

Spousal RRSPs - Understanding How They Work

RRSP time brings a number of questions including many on spousal RRSPs. This article will examine the use of spousal accounts and whether they are right for you.

What is a spousal account?

A spousal RRSP is an account in which you make contributions however, your spouse is the annuitant or the owner of the account. This means that your spouse has control over the account in terms of investment decisions and when payments are received from the account.

Why use a spousal account?

Effective tax and retirement planning would ensure that spouses had equal income at retirement to reduce the overall tax burden that a family would have. The main advantage of a spousal RRSP therefore is to help divide assets that will produce that future income. Usually, the higher income spouse contributes to a spousal RRSP and receives a tax deduction at a high marginal tax rate. Then in retirement, the other spouse withdraws that money to produce income and pays tax at a lower tax rate (subject to the attribution rules explained below).

As an example, a family with annual income of \$70,000 earned by spouse would pay approximately \$17,000 in taxes. However that same family with each spouse earning \$35,000 would lower the tax bill to \$11,900.

There may be situations where the lower income spouse would make contributions to a spousal account. In this case, they would likely be a member of a pension plan that is going to provide them with retirement income. Or, they have other assets that will cause them to have more retirement income than their higher income spouse.

Remember, the overall goal is to have both spouses with the same amount of retirement income.

How does a spousal account work?

When you choose to open a spousal account, your spouse's name will appear on the account. You will be the contributing spouse and will receive the tax deduction; however, the legal owner of the plan is your spouse.

When they withdraw the money in the future, the taxes due will be in their name, subject to the attribution rules.

Attribution Rules

The attribution rules in the Income Tax Act are designed to prevent abuse of spousal accounts.

If a person makes a withdrawal from a spousal plan in the current calendar year and contributions have been made to any spousal account in the year of withdrawal, or the previous two years calendar years, that income will be attributed back to the contributing spouse.



The word "any" is important. A withdrawal from a spousal RRSP to which no contributions were made during the three-year period will still be attributed to the contributor's income, if over that three-year period any contributions were made to any other spousal plans.

Note also the term "calendar year." Making a spousal contribution in January 2006 would mean that the owner must wait until January 2009 before a withdrawal could be made.

However, if that same contribution was made in December 2005, and no other spousal contributions were made after, those funds could be withdrawn on January 2008, without any attribution.

Other Ways to Avoid Attribution of Income

In addition to the above, attribution of income from spousal withdrawals doesn't apply in the following circumstances:

- If the funds in the spousal plan are transferred to a RRIF and only minimum withdrawals are taken. If more is taken, then the excess withdrawal is subject to attribution.
- If the spouse's are living apart because the relationship has ended.
- If the contributing spouse died in the year a withdrawal is made.
- If either spouse becomes a non-resident.
- If the plan holder transfers money directly from the spousal plan to an annuity or to a locked in RRSP that can't be cashed out for at least three years.

Can I make contributions to my spouse's existing RRSP?

The short answer to that question is yes. However, as soon as you combine or co-mingle your spousal contributions with their regular contributions, the account is considered a spousal account for the purposes of the attribution rules as described above.

Depending upon your circumstances, it may be appropriate to have two accounts. If you were to require funds from an RRSP before retirement, and you had two accounts, you could withdraw from the account that made the most sense from a tax perspective (ie. the account where the contributor would have the lower tax rate).

If the accounts have been co-mingled and are therefore a spousal account, the withdrawal would be taxed back to the contributing spouse.

Summary

Spousal accounts can be a very effective tool to help you plan for retirement. Talk to your ScotiaMcLeod advisor to determine if a spousal account is right for you.

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