The LeBlanc Report

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Six Tax Tips for a Special Valentine: Acquiring a Spousal RRSP

Here's a unique way to share some love with your sweetheart: make a spousal RRSP contribution by March 1.

It's a gift that's a win-win to help secure your financial future together. Even better, it's you, the contributor, who gets the RRSP deduction. Whether you have a spouse or common-law partner, here are six basic tips to know:

The basics for individual RRSPs

When a contributor opens a regular RRSP, contributions to that RRSP are based on his or her own RRSP contribution room and age eligibility. Any contributions made to that account may be claimed as a tax deduction by the taxpayer and any later withdrawal (of principal and earnings) from that account are taxable to the taxpayer.

How is a spousal RRSP different?

When a contributor opens an RRSP account for his or her spouse or common-law partner, again, he or she may make contributions to that account based on his or her own RRSP contribution room (an advantage if the contributor has higher income and, therefore, more contribution room), and may claim a tax deduction on his or her own tax return for the contributions (which can help reduce that higher taxable income).

Another potential plus: for contributions to the spousal RRSP, the age eligibility rules work to an older contributor's advantage because they are based on the spouse's age. This makes the spousal RRSP a great planning tool when the contributor still has RRSP contribution room but is no longer age-eligible, being over the age of 71.

Who owns the spousal RRSP?

A spousal RRSP is the property of that spouse, the partner in whose name the account is registered (also known as the annuitant of the account).

Any withdrawals from a spousal RRSP are taxed as income of the spouse (annuitant) unless there have been contributions made by the contributor in the current or previous two taxation years. In that case, the contributor must report the lesser of the contributions in that period and the amount of the withdrawal. Once the three-year period has passed, and as long as no further spousal contributions are made, any income withdrawn from a spousal RRSP will be taxed to the annuitant and not attributed back to the contributing spouse. However, if an additional spousal contribution is made in the future, the attribution rules again apply to withdrawals made in that year or either of the subsequent two years.

Exception to the three-year rule: RRIF withdrawals

There is an exception to the three-year attribution restriction.

Spousal RRIFs (Registered Retirement Income Funds) are those that are established with funds originating from a spousal RRSP. The income attribution rules apply only to withdrawals from the spousal RRIF above the minimum amount. As long as the withdrawals are limited to the minimum amount, they will not be attributed back to the contributor, even though contributions may have been made to a spousal RRSP within the previous three years.

Normally, there is no advantage to opening a RRIF prior to either spouse turning 65, unless the income is needed by the client (recall, this is the age at which you are eligible for income-splitting benefits with your spouse on withdrawals from an RRSP/RRIF). Once the RRIF is opened, annual withdrawals must be made, and no additional contributions can be made into the account.

Transfers between RRSPs

It is also possible to make transfers between RRSPs on a tax-free basis.

However, some caution is required here. It's true that transfers may be made to or from a spousal RRSP without tax penalties. For example, if the transfer is from a spousal RRSP to that spouse's regular RRSP, then the regular RRSP also becomes a spousal RRSP. So, remember, if you consolidate any of your spouse's original RRSPs in a spousal RRSP, the consolidated RRSP will be a spousal RRSP.

A retirement plan for your Valentine

Spousal RRSPs are an important component of any tax-efficient retirement income plan for every couple.

It makes sense to contribute in the pre-retirement period, with the goal to equalize income in retirement; this strategy provides a route to tax-efficiency for the couple's accumulations. For example, with proper planning, couples may choose to income split later in life and income average for a lower overall marginal tax rate in the retirement period.

Options include withdrawing RRSP funds in a lower-earning spouse's hands prior to age 65; then income splitting with the higher-earner's funds at age 65. In addition, it's possible to structure RRSP income withdrawals between the spouses to avoid Old Age Security claw backs or defer Canada Pension Plan or Old Age Security benefits until age 70 to maximize those RRSP benefits[1].

For more information on spousal RRSPs, please contact LeBlanc Group at leblanc.group@cgf.com or by phone at 604.661.7839. You can visit our website by following the link http://www.leblancgroup.ca/.

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[1] February 2019. Source: AGF Perspectives. Retrieved from: Link