designation	★	
Probate Bypass Opportunity	★	
Potential for Creditor Protection	★	
Potential for Pension Tax Credit Eligibility	★	
Potential for Pension Splitting Opportunities	★	
Deposit Protection*	★	★

Sometimes, the most important thing of all is safety.

If what you're looking for is the confidence that comes with knowing your money is secure, take a look at Standard Life's Ideal Term Funds.

They offer a high-interest alternative to GICs and Canada Savings Bonds as well as safeguard your capital *and* deliver predictable income.

* Deposits are backed by Assuris, the insurance industry's equivalent to CDIC.

Which investor should consider this strategy?

Those who are looking for:

- ✓ A predictable income stream
- ✓ An income stream eligible for the Pension Tax Credit (possibly for both spouses)
- ✓ Opportunities to pension split with their spouse
- ✓ Opportunities to lower their taxable income without increasing their exposure to investment risks
- ✓ A cost efficient way to transfer their assets to their heirs.

Ideal Term Funds are offered under Standard Life's savings and retirement income plans, which are insurance products.

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