Using Spousal RSPs to Reduce and Defer Taxes

If you have a significantly higher income now than your spouse, or you expect this to be the case in retirement, you should consider taking advantage of a spousal RSP. Contributing to a spousal RSP can help defer taxes right away and reduce taxes in retirement. Spousal RSPs provide a means of income splitting for couples, whether they are married or common-law partners.

What is Income Splitting?

Income splitting is a way to reduce a family's overall tax bill by shifting income or capital gains from a higher income earner to a lower income earner. As a result of income splitting, the same amount of income is taxed at a lower rate, or not at all if the lower income earner's income is low enough.

Other Benefits of Income Splitting

Income splitting also provides benefits when calculating your Old Age Security (OAS) benefit and any potential claw-back you might face. The OAS program requires a repayment of a portion of your benefits (or clawback) starting when your personal income exceeds $59,790.[1] For each dollar that you earn above this limit, your basic OAS pension is reduced by 15 cents. If you and your spouse can keep your respective income levels below that threshold through income splitting, you can avoid any clawback.

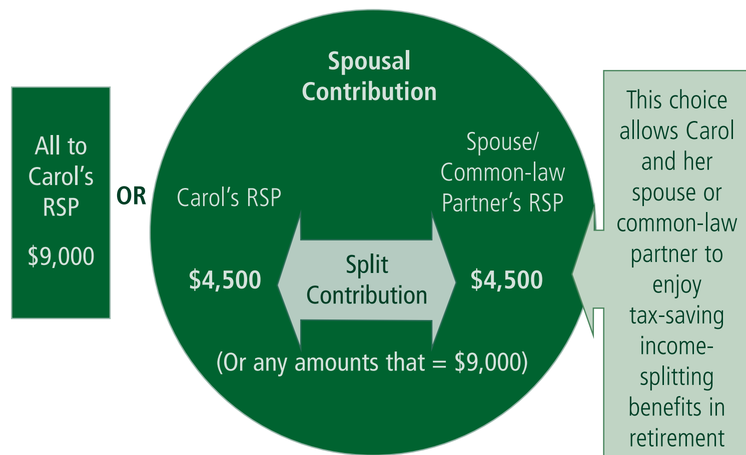
How to Equalize Income in Retirement with a Spousal RSP

Spousal RSPs also allow a couple to create a retirement fund for both partners. A taxpayer may choose to contribute to their personal RSP or to an RSP in their spouse's name while claiming the contribution as a deduction on their tax return.

The immediate benefit to the contributor is the deduction on their income tax return. However, in the long term the overall family tax bill may be reduced as income will be available for withdrawal by each spouse during retirement. The goal of using a spousal RSP is to attempt to equalize, as much as possible, the retirement income of both spouses.

Your spousal RSP contribution, when combined with your personal RSP contribution, may not exceed your personal RSP deduction limit.
For example, let's say Carol earns $50,000 a year. Based on the current contribution limit of 18% of previous year's earned income, Carol may contribute $9,000 to an RSP (assuming no carry-forward of unused contributions or over-contributions and no pension adjustments).

Carol has $9,000 to contribute to RSP(s)



A spousal RSP is also a way to defer taxes if you are no longer able to contribute to a personal RSP due to your age. As long as your spouse is 69 or younger, you can contribute to their spousal RSP and still claim the tax deduction.

Three-Year Attribution Rule

The three-year attribution rule is designed to prevent a high-income spouse from contributing to a spousal plan and then withdrawing the funds immediately and having the withdrawal taxed to the lower income earning spouse. If your spouse withdraws from their spousal RSP within three calendar years of your last contribution to *any* spousal RSP, the withdrawal is treated as income on *your* personal tax return. If the withdrawal is made more than three years after the contribution, the withdrawal is treated as income on your spouse's tax return.

It is important to note that the three years are based on calendar years. If your last contribution was made in December 2003, a withdrawal is taxable as your income until January 2006.

If the contribution were made in January 2004, even if it is applied to your 2003 tax return, a withdrawal before January 2007 would be taxable as your income. The three-year rule does not apply in the following cases:

- The spouses are living apart due to marriage breakdown.
- Death of the contributing spouse in the year a withdrawal is made.
- Either spouse becomes a non-resident of Canada for tax purposes.
- If the money is transferred to an annuity.

If you convert your spousal RSP into a RIF, you are only allowed the minimum withdrawal until three years after the last contribution. Any withdrawals above the minimum will be taxed as income on the contributor's tax return.

A spousal RSP offers Canadians an opportunity to work within the graduated income tax system in order to minimize a household's overall tax burden in retirement. This is one of the few income-splitting options still available to Canadians, and it is beneficial when most people need it – in retirement.

Your Financial Advisor would be happy to discuss the benefits of income splitting and how spousal RSPs may fit into your financial plan.

	Annual Income	Estimated Tax Rate	Tax Payable	Income After Splitting	Estimated Tax Rate	Tax Payable
Carol's Income After Retirement	$60,000	40%	$24,000	$45,000	35%	$15,750
Spouse's Income After Retirement	$25,000	30%	$7,500	$40,000	35%	$14,000
	Total Tax Payable Before Income Splitting		**$31,500**	Total Tax Payable After Income Splitting		**$29,750**

A tax savings of **$1,750**

[1]Old Age Security Repayment rate for 2004.

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