THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

How splitting income with your spouse in retirement can boost your lifestyle

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED FEBRUARY 26, 2021

I think my wife takes great pleasure in terrifying me. Last Saturday morning, sitting in the kitchen, she said, "Did you remember what today is?" Immediately, I broke out into a sweat, knowing that I had not given any thought to what important day might be coming up.

Visions of anniversaries gone by flooded my mind, particularly one when, at the last minute, I had scrambled to make it to the store to buy some flowers, a card, and some beef jerky (there was a hockey game on that night, and I needed a snack). The beads of sweat on my forehead grew as I squirmed in my seat and waited for her to announce that it was her birthday, or something.

"Uh, tell me, what is today?" I asked. "Nothing" she said. "I just wanted to see the look on your face." Cruel. All I do is lavish gifts on her, and this is what I get in return. The most recent gift I've given her is the gift of income splitting. It doesn't look as good as the flowers I bought her on our anniversary, but she'll thank me later – I think. Let me explain.

THE IDEA

In a perfect world, you and your spouse will have equal incomes in retirement, which will generally allow you to minimize taxes. Consider William and Wendy, a married couple, both age 70, who live in Ontario. Their household income is about $121,500, which consists of Canada Pension Plan benefits ($13,380 each), Old Age Security benefits ($7,384 each) and $80,000 of total RRSP withdrawals.

How much tax will this couple pay? Well, it depends on who's reporting the income. If, for example, one spouse paid the tax on the $80,000 of RRSP withdrawals (perhaps the other spouse doesn't have RRSP savings), the taxes paid by this couple would be $25,850. But if they were to each withdraw $40,000 from their RRSPs so that they have equal incomes in retirement, the total taxes owing would be $20,600, for tax savings of $5,250 every year. (That's a lot of beef jerky I could buy.) Or my wife might prefer a vacation somewhere warm once that's possible again (this is the part where she'll thank me later).

THE STRATEGIES

So, how can you and your spouse set things up so that your incomes in retirement are as equal as possible? Consider four ideas.

Split pension income. As you might know, spouses can elect to take up to one half of eligible pension income and report it on the other spouse's tax return (use Form T1032 for this). I'm talking about pensions through your work, or withdrawals from your RRSP or RRIF if you're age 65 or older (some withdrawals earlier than age 65 may qualify from the death of a spouse). CPP and OAS benefits, and certain foreign pension amounts, don't qualify for this pension splitting.

Use a spousal RRSP. If you're the higher income earner, consider using some of your RRSP contribution room to contribute to a spousal RRSP. Provided you have sufficient contribution room, you'll be entitled to a tax deduction as you would for any contributions to your own RRSP. But your spouse will make the withdrawals later in life and will generally pay the tax on those withdrawals. Aim to have equal amounts in your RRSPs if you can.

Make a spousal loan. If you have investments in a non-registered account, and you're in a higher tax bracket than your spouse, consider lending money to your spouse to invest. To avoid the attribution rules (which will cause you, and not your spouse, to pay tax on any investment income on those loaned funds) you'll need to charge the prescribed rate (currently just 1 per cent) on the loan. This low rate can be locked-in forever. Your spouse will need to pay you the interest each year by Jan. 30 (for the prior year's interest), which will be taxable to you, but any investment income earned on the loaned funds can now be taxed in your spouse's hands.

Issue shares to your spouse. If you're a business owner with a corporation, there's a good chance that, in retirement, much of your retirement savings could be sitting in the corporation. Under new rules first introduced in 2017, it has become much more difficult to pay dividends out of your corporation to your spouse (or kids, for that matter). These rules are called the Tax on Split Income (TOSI) rules. The good news? Once you're age 65, you can reorganize your corporation to provide your spouse with shares so that you can pay dividends on those shares to your spouse and split income this way. The rules are complex, so visit a tax pro to talk it over.

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