



Pension splitting: Do spousal / common-law partner RRSPs have a role to play?

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Under Canadian tax law, each individual files their own tax return and is taxed on the income they earn on an individual basis. The United States, on the other hand, allows the filing of joint returns in which both spouses can choose to pool their incomes on the same return, with higher joint tax brackets for the couple than for a single person. We have a progressive tax system in Canada, and the more an individual makes, the higher the tax rate. This has always been a source of concern for senior couples, where one spouse or partner receives a pension while the other has very little income. The couple would be far better off and pay significantly less tax if the pension income, which is being used to support the couple jointly, could be split between both partners' tax returns. This is an option under Canadian tax law.

Pension income

Any Canadian resident who receives income that qualifies for the existing pension income tax credit, can allocate up to one-half of qualifying pension income to his or her resident spouse or common-law partner. So, what pension income qualifies? The definition mirrors the definition of eligible pension income for purposes of the \$2,000 pension income amount. Specifically, for Canadians under age 65, eligible pension income includes lifetime annuity payments under a registered pension plan (RPP), and certain other payments received as a result of the death of the individual's spouse or partner. For those who are 65 years and over, eligible pension income also includes lifetime annuity payments under a registered retirement savings plan (RRSP), RPP or a deferred profit-sharing plan, as well as any payments out of a registered retirement income fund (RRIF). Old Age Security and Canada Pension Plan payments are not eligible pension income. (CPP/QPP can already be split under separate legislation.)

Pension splitting works as follows: the pension income that one spouse or partner chooses to allocate their spouse or partner may be simply deducted from the income of the spouse or partner who actually receives the income and included on the other's tax return. Up to 50% of eligible pension income can be allocated to a spouse or partner. Obviously, both spouses / partners must agree to the allocation in their tax returns for the particular year in question. The election to split can be made one year at a time and can be changed or modified each tax year, depending on financial circumstances and planning needs. Let's explore a number of planning opportunities.

OAS recovery tax planning

Under pension splitting rules, pension income being transferred qualifies for the \$2,000 pension income credit in the hands of the transferee spouse or partner. It is also deducted from the transferor's income and included in the transferee's net income for the purposes of determining any recovery tax of OAS benefits. The OAS recovery tax, which only affects about 3% of eligible Canadian seniors, kicks in at net income greater than \$79,054 in 2020 and is fully recovered when net income reaches \$128,137. The ability to split pension income may be beneficial for people who are subject to OAS recovery tax. Pension income that pushes an individual

above \$ 79,054 (for 2020) can be transferred to a lower-income spouse or partner's return, thus preserving OAS payments for the higher income spouse or partner.¹

Spousal / common-law partner RRSPs

So how do these rules affect spousal / common-law partner RRSPs? Are they still needed and, if so, why and in what capacity? As a quick refresher, a spousal or common-law partner RRSP is an RRSP where one spouse or partner has contributed to the plan and the other spouse or partner is the annuitant or owner of the plan. It is often used by spouses / partners to accomplish post-retirement income splitting so withdrawn funds are taxed in the hands of the annuitant spouse / partner instead of the contributor spouse / partner. If the annuitant spouse / partner is in a lower tax bracket than the contributor spouse / partner in the year of withdrawal, there may be an absolute and permanent tax savings. The pension splitting rules have not heralded the death of spousal / common-law partner RRSPs, primarily due to the definition of pension income, as described earlier.

Remember, if an individual is under 65, eligible pension income typically only includes payments from an RPP and will not generally include amounts paid from an RRSP or RRIF. So anyone who wants to retire before age 65 and does not have an RPP should still consider the use of spousal / common-law partner RRSP contributions, which would allow the ultimate withdrawals to be taxed in a lower-income spouse's or partner's hands without having to wait until age 65.

The rules still tend to discriminate against Canadians who save for retirement through RRSPs instead of those who end up saving through, employer-sponsored RPPs. The reason is that RPP income recipients are allowed to income-split at any age, whereas RRSP annuitants must wait until age 65. However, spousal / common-law partner RRSPs will still play an important role for those wishing to retire early (i.e., before 65), and split income. They will also continue to play a role where an individual may wish to split more than 50% of their pension income. With a spousal / common-law partner RRSP, they could theoretically split up to 100% of their RRSP income with a lower income spouse or partner. This may still be advantageous to some couples, depending on their individual retirement incomes and tax brackets.

Note that in Quebec, the ability to split pension income, regardless of the type of income, only starts at age 65.

Contributors over 71

Spousal / common-law partner RRSPs may also play a role in financial planning for people who are over age 71 – the age at which they can no longer have an RRSP in their own name. That, however, doesn't mean they can't continue to contribute to a spousal / common-law partner RRSP if they continue to have RRSP contribution room beyond age 71. In fact, with many seniors continuing to work well into their 70s, they may still be generating earned income and are thus able to contribute to a spousal / common-law partner RRSP as long as their spouse or partner is under age 72.

And keep in mind they don't necessarily have to be working to have earned income. They may own a rental property that generates rental income, which is specifically included in the definition of earned income for the purposes of calculating eligible RRSP room.

Home Buyer's Plan withdrawals

Spousal / common-law partner RRSPs can also be useful for younger couples looking to save up enough money for a down payment on their first home. Often, the only savings they may have are in RRSPs. Let's say one spouse or partner is working while the other is either in school or perhaps staying at home looking after young children. The working spouse or partner, over the years of accumulation, could contribute a total of \$35,000 to their own RRSP and then contribute \$35,000 to a spousal / common-law partner RRSP, while building up the savings for the new home. Then each could withdraw \$35,000 under the HBP – something that could not be achieved without a spousal / common-law partner RRSP.

¹ Remember that this could affect the income of the lower income earning spouse for OAS purposes too.

Post-death RRSP contribution

Finally, the spousal / common-law partner RRSP still plays a role in a situation where an individual dies with unused RRSP contribution room. In that scenario, assuming the will permits it, the estate representative can make an RRSP contribution to spousal / common-law partner RRSP for the survivor and obtain one final RRSP deduction on the deceased's terminal return.

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