How the Tax System Discriminates Against Single Retirees

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A retired couple is afforded the opportunity to split certain forms of income in order to balance out their individual amounts of taxable income; and they have two sets of exemptions and tax credits—all of which helps to reduce their total household tax bill. But of course, not every retirement scenario involves a couple, and the financial picture is different when there is only one taxpayer. The tax system does not treat a retired couple and a single retiree in the same manner.

A person may be single when they commence retirement. They may become a single retiree either through the passing of a partner or as the result of a divorce. In our practice, we most commonly witness the financial impact on the survivor after the loss of their spouse. If you are a couple planning your retirement income, it is critically important to look ahead and take into account what may happen financially if one of you passes and what that means for the surviving spouse. The decisions you make today as a couple may significantly impact income levels and the resulting taxation for the surviving spouse, who would then be a single taxpayer.

To illustrate the difference in taxation for a retired couple and a single retiree, let's look at two examples. First, there is Brian. Clients of our firm introduced us to him several months after he had been widowed. Although Brian had come a long way in dealing with the loss of his wife, Erica, he was having challenges in handling the many changes to his financial affairs. Brian had discovered the hard way that there are two meaningful financial "adjustments" resulting from the loss of a spouse in retirement. First, the reduction or cessation of the deceased's CPP and OAS income streams. In Brian's case, there was no CPP survivor benefit because he was already receiving the maximum CPP retirement pension, having waited until age 65 to start his payments. The second change for him was the increase in taxation on household income. As the survivor, all income was now being taxed in his name. This is not a favourable combination of events. Of course, the ultimate impact for a survivor will vary, depending on several factors, in particular the level of taxable income involved. The tables below show two different levels of taxable income, using the same assumptions, as follows:

- All individuals are age 65 or older.
- Taxation rates are for the province of Ontario.
- The OAS payment is $600 monthly ($7,200 yearly).

- "Single Taxpayer (1)" shows the impact if pre-tax household income remains at the same level of $110,000.
- "Single Taxpayer (2)" shows the impact if household income is reduced to $95,000 due to the loss of Erica's CPP and OAS which totaled $15,000 per year.

The Before and After for Brian

	Two Taxpayers	Household	Single Taxpayer (1)	Single Taxpayer (2)
Individual Income	$55,000	$110,000	$110,000	$95,000
Tax Payable	$8,670	$17,340	$31,414	$23,788
After-tax Income	$46,330	$92,660	$78,586	$71,212
Average Tax Rate	15.76%	15.76%	28.56%	25.04%
Marginal Tax Rate	29.60%	29.60%	43.40%	37.90%
OAS Repayment*	$0	$0	$4,863	$2,625

*estimate, assuming $600 monthly payment

Prior to Erica's passing, she and Brian were able to split their household income of $110,000 evenly. You can see that by doing this, their taxable income of $55,000 each resulted in total tax payable of $17,340, leaving $92,660 after tax. But Brian is now a single taxpayer with $110,000 of income, putting him into a higher tax bracket than he and his wife each were when they could split their income. The tax owing is now $31,414. That is 81 percent more tax on the same amount of household income. This illustrates the significant benefit of being able to split eligible pension income, which, of course, Brian is no longer able to do. In addition to no longer having the OAS income from his spouse, Brian finds himself having to repay $4,863 of his own OAS benefit. This is once again because of the level of net income and taxable income he now faces as a single taxpayer.

The far right-hand column on this table shows taxable income of $95,000. As stated in the assumptions above, this reflects the loss of Erica's OAS and CPP income, amounting to $15,000. This scenario would reduce his total income to $95,000. Even at that income level, his tax bill as an individual will still be higher ($23,788) than it was when $110,000 could be split ($17,340), and he will still be required to repay $2,625 of his own OAS.

The Before and After for Sally

	Two Taxpayers	Household	Single Taxpayer
Individual Income	$30,000	$60,000	$45,000
Tax Payable	$2,042	$4,084	$5,400
After-tax Income	$27,958	$55,916	$39,600
Average Tax Rate	6.80%	6.80%	12.00%
Marginal Tax Rate	20.05%	20.05%	20.05%
OAS Repayment*	$0	$0	$0

*estimate, assuming $600 monthly payment

In the second scenario, we can trace the income changes now facing Sally, who recently lost her husband. All assumptions used are the same as they were for Brian and Erica, except for the level of household income, which for Sally and her husband was $60,000. You can track through the differences in taxation in her situation in the same way as we viewed Brian's.

At her level of income, while she no longer has the OAS and CPP income of her husband, at least she is not losing any of her own OAS benefit. But I have included this second example to make an important point. Unlike Brian's and Erica's situation, Sally and her husband had about half of their total, pre-tax income coming from their combined CPP and OAS payments. On the surface that is fine. But at her husband's passing, her household income was cut by 25 percent ($15,000 from $60,000). The point I am making is this: Be very careful if you are thinking about using your personal assets to create income when you retire in order to defer your CPP and OAS benefits later than age 65. On the surface, doing this in order to receive a higher, "guaranteed" income later may seem to make sense. But things could change dramatically at the passing of one person if a substantial percentage of your household income disappears. For Sally, her household, after-tax income as a single taxpayer went from $55,916 to $39,600. That is a drop of just over 29 percent. Couples should think through how this may unfold for them over the long term, including what the situation will look like for the survivor.

There is one other major consideration in all of this. Even though the cost of living will be somewhat lower when you go from being a couple in retirement to a single retiree, there are still fixed costs that don't reduce. The costs for certain things such as accommodations, property taxes, utilities, and so on are the same whether there is one person living there, or two. And now the survivor will have less income and, in certain situations, higher taxation on that lower income.