

Income Splitting: Strategies to Reduce Your Taxes

1. Spousal Loan

Take advantage of today's low interest rate environment to arrange a loan from a higher-income spouse to a lower-income spouse at what is referred to as the prescribed interest rate (set by the government). That loan rate is locked in until the loan is paid off. The lower-income spouse then invests the loan proceeds in his/her own name to generate investment earnings. This income will not be attributed back to the lending spouse as long as the interest owed on the loan is paid by January 30th of each following year. If this payment is missed the loan will be invalid and full attribution occurs for that year and all future years.

The interest on the loan is deductible to the spouse paying the interest but must be included in income by the other spouse. For this reason, the investment income earned by the lower income spouse must be in excess of the prescribed loan rate for this strategy to be effective and beneficial. For example, based on a 4% prescribed rate, the lower income spouse would have to be earning a rate of return in excess of 4% for this to be advantageous.

Be sure to properly document the loan. Consider a promissory note signed by the borrower, detailing the date, amount, interest rate charged, terms of repayment and when interest is due.

2. Make a Spousal RSP contribution

To even-out retirement income between spouses and reduce your tax bill, consider a spousal RRSP. The spouse with the higher retirement income makes a spousal RRSP contribution to a plan in the name of the lower income spouse. The deduction belongs to the high-income spouse, however the funds accumulate for the benefit of the lower-income spouse. This spousal plan enables spouses, in retirement, to trigger a lower marginal tax rate because registered income payments are effectively split between spouses rather than reported by one spouse. Please note attribution to the contributor will only apply if withdrawals are made from the plan in the year of contribution and the following two years.

3. Split CPP benefits with your spouse

Human Resources Development Canada will allow you to split up to 50% of your Canada Pension Plan benefits with your spouse. To determine if this income splitting opportunity would be beneficial for tax purposes, it is necessary to estimate the income of both spouses. It is suggested that you consult with your tax accountant prior to receiving your Canada Pension Plan benefits, to get help with this analysis.



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4. **High Income Earner pays expenses**

Have the higher-income spouse pay all the family bills and expenses, allowing the lower-income spouse to make investments with their capital. The income on those investments is taxed at a lower-rate to the lower-income spouse.

5. **Minor children invest in capital growth equity investments**

A parent can purchase equity investments or growth mutual funds in a child's name and there is no attribution of any resulting capital gains back to the parent as capital gains are exempt from the attribution rules with respect to property transferred