



Spousal RRSPs

Spousal RRSPs (or RRIFs, as the case may be) are one of the best income-splitting vehicles available to Canadians. Too often, in my experience, spousal RRSPs are underutilized.

The long-term objective of investing in a spousal RRSP is to minimize taxes for a couple during retirement by putting retirement income in the hands of the lower-income spouse. It's based on the assumption that the current lower-income spouse will continue to have a lower-income tax bracket during retirement. A spousal RRSP will be worth consideration if your current level of projected retirement income is disproportionate to that of your spouse, to a degree where you rest in different tax brackets.

A spousal RRSP can aid in shifting retirement income from a high tax bracket to a lower one. Let's look at an example. Mary has an income of \$65,000; husband Bob has an income of \$35,000. If Mary continues to contribute the maximum to her RRSP and Bob contributes the maximum to his RRSP, Mary will have significantly more RRSPs down the road at retirement.

Suppose they have 20 years to retirement; Mary can contribute \$11,700 per year to her RRSP and Bob can contribute \$6300 per year to his RRSP. After 20 years, Mary will have almost twice as much in her RRSP (\$815,000) as Bob will have in his RRSP (\$439,000). This disparity in assets can

easily translate in a disparity of income. The ideal situation for Mary and Bob is to have their RRSP assets split equally (\$626,500 each), hence the term income-splitting.

Funds for a spousal plan must be kept in a separate RRSP.

How does it work?

The higher-income spouse can invest the RRSP in his or her own name or that of the spouse. The spousal RRSP allows the higher-income spouse to obtain the much-needed tax deduction while at the same time, ensure that the lower-income spouse has an amount set aside from which to draw a retirement income. It should be remembered that the contributor's RRSP contribution limit is the restricting factor. If your RRSP contribution limit for the year is \$7000, you can only contribute that amount to your RRSP, to the spousal RRSP, or to some combination of the two.

Funds for a spousal plan must be kept in a separate RRSP. They cannot be combined with any other RRSP funds the spouse may have. The money in that spousal RRSP now belongs to your partner.

As long as more than three years pass from the time a contribution is made,

the money withdrawn will be treated as your partner's income. If your partner is in a lower tax bracket, the withdrawal will be taxed at a lower rate.

To discourage couples from taking advantage of this in an abusive manner, there are certain consequences if a spouse contributes to a spousal RRSP one year and the other spouse withdraws the funds within the two years following the RRSP contribution. The funds will be taxed in the hands of the contributor, not in the hands of the spouse who withdrew the funds.

There may be situations where you know that one or the other will have a lower income in a few years. This would happen where a spouse decides to stay home to look after children or perhaps return to school or take a training course. In these periods of relatively lower income, it may be possible to remove funds from the spousal RRSP and pay much less tax.

If you are nearing retirement (or a time where the receiving spouse has little or no income), consider making the spousal RRSP contributions in December instead of January or February when most people make them. Contributions made in December 2003 could be taken out by the lower income spouse as early as January 2006. If the contributions were made one month later, in January 2004, you would have to wait a full year longer, to January 2007, to avoid the attribution rules.

Is it risky to invest in a spousal RRSP?

What if there is a divorce or if one partner dies? In most situations, if you divorce, all RRSPs (spousal and personal) and pensions will be split between the spouses. Or you can agree to split other family properties if you want to maintain your RRSP. If one spouse dies, RRSPs can be transferred tax-free to the surviving spouse, as long as the spouse was named as the beneficiary of the RRSP plan.

Who should use a spousal RRSP?

When considering income-splitting for tax purposes at retirement, look at all sources of retirement income, including company pension plans, government pension plans, rental income, income from investments, and income from registered plans. In a case where one spouse has a pension plan at work and the other spouse doesn't work, each year the income-earning spouse can make a spousal RRSP contribution rather than contribute to his or her own RRSP. This strategy will permit both spouses to have a retirement income and ultimately pay less tax.

If you are over the age of 69 and have a spouse who has not yet attained age 69, the spousal RRSP creates an avenue for tax-sheltered contributions. The contributing person over the age of 69 must have RRSP room via carry-forwards or continuing earned income from employment and/or rental income. For example, Bob is happily married to Sue. Bob turned 69 this year. Sue is only 66. Bob has earned income of \$50,000 from doing consulting work this year, which will provide him with \$9000 of RRSP contribution room next year. CCRA requires him to wind up his RRSP by the end of the year he turns 69. He has already contributed his maximum into his RRSP for the year.

The problem, of course, is that Bob won't have an RRSP of his own next year to which he can contribute. You might think that because Bob won't have an RRSP next year, he would lose the benefit of this \$9000 RRSP contribution

room, right? Wrong! In fact, he could explore a couple of avenues.

First, he could make a \$9000 over-contribution to his RRSP in December before he converts his RRSP to a RRIF. This will result in a penalty of 1 percent a month of the excess amount contributed to his plan. Because we're all entitled to a \$2000 over-contribution without penalty, Bob's excess amount is only \$7000 (\$9000, less the allowable \$2000). The penalty Bob will face is \$70 for the month of December because in January of the next year, the \$9000 of contribution room will have opened up and his monthly penalties will stop.

Here's the best part. Bob will be entitled to claim a deduction for the \$9000 contribution made in December. This \$9000 deduction will save Bob about \$4500 at his marginal tax rate of 50 percent. What did it cost him? Just \$70 in penalties for the month of December.

His other option is to make the contribution directly into a spousal RRSP in Sue's name because she still has three years before she reaches age 69. The strategy above can be exercised with either the individual or spousal RRSP. The deciding factor will be dependent upon the amount of income-splitting you require to ensure your projected retirement income is proportionate with both spouses.

Review your current situation before you make your next RRSP contribution; determine if spousal RRSPs should be in your future. Take the time to make some projections and solicit the help of a financial advisor. ▲

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