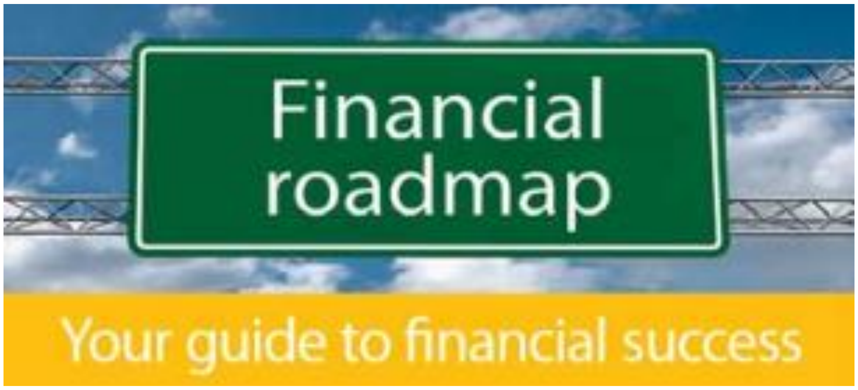

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Income Splitting—Helping You Save on Taxes

Income splitting is a tax strategy used to reduce the amount of income tax that a family pays, by shifting income from a high income earner to a lower income earner. For income splitting to be effective, family members need to be in different tax brackets.

In Canada, we have a “progressive” tax system. This means that the higher a person’s taxable income, the higher their tax rate. But by using income splitting, a portion of the income of a family member with a high income can be shifted to a family member with a lower income. This way, that income will be taxed at a lower rate resulting in lower overall taxes for the family.

Each tax payer is also required to file a personal income tax return and report their taxable income each year. This differs from countries such as the United States where the tax system is also “progressive”, but spouses may file a joint tax return.

> Income splitting allows you to reduce the overall amount of tax your family pays.

When Does the Income Splitting Occur?

Certain types of income are split at “source”, such as Spousal RRSP contributions. There are other types of income which you split when you file your annual income tax return, after you have received the income. This includes income received from a Registered Retirement Income Fund (RRIF) or a registered pension plan.

Who Can You Split Income With?

This depends on the type of income eligible for splitting. For example, eligible pension income can be split only with your spouse. However, there are opportunities available to shift income to other members of the family, such as your children.

Splitting Income With Your Spouse

The most common type of income splitting is between spouses. Please note that the term “spouse” refers to both a legal spouse and/or a common-law partner, since they are treated the same for income tax purposes.

Following is more information on the types of income splitting that can occur between spouses.

- **CPP Pension Sharing**

  If you are receiving your CPP pension or are eligible to begin receiving it, you can apply to Service Canada and request that your CPP pension be shared with your spouse. The following rules apply:

  1. You both must be at least 60 years of age.
  2. You must be living with your spouse.
  3. If only one of you is entitled to a pension from the CPP, you can share that one pension.
  4. If both of you are entitled to a pension from the CPP, you and your spouse may receive a share of both pensions – the combined total amount will not change.
  5. You can only share the portion of the pension you earned while living with your spouse.
  6. You must submit an application and provide proof of marriage or common-law relationship.
  7. Sharing of your CPP pension ceases at the earliest of: when you and your spouse submit a cancellation request; get divorced; or when one of you dies. Your monthly pension is then adjusted to the amount you were entitled to receive before the income splitting began.

- **Eligible Pension Income**

  This form of income splitting was introduced by the federal government in 2008. Income that is eligible for a pension income tax credit may be split between you and your spouse. Unlike CPP pension sharing, where your CPP pension is first split and then paid out, eligible pension income is split with your spouse at the time of filing your respective income tax returns, after you have received the income. The following rules apply:

  1. Pension payments you receive from a registered pension plan, such as the UVic Staff Pension Plan, may be split with your spouse.
  2. Other eligible pension income, such as payments from a Registered Retirement Income Fund (RRIF), a Life Income Fund (LIF), or an RRSP may be split with your spouse only after age 65.
  3. You can allocate up to 50% of your eligible pension income to your spouse.
  4. You and your spouse must jointly complete *Form T1032 Joint Election to Split Pension Income* and submit it to Revenue Canada along with your respective income tax returns.

  Splitting your eligible pension income with your spouse, allows each of you to claim the $2,000 pension income tax credit. Income splitting may also eliminate or reduce the claw back on your Old Age Security pension, if one of you is subject to the claw back.

The pension income tax credit is available to you if you are 55 years of age or older. Basically, it enables you to deduct, from taxes payable, an amount equal to the lesser of your pension income or $2,000.00.

- **Spousal RRSPs**

  This is the oldest and most common method of income splitting. It involves the higher income spouse contributing to an RRSP on behalf of the lower income spouse. The higher income spouse claims the RRSP contribution tax deduction, but any amounts withdrawn will be considered taxable income for the lower income spouse. However, if it has been less than 3 years since the contribution was made to the spousal RRSP, the withdrawal will be taxable to the higher income spouse.

  A spousal RRSP remains an effective tax strategy if you plan to split your retirement income with your spouse before age 65. It also serves as a safeguard against any future attempts the federal government may make to eradicate or lessen the tax savings available through income splitting.

- **Payment of Household Expenses**

  This is an income splitting strategy which often goes unnoticed. You can strike an arrangement with your spouse whereby the higher income spouse pays most or all household expenses, leaving disposable income for the lower income spouse to invest. The investments are then taxed at the lower income spouse's tax rate.

Splitting Income with your Children

There are certain types of income which may be shifted from parent to child. You may already be doing this without realizing that it is called "income splitting".

- **Registered Education Savings Plans (RESPs)**

  This is the most common type of income splitting between parents and children. RESPs are used to finance the higher education of children. The parent makes contributions to the RESP and government grants (within a limit) are paid to the RESP. Contributions are not tax deductible and as long as the income earned stays in the RESP, it is not taxable. However, once withdrawn, the income earned is taxed at the student's tax rate which is much lower than the parent's.

- **Monetary gifts to children under 18 years of age**

  If you invest an amount of behalf of a child and it generates future capital gains, the capital gains are considered taxable income for the child. If the investment earns interest or dividends, it is considered taxable income for you.

- **Monetary gifts to children over 18 years of age**

  Any return generated by a gift to an adult child is taxable for the adult child.

Splitting Income with Family members

Following are additional ways to shift income to your spouse or children.

- **Employ your spouse and/or children**

  If you are a business owner, you can employ your spouse and/or children. Make sure that the work is bona fide and the pay is reasonable because the Canada Revenue Agency has rules in place to prevent abuse.

- **Tax Free Savings Accounts (TFSAs)**

  Contributions to a TFSA are made with after-tax income and the investment returns earned are not taxable. Therefore, it doesn’t matter who earned the income - you can give your lower income spouse or adult children money to invest in their TFSA.

Income splitting strategies should be carefully considered. Speak to your financial advisor or a tax specialist to determine if income splitting is right for you.