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Income Splitting

By Clinton Orr

Splitting income with your spouse can be an effective way to reduce your tax burden. This strategy works best when one partner earns more than the other. Higher income earners pay more tax. So, splitting or sharing the income can lower the income of the higher earning spouse and result in both partners being in a low tax bracket, reducing the couple's overall tax burden. However, in Canada this can be difficult to achieve. The government only permits a handful of techniques. Below we will review a few common strategies to split income.

Pension Splitting

In 2007 the federal government permitted pension splitting. For many retirees, pension splitting results in significant savings. If you are over the age of 65 you are permitted to allocate up to 50% of your pension income to your spouse. Your spouse does not have to be over 65. You do not have to split the actual funds; the money can be received by one partner. The allocation is for tax purposes and is done on your tax return. The percentage allocated to your spouse can be changed every year. Pension splitting is a flexible tax savings tool.

The main restriction pertains to what qualifies as pension income. If you are over the age of 65 payments from your RRIF, Deferred Profit Sharing Plan and lifetime annuity payments from a registered pension (for example payments from your employer's defined benefit pension plan) all qualify. If you are under the age of 65 the list is limited to lifetime annuity payments from a registered pension.

Spousal Loan

The above strategy applies to retired couples. A spousal loan, however, can be implemented while you are still working. This strategy is a way to split the income earned from non-registered investments. A non-registered investment is simply money invested outside of a RRSP or TFSA. The spouse with the higher income lends money to their partner who is in a lower tax bracket. The lower income spouse then invests the money, and since they are in a lower tax bracket, the interest earned on the investment will be taxed at a lower rate.

Clinton Orr
Vice President, Investment Advisor & Portfolio Manager
T: 204.259.2860
Beausejour: 204.205.0101
corr@cgf.com

Kevin Becker
Investment Advisor & Portfolio Manager
T: 204.259.2863
TF: 1.877.259.2888
kbecker@cgf.com

Alicia Roache
Investment Advisor Assistant (Licensed)
T: 204.259.2851
asroache@cgf.com

Maricar Irwin
Investment Associate
T: 204.259.2861
mirwin@cgf.com

Adam Buss
Wealth & Estate Planning Specialist
T: 204.259.2865
abuss@cgf.com

Canaccord Genuity Wealth Management
1010-201 Portage Avenue,
Winnipeg, MB R3B 3K6
beckerorr.com

There are several details that need to be correct for this strategy to work. For example, interest must be charged on the loan and the interest rate cannot be lower than CRA's prescribed rate (currently 2%). If the loan is not properly administered the income earned on the investments will be attributed to the spouse lending the money, the higher income spouse, and the tax savings will be lost.

CPP Sharing

Similar to pension splitting, couples can share their CPP. If one spouse receives a higher CPP benefit and is in a higher tax bracket, sharing their CPP can result in savings. Unlike pension splitting, the actual CPP benefits must be split. As well the allocation must be 50/50, no other allocation is permitted. For example, if Susie is in a high tax bracket and receives $1,000 a month from CPP and her husband John is in a lower tax bracket and receives $400 a month from CPP, they could lower their tax bill by sharing their CPP. In this example after applying and being approved for CPP sharing, both John and Susie will receive $700 a month from CPP.

The list above is not exhaustive, consider it an introduction to income splitting. Minimizing taxes is an important part of your financial plan. I encourage folks to talk to their tax professional and ensure they are making the most of the available strategies.

Clinton Orr B.Comm (hons.), CIM, CFP, DMS, FMA lives in Beausejour and is a vice president and portfolio manager with Canaccord Genuity Wealth Management.