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FINANCIAL ADVISORY SUPPORT

Spousal RRSPs

An overview of the benefits and rules surrounding spousal RRSPs

You should obtain professional advice from a qualified tax advisor before acting on any of the information in this article. This will ensure that your own circumstances have been considered properly and that action is taken on the latest information available.

This article covers the basics of spousal RRSPs, including some potential benefits and considerations.

A spousal RRSP is often used to provide the family unit with two streams of income during retirement. Spousal RRSPs provide a simple way to split retirement income between spouses in an effort to equalize the retirement income and minimize the couple's income taxes.

The basics of a spousal RRSP

A spousal RRSP is an RRSP to which one spouse makes contributions (the contributor), but is opened in the name of the other spouse, who is the annuitant (or owner) of the RRSP.

If you would like to be a contributor and make a contribution to a spousal RRSP for the benefit of your spouse, you will need to ensure you have sufficient unused RRSP contribution room — making a spousal contribution affects your RRSP contribution room, not your spouse's.

Naturally, the deduction for the spousal RRSP contribution must be reported on your tax return and not your spouse's. However, when the funds are later withdrawn from the spousal RRSP, the RRSP income will be taxable to your spouse as the annuitant of the RRSP and not to you (unless the withdrawal is subject to the income attribution rules discussed later in this article).

Common-law couples, of the same or opposite sex, are treated identically by the Income Tax Act as legally married spouses, and therefore can also take advantage of spousal RRSPs.



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Advantages of a spousal RRSP

Income splitting during retirement

The main advantage of a spousal RRSP is that it enables a couple to split their RRSP income during their retirement years. The strategy of income splitting takes advantage of our progressive tax system where, as taxable income increases, marginal tax rates increase.

Spousal RRSPs allow a couple to:

- Deduct the RRSP contributions on the higher income spouse's tax return to benefit from higher tax savings; and
- Report the RRSP income received from the plan on the lower income spouse's tax return to pay tax on the income at a lower rate.

The net effect is a lower combined tax liability for the couple, both during their working years (while contributing) and during their retirement (while receiving RRSP income).

Pension income splitting measures

Since the introduction of the pension income splitting measures, there has been some discussion as to whether contributing to a spousal RRSP still makes sense. The following are some of the key reasons why, even with the pension income splitting measures, using a spousal RRSP may still be a useful strategy for you and your spouse:

Enhanced income splitting: Under the pension income splitting provisions, a qualifying spouse can allocate a maximum of 50% of qualifying income to their spouse. There will be many cases where a couple will not be able to achieve the optimum result from splitting income through these provisions alone (for example, when the qualifying income received in the current year represents only a small fraction of the family's total retirement income). In such cases, having funds in a spousal RRSP may enable the couple to further reduce their overall tax bill. More specifically, if the higher income spouse has a significant amount of non-registered investment income, this type of income cannot be split under these provisions. If during his/her working years the higher income spouse made all his/her RRSP contributions as spousal RRSP contributions, then each spouse may have a more even split of investment assets and hence taxable income in retirement.

Income splitting prior to age 65: If both spouses retire prior to age 65 and the couple requires income above and beyond whatever fixed sources are available (such as government income sources and a company pension), it may be beneficial for the couple to be able to draw on a spousal RRSP or spousal registered retirement income fund (RRIF) owned by the lower income spouse to fund the shortfall and keep the couple's income tax bill at a minimum (assuming non-registered assets are not available, or they need to be preserved for use at a later date). Under the pension income splitting rules, RRIF income of the higher income spouse cannot be split prior to the RRIF annuitant reaching age 65.

Other advantages

Spouses 71 years of age or older are able to contribute to a spousal RRSP: Spousal RRSPs also enable an older spouse, one that is over 71 and no longer eligible to contribute to their own RRSP, to contribute to a spousal plan. It must be stressed that a spouse aged 71 or over can contribute to a younger spouse's RRSP only if the older contributing spouse has RRSP contribution room. As well, the younger spouse must not be older than age 71 in the year of contribution.

Use of the Home Buyers' Plan and Life Long Learning Plan: Having a spousal RRSP enables both spouses, rather than just one of the spouses, to potentially make use of these government programs. However, repayments to an RRSP under these plans cannot be made with contributions to a spousal RRSP. The spouse who makes the withdrawal must make the repayments to an RRSP of which they are the annuitant.

