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Spousal RSPs

An overview of the benefits and rules surrounding spousal RSPs

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

A spousal RSP is often used to provide the family unit with two streams of income during retirement. Spousal RSPs 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 RSP

A spousal RSP is an RSP 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 RSP.

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

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spousal RSP contribution must be reported on your tax return and not your spouse's. However, when the funds are later withdrawn from the spousal RSP, the RSP income will be taxable to your spouse as the annuitant of the RSP and not to you (unless the withdrawal is subject to the income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

Advantages of a spousal RSP

INCOME SPLITTING DURING RETIREMENT

The main advantage of a spousal RSP is that it enables a couple to split their RSP 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 RSPs allow a couple to:

- Deduct the RSP contributions on the higher income spouse’s tax return to benefit from higher tax savings; and

- Report the RSP 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 RSP income).

NEW PENSION INCOME SPLITTING MEASURES

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

Enhanced income splitting: Under the new 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 RSP may enable the couple to further reduce their overall tax bill.

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 RSP or spousal registered income fund (RIF) 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 new pension income splitting rules, RIF income of the higher income spouse cannot be split prior to the RIF annuitant reaching age 65.

OTHER ADVANTAGES

Spouses 71 years of age or older are able to contribute to an RSP: Spousal RSPs also enable an older spouse, one that is over 71 and no longer eligible to contribute to their own RSP, to contribute to a spousal plan. It must be stressed that a spouse aged 71 or over can contribute to a younger spouse's RSP only if the older contributing spouse has RSP 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 RSP enables both spouses, rather than just one of the spouses, to potentially make use of these government programs. However, repayments to an RSP under these plans cannot be made with contributions to a spousal RSP. The spouse who makes the withdrawal must make the repayments to an RSP of which they are the annuitant.

Planned leaves of absence, low income years: Spousal RSPs 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 RSP 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 RSPs, the income attribution rules can result in RSP income being attributed back to the contributing spouse. Therefore, the income withdrawn from spousal RSPs may be taxed in the hands of the contributor, usually the higher income spouse, at their higher marginal tax rate.

The net effect of the income attribution rules (where they apply) is that the original goal of income splitting with the lower income spouse is not achieved.

WHEN INCOME ATTRIBUTION APPLIES

Generally, when the annuitant spouse of a spousal RSP (usually the lower income spouse) makes a withdrawal from their spousal RSP, 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**.

Otherwise said, if the owner of a spousal RSP (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 RSP 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 RSP contribution you made to your spouse's RSP plan was in October 2007 and your spouse made a withdrawal from their RSP in 2007 or 2008, or plans to make a withdrawal in 2009, the income attribution rules will apply and you will need to report the income. In this case, a withdrawal on January 1, 2010, will not trigger any attribution.

If you make more than one contribution to your spouse's RSP 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 RSPs do not apply in the following circumstances:

- Spousal RSP withdrawals during and after the year of death of the contributing spouse;
- Spousal RSP withdrawals when either spouse is a non-resident of Canada;
- Spousal RSP withdrawals when spouses are living separate and apart due to marriage breakdown;
- Spousal RSP withdrawals for amounts in excess of any spousal RSP contributions in the year of withdrawal or the two previous years. For example, assume a spousal RSP withdrawal of $10,000 is made in 2009 after spousal RSP contributions of $3,000 are made in each of 2007, 2008 and 2009 (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 RSP withdrawals from a spousal RSP under the Home Buyer's Plan. It is the annuitant's responsibility to make the minimum RSP repayments. If a minimum RSP 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 RSP contributions.

RIF WITHDRAWALS AND INCOME ATTRIBUTION

RIF minimum payments are never subject to the income attribution rules. Keep in mind that in the first year of a RIF, the minimum payment is zero dollars. Any withdrawal made from a spousal RIF **in excess of the minimum RIF withdrawal** is attributed back to the contributor to the extent of any spousal RSP 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 RSP for his spouse, Diane, in 2006, 2007, 2008 and 2009 in the amount of $5,000 each year. Diane turns age 71 in 2009, and as a result, converts her spousal RSP into a spousal RIF in the year 2009. After this conversion, she makes withdrawals from the spousal RIF on December 15 of every year from 2009 to 2012. The attribution of the RIF withdrawals are outlined in the following table:

Year	**Age on Jan. 1**	**RIF Min %** (A)	**RIF balance on Jan. 1** (B)	**Minimum RIF withdrawal required** (C) = (A) x (B)	**Actual RIF withdrawal made** (D)	**Amount attributed to Jack** (E)	**Amount taxed to Diane** (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 RIF 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 RSP AND REGULAR RSP COMMINGLED

When a spousal and regular RSP with the same annuitant are commingled, the account is identified as a spousal RSP 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 RSP in 2005, 2006, 2007 and 2008. Her spouse, Mark makes spousal RSP contributions to her plan in 2005 and 2007.

CONTRIBUTIONS TO MARIE'S RSP:

Year	Mark	Marie
2005	$5,000	$4,000
2006	nil	$3,000
2007	$3,000	$2,000
2008	nil	$5,000

In 2009, Marie determines she needs to withdraw $9,000 from her RSP. 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 2010 to make the withdrawal. Or, if Mark and Marie each contribute to a separate account (Marie to her own RSP and Mark to a spousal RSP for Marie), the income attribution rules will not apply. The additional cost, if any, of having more than one RSP 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 RSP plans and you make a contribution to any of your spouse's RSP 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 RSP 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 RSP in the current year or any of the previous two calendar years.

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 RSP (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 RSP; they may not be transferred to a spousal RSP. However, if there is a taxable portion of the commuted value and you have sufficient unused RSP contribution room, you may consider making a spousal RSP 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 RSP as a retiring allowance rollover without using any of your regular unused RSP contribution room. This is called an "eligible retiring allowance." This type of rollover must be transferred to your own RSP — it may not be transferred to a spousal RSP.

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