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Financial Focus

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Saving Tax in Retirement with CPP Sharing

November 2021

By Clinton Orr

A common objective for retirees is to minimize tax. In my view, most tax tips fall into one of three big categories: Deduct, Divide or Defer. In the first category, the tax tool could be a credit or deduction that can reduce your taxable income. The second bucket contains strategies that could help divide taxable income by either spreading it over a few calendar years or dividing it between spouses; in both cases the net result is a reduction in the overall tax burden. The last category has tax strategies that could defer the tax liability, so you can hang on to your money for longer and pay the tax bill down the road. Recently, my team and I have worked with a few clients who were sharing their Canada Pension Plan (CPP) and it has helped lower their tax bill. CPP sharing is in the Divide category. It is not applicable to everyone's retirement plan, but for some it can help minimize the tax bill, so I wanted to pass along the details.

CPP sharing is a way of splitting income between spouses. It is most effective when one spouse is in a higher tax bracket and receives a large CPP benefit and the other spouse is in a lower tax bracket and has a smaller CPP benefit. If both spouses receive a similar amount of CPP or are in the same tax bracket, CPP sharing will not be as effective in reducing tax.

Sharing CPP does divide the income between spouses, however the division is not necessarily 50/50. The percentage that can be split is based on a formula. The key factors are the number of years you have lived together with your spouse or common-law partner, and your joint contributory period. The joint contributory period begins when the older spouse turns 18 and ends when both of you start collecting CPP. The amount of CPP that is eligible to be split will be the percentage of your joint contributory period that you have been married or common-law and living together.

Let's look at an example. Bob and Joan are married, and both decide to start collecting their CPP at 65. Joan is three years older than Bob, so when Bob turns 65 and starts collecting CPP, she will be 68. In this example, the joint contributory period will be 50 years, it begins when Joan turns 18 and ends when Bob starts receiving CPP.

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They have been married and living together for 30 years, which is 60% of their joint contributory period. Bob receives $400 a month in CPP and Joan receives $1,200, so the difference between the two is $800. Since they have been living together for 30 years of the 50-year contributory period, 60% of that $800 is eligible to be split, which means $480 can be split between Bob and Joan. At this point in the calculation, Joan has CPP of $720 a month, Bob has $400 and there is $480 that is eligible to be split. CPP sharing is a two-way street, so that $480 is split evenly between Bob and Joan, so in the end, Joan will have CPP benefit of $960 a month and Bob will get $640 per month. Joan's CPP was reduced, and Bob's was increased. If Bob is in a lower tax bracket than Joan, the net result will be that couple pays less in tax.

The amount of CPP that Bob and Joan can be split depends on how many years of their joint contributory period they lived together. The total amount of CPP for the couple does not change, but the longer they have lived together, the more of their CPP can be shared and the larger the tax savings. The only time the total amount of CPP is divided equally amongst Bob and Joan is when they have lived together for the entire joint contributory period.

CPP sharing results in the actual payments changing. In our example, the amounts that hit Bob's bank account will increase and the amount Joan receives will decrease. It is not simply paperwork; the actual cash flows are adjusted.

In order to share CPP with your spouse, you must apply for it. The application form is ISP1002 and can be found on Canada.ca. CPP sharing remains in effect until one of the spouses passes away, there is a divorce, or the couple cancels it, which can be done with form ISP1014.

CPP sharing can be an effective way to reduce tax, but it is not appropriate for everyone. It is important to chat with your financial professional to ensure any tax minimization strategy is a fit for your overall plan.

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