Planned leaves of absence, low income years: Spousal RRSPs do not necessarily have to be used for retirement. With proper advance planning to avoid income attribution, it may be possible to use a spousal RRSP to pay expenses during a period of low earnings prior to retirement such as a sabbatical, a period of unemployment or even a parental leave.

Income attribution

Income attribution is the term used when income that is normally taxed in the hands of one taxpayer is attributed to another taxpayer and taxed in their hands instead.

For spousal RRSPs, the income attribution rules can result in RRSP income being attributed back to the contributing spouse which means that the income withdrawn from the spousal RRSP will be taxed in the hands of the contributor, usually the higher income spouse, at their higher marginal tax rate. Effectively, the application of the income attribution rules means that income splitting with the lower income spouse is not achieved.

When income attribution applies

Generally, when the annuitant of a spousal RRSP (usually the lower income spouse) makes a withdrawal from their spousal RRSP, the income is taxed in their hands. However, income attribution applies (i.e. the income is taxable to the contributing spouse) in either of these two cases:

- If the contributing spouse makes a contribution **in the year of the withdrawal; or**
- If the contributing spouse makes a contribution **in one of the two immediately preceding taxation years.**

In other words, if the owner of a spousal RRSP (i.e. the annuitant, which is usually the lower income spouse) withdraws funds from the plan in the same year that a spousal contribution is made or makes a withdrawal in any of the following two calendar years, income attribution will apply. However, the amount of the withdrawal subject to attribution will be limited to the total spousal RRSP contributions made during this three-year period.

Basically, two full taxation years after the taxation year of the last spousal contribution must pass before amounts can be withdrawn without triggering the income attribution rules.

For example, if the last spousal RRSP contribution you made to your spouse's RRSP plan was in October 2010 and your spouse made a withdrawal from his or her RRSP in 2010 or 2011, or plans to make a withdrawal in 2012, the income attribution rules will apply and you will need to report the income. In this case, a withdrawal on January 1, 2013 will not trigger any attribution.

If you make more than one contribution to your spouse's RRSP during this three-year period, the particular contribution that must be included in income is based on a "first in, first out" basis.

Exception to the income attribution rules

The income attribution rules for spousal RRSPs do not apply in the following circumstances:

- Spousal RRSP withdrawals during and after the year of death of the contributing spouse;
- Spousal RRSP withdrawals when either spouse is a non-resident of Canada;
- Spousal RRSP withdrawals when spouses are living separate and apart due to marriage breakdown;
- Spousal RRSP withdrawal is a commutation payment that is transferred directly from your spouse to another RRSP, to a RRIF, or to an issuer to buy an eligible annuity that cannot be cashed in for at least three years;
- Spousal RRSP withdrawals for amounts in excess of any spousal RRSP contributions in the year of withdrawal or the two previous years. For example, assume a spousal RRSP withdrawal of \$10,000 is made in 2012 after spousal RRSP contributions of \$3,000 are made in each of 2010, 2011 and 2012 (totalling \$9,000). The first \$9,000 of the withdrawal will be attributed back to the contributing spouse and the remaining \$1,000 will be taxed to the annuitant spouse;
- Spousal RRSP withdrawals from a spousal RRSP under the Home Buyers' Plan or the Lifelong Learning Plan. It is the annuitant's responsibility to make the minimum RRSP repayments. If a minimum RRSP repayment is not made, the required repayment amount will be included in the income of the annuitant spouse, not the contributing spouse, regardless of recent spousal RRSP contributions;
- Where the fair market value of the spousal RRSP is deemed to be received by the annuitant because of death.

RRIF withdrawals and income attribution

RRIF minimum payments are never subject to the income attribution rules. Keep in mind that in the first year of a RRIF, the minimum payment is zero dollars. Any withdrawal made from a spousal RRIF **in excess of the minimum RRIF withdrawal** is attributed back to the contributor to the extent of any spousal RRSP contributions made in the year of withdrawal or the two previous years. The following example illustrates these attribution rules.

