THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

Splitting income with family can save meaningful tax dollars

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED JANUARY 19, 2023

When my kids were young, they could often give me a splitting headache. As they got older, they began to give me opportunities for splitting income – which has saved our family thousands in taxes over the years. Continuing the conversation about the pillars of tax planning, I want to talk today about the third pillar: dividing to save tax. This is the idea of dividing up, or splitting income with family members. Here are several ideas to consider.

Split CPP benefits. It's possible to transfer up to one half of your Canada Pension Plan benefits to your spouse (or common-law partner) to be taxed in his or her hands. It's reciprocal so that you have to take the same percentage of your spouse's CPP benefits and report them on your tax return. Sharing CPP benefits could result in tax savings if one spouse has a much higher income than the other. You have to apply for this pension sharing, which can be done online at your My Service Canada Account (go to www.canada.ca and search for this term).

Split pension income. If you're receiving eligible pension income, you can report up to one half on the tax return of a lower-income spouse. How? By filing Form T1032, the Joint Election to Split Pension Income by the deadline for your tax return. Eligible pension income includes, for those under age 65, payments from a registered pension plan or certain amounts received as a result of a partner's death. For those over 65, you can add payments from a registered retirement income fund (RRIF) or annuity payments from a registered plan (CPP and OAS benefits won't qualify).

Make a spousal loan. This idea worked better when interest rates were lower, but it's still worth considering. You can lend money to your spouse and charge interest at our tax law's prescribed rate – which is 4 per cent as of Jan. 1, 2023. Your spouse can then invest those dollars, and any income earned will be taxed in your spouse's hands, not yours. Your spouse has to pay you interest each year by Jan. 30 for the prior year's interest charge. Given how high the prescribed rate is currently, your spouse will generally have to earn at least mid to high single digit returns to make this worthwhile.

Lend for second-generation income. It's possible to give or lend money to your spouse for investing. If you don't charge the prescribed rate that I described above, then the income earned by your spouse will be attributed back to you and you'll pay the tax. But this doesn't apply to second-generation income – that is, income on the income. So, your spouse can take the income earned each year and move it to a separate account and there will be no attribution back to you of income from that separate account.

Contribute to a spousal RRSP. This is a registered retirement savings plan (RRSP) where, typically, the higher-income spouse makes contributions and claims the RRSP deduction while the other spouse makes the withdrawals later in retirement as the annuitant. If you make contributions, you'll use up all or some of your RRSP contribution room, but you'll save tax as a couple later if your spouse is in a lower tax bracket. Your spouse will pay tax on the withdrawals to the extent that contributions were not made to the plan in the year of the withdrawal or the two preceding years.

Give assets to an adult child. You can give cash or other assets to an adult child to invest. Any income earned will be taxed in your child's hands – not yours. That is, the attribution rules that can apply to tax income in your hands will not apply in this case. This may not be true if you lend (not gift) assets to your child and the taxman determines that one of the main reasons for the loan was to reduce your taxes. If you do give assets in-kind to your child, you'll be deemed to have sold the asset at fair market value, which could create a tax bill if the asset has appreciated in value, or could trigger a capital loss that you can claim if the asset has declined in value.

Earn growth in a minor's hands. It's possible to save tax by placing growth assets in the name of a minor child. If you give money to a minor to earn income, any interest or dividends will be attributed back to you, but capital gains will be taxed in the hands of the child. You can set this up by opening an "in-trust-for" investment account at your financial institution, or by transferring funds to a formal family trust governed by a trust agreement. There can be some limitations to in-trust-for accounts (see my article from Aug. 20, 2020).

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at *tim@ourfamilyoffice.ca*