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Spousal RRSPs still have a place in clever planning

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Last Friday, I came home after work and Carolyn said to me, "Let's go out tonight and have some fun."

"Sounds good to me," I replied. "If you get back before me, just leave the light on."

Now, as it turns out, we did end up going out – together. I think we're pretty good at doing things as a couple on a regular basis. This includes regular date nights, and even saving for retirement. That's right. We're co-ordinating our savings by using a spousal RRSP in our planning. Some people wonder why. Let me explain.

The Idea

In perfect world, you and your spouse – if you have one – should have equal incomes throughout your lives. The reason? You'll pay less tax as a couple if your income is split about equally than if one of you has a disproportionately higher income.

Use our Spousal RRSP Withdrawals Calculator to see when withdrawals are taxed

When it comes to income in retirement, it's a little easier to split income thanks to the pension income-splitting rules. These rules were introduced in 2007 and they allow you to deduct up to one half of your eligible pension income on your tax return and report it on your spouse's return. Eligible pension income includes, most commonly, payments from a work pension plan (but not CPP benefits). And if you're age 65 or older at the end of the year, it can also include payments out of a registered retirement income fund (RRIF) or annuity payments out of an RRSP, among a few other less common amounts.

With these rules in place, many people no longer see the benefit of using spousal RRSPs. A spousal RRSP allows a contributing spouse to claim a deduction for contributions to the spousal plan, and for the other spouse – called the annuitant – to be taxed on withdrawals from the plan. But is there still a role for spousal RRSPs? Absolutely.

The reasons

Consider these seven reasons to use a spousal RRSP in your planning.

Avoiding the attribution rules. Some people simply give their spouse money to make contributions to the recipient's RRSP. The problem? The attribution rules could be used to tax withdrawals in the hands of the spouse who gave the money. The Canada Revenue Agency considers an RRSP to be "property," with the result that any withdrawals from an RRSP are considered to be "income from property," to which the attribution rules apply. A spousal RRSP can avoid these rules if used properly.

Enhancing income splitting. The pension splitting rules may not achieve equal incomes in retirement if one spouse has other non-registered investment income in retirement that can't be split. If the higher-income spouse contributes regularly to a spousal RRSP during his or her working years, it could become easier to equalize incomes in retirement.

Enabling different retirement dates. If you and your spouse retire in different years it could be that the higher-income spouse may not make withdrawals or receive eligible pension income that can be split. Building up an RRSP for the spouse that plans to retire first could make sense, and a spousal RRSP could be the vehicle to allow this to happen.

Facilitating low-income years. While an RRSP is primarily used for retirement, a spousal RRSP could also be used to provide income to the lower-income spouse if they'll experience some years of little or no income – such as during a sabbatical, parental leave or a period of unemployment. Make sure you consider the special rules that will tax withdrawals from a spousal RRSP in the hands of the contributor to the extent contributions have been made in the year of the withdrawal or the two prior years.

Making withdrawals before age 65. If both spouses retire before age 65 and you need to make withdrawals from your RRSP or RRIF, you won't be able to split that income until age 65. So, it could make sense to withdraw from a spousal RRSP or RRIF owned by the lower-income spouse. If all the RRSP or RRIF assets are in the higher-income spouse's name, withdrawals before age 65 will be taxed in their hands at a higher rate.

Using the HBP or LLP. Do you plan to make RRSP withdrawals under the Home Buyers' Plan (HBP) or Lifelong Learning Plan (LLP)? Both spouses could use these plans if both have RRSPs. Setting up a spousal RRSP could allow for both spouses to have an RRSP even if just one spouse has earned income to make contributions, and thereby enable both spouses to participate in the HBP or LLP.

Contributing after age 71. You won't be able to make contributions to your own RRSP after the year in which you reach age 71 since your RRSP won't be around beyond that year. But you can contribute to a spousal RRSP if your spouse is age 71 or younger in the year.

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