The Navigator

Income Splitting Checklist

The following article contains a checklist of legitimate income splitting strategies you may wish to consider in order to reduce your family's overall income tax bill.

Income Splitting May Lead to Income Tax Savings

If your family consists of a high-income spouse and a low-income spouse or if you have low-income children, you may want to consider implementing an income splitting strategy. The strategy of income splitting takes advantage of our progressive tax system where, as taxable income increases, marginal tax rates increase. Spreading taxable income among your family members may help to reduce your overall family tax burden.

Note that "spouse" includes persons who are married, as well as those who satisfy the definition of "common law partners" under federal income tax rules (including same sex couples).

Strategies to Consider

The following is a checklist of legitimate income splitting techniques you may wish to consider. Please note that this is not an exhaustive list:

- Spousal loan strategy – the high-income spouse loans money to the low-income spouse at the Canada Revenue Agency's prescribed rate of interest; then the low-income spouse invests the proceeds of the loan and pays the income taxes on the net investment income at their lower marginal tax rate. The low-income spouse must make annual interest payments, in accordance with a drafted and signed loan agreement, to the high-income spouse no later than 30 days after the calendar year's end. This will ensure that the income attribution rules do not apply. The prescribed rate loan strategy may also function between a parent and a child.
- Income-on-income strategy – the high-income spouse transfers property to the low-income spouse and the income earned is attributed back to the high-income spouse for tax purposes. However, if this income is reinvested by the low-income spouse, the income on that reinvested amount is not attributed back to the high-income spouse – it can be taxed in their hands of the low-income spouse.
- Spousal RRSP – the high-income spouse contributes to an RRSP for the future benefit of the low-income spouse. The withdrawals from the spousal RRSP will be taxable to the low-income spouse (provided that the high-income spouse hasn't made a contribution in the three years prior to the withdrawal).
- Expense funding strategy – the high-income spouse pays for all family expenses and the low-income spouse invests their own income. This way, investment income will be taxable at the marginal rate of the low-income spouse.
- The high-income spouse pays any of the low-income spouse's quarterly tax installments or final tax-owing payment (in April following the taxation year) and the low-income spouse invests their own income.
- Pension income splitting – when one spouse receives pension income or one spouse is 65 years of age or older and receives RRIF or LIF income, the income may be split between

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the spouses' tax returns, up to a maximum of 50%.

- CPP/QPP sharing – under certain circumstances, spouses are permitted to split their CPP/QPP pensions between themselves for income tax purposes, based on the number of years they were considered spouses and the pension benefits they earned while together.
- The high-income spouse gifts money to the low-income spouse, who will then contribute the gifted funds to their TFSA. The attribution rules do not apply in this situation, and therefore the income earned on these gifted funds in the TFSA will be earned tax-free.
- The low-income spouse transfers unrealized capital losses to the high-income spouse.
- The high-income spouse transfers unrealized or future capital gains to the low-income spouse.
- The low-income spouse sells a non-income producing asset to the high-income spouse and then invests the proceeds. The income earned on the proceeds will be taxable to the low-income spouse.
- The high-income spouse contributes to an RESP for their children. The maximum contribution that can be made to an RESP is $50,000 for each beneficiary. Income earned in the RESP can be taxable to the children at their lower marginal tax rates when they withdraw funds for their education.
- The high-income spouse contributes to an RDSP for a disabled family member. The maximum contribution that can be made to an RDSP is $200,000. The income earned in an RDSP can be taxable to the disabled family member at their lower marginal tax rates when they withdraw funds.
- The family business pays a reasonable salary to the low-income family members for services rendered.
- An estate freeze of the family business is implemented in order to transfer future business growth to the children. An estate freeze is a strategy that can facilitate the succession of your family business by fixing the value of your shares in the business as at a particular date and passing the future growth on to your spouse or children.
- Parents gift assets to adult children for investment (however, capital gains may be triggered on transfer).
- The high-income spouse can make a prescribed rate loan to a family trust where the beneficiaries are various low-income family members. The income earned in the trust can be distributed to these beneficiaries and taxed at their lower marginal rates.
- Trust account for minor children – there may be an opportunity to have

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capital gains within the trust taxed in the hands of minor children who pay little or no tax on the gains.

- The high-income spouse can loan or gift funds to the adult child to purchase a principal residence. As the funds will not be used to earn income, there will be no attribution to the high-income spouse. Additionally, when the adult child sells the home, they may be able to use the principal residence exemption.
- If a high-income spouse runs an unincorporated business, they should consider incorporating and adding their lower-income adult family members as shareholders. This provides the opportunity to declare dividends from the corporation to the family members and take advantage of their lower marginal tax rates. Different classes of shares with different voting and dividend rights can be used to more effectively manage the business and the income splitting opportunities.
- If a high-income spouse runs an incorporated business, they should consider adding their lower-income spouse as a director of the corporation and paying them a director's fee.
- You may put provisions in your will or in an insurance policy for the creation of a testamentary trust. Since the income earned within a testamentary trust is taxed on a separate tax return at graduated tax rates, an income splitting opportunity exists.

Speak to your advisor and your tax and legal advisors in order to learn more about what these strategies are and which ones may be appropriate for you. Your advisor may also be able to provide you with other articles that describe many of the above strategies in greater detail.

Please contact us for more information.

Please contact us for more information about the topics discussed in this article.

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