Let's assume that Jack makes contributions to a spousal RRSP for his spouse, Diane, in 2006, 2007, 2008 and 2009 in the amount of \$5,000 each year. Diane turns 71 in 2009, and as a result, converts her spousal RRSP into a spousal RRIF in the year 2009. After this conversion, she makes withdrawals from the spousal RRIF on December 15 of every year from 2009 to 2012. Attribution of the RRIF withdrawals is outlined in the following table:

Year	Age on Jan. 1	RRIF Min %	RRIF balance on Jan. 1	Minimum RRIF withdrawal required	Actual RRIF withdrawal made	Amount attributed to Jack	Amount taxed to Diane
		(A)	(B)	(C) = (A) x (B)	(D)	(E)	(D) – E
2009	70	0%	N/A	\$0	\$8,000	\$8,000	\$0
2010	71	7.38%	\$100,000	\$7,380	\$8,000	\$620	\$7,380
2011	72	7.48%	\$ 98,000	\$7,330	\$8,000	\$670	\$7,330
2012	73	7.59%	\$ 95,880	\$7,277	\$8,000	\$0	\$8,000

Note that there can be no further attribution of spousal RRIF withdrawals, regardless of the amount of the withdrawal after 2011 (i.e. no possibility of attribution starting in 2012) since the contributor is only able to make a contribution at the end of the year in which their spouse turns 71 (in this case, by December 31, 2009).

Spousal RRSP and regular RRSP commingled

When a spousal and regular RRSP with the same annuitant are commingled, the account is identified as a spousal RRSP account. The income attribution rules apply to the commingled account if the annuitant spouse makes a withdrawal from the commingled account and the contributing spouse makes a contribution in the same year or in any of the two prior years — even if the annuitant makes contributions at the same time. It is assumed that the withdrawn amounts are those of the contributing spouse first.

Consider the following example. Marie contributes to her RRSP in 2008, 2009, 2010 and 2011. Her spouse, Mark makes spousal RRSP contributions to her plan in 2008 and 2010.

Contributions to Marie's RRSP:

Year	Mark	Marie
2008	\$5,000	\$4,000
2009	nil	\$3,000
2010	\$3,000	\$2,000
2011	nil	\$5,000

In 2012, Marie determines she needs to withdraw \$9,000 from her RRSP. Since the account is commingled, of her \$9,000 withdrawal, \$3,000 will be attributed back to Mark. In order to prevent this, Marie could wait until 2013 to make the withdrawal. Or, if Mark and Marie each contribute to a separate account (Marie to her own RRSP and Mark to a spousal RRSP for Marie), the income attribution rules will not apply. The additional cost, if any, of having more than one RRSP account must also be considered.

More than one spousal plan

The income attribution rules will apply if your spouse makes a withdrawal from one of their spousal RRSP plans and you make a contribution to any of your spouse's RRSP plans in the current year or any of the two previous calendar years. The fact that your spouse is withdrawing from one spousal plan and you are contributing to another spousal plan does not prevent the income from being attributed to you.

If your spouse has their own RRSP plan — not a spousal plan — they can withdraw from that plan without triggering the income attribution rules, even if you make a contribution to their spousal RRSP in the current year or any of the previous two calendar years.

Who reports taxes withheld where attribution applies

In all cases, even where the spousal RRSP withdrawal is attributed to the contributor spouse, the taxes withheld have to be claimed by the individual to whom the slip is issued, which is the annuitant.

Transferring the commuted value of your pension benefits

Under certain circumstances you may be able to transfer all or a portion of the commuted value of your pension benefits to a locked-in RRSP (e.g. from a defined contribution or defined benefit pension plan). This option may be available to you, if you leave your employer, as part of a severance or early retirement package. These assets must be transferred to your own locked-in RRSP; they may not be transferred to a spousal RRSP. However, if there is a taxable portion of the commuted value and you have sufficient unused RRSP contribution room, you may consider making a spousal RRSP contribution to reduce the tax payable on the taxable portion.

Retiring allowance

If you receive a retiring allowance from your employer and you have years of service with that employer prior to 1996, you may be able to transfer a portion or perhaps all of this payment to your RRSP as a retiring allowance rollover without using any of your regular unused RRSP contribution room. This is called an “eligible retiring allowance.” This type of rollover must be transferred to your own RRSP — it may not be transferred to a spousal RRSP.

However, if you have sufficient unused RRSP room, you may want to consider transferring your retiring allowance or a portion of it to a spousal RRSP by using your regular unused RRSP contribution room.

If you have any questions or require clarification of any of the issues discussed in this document, do not hesitate to discuss these with your RBC advisor.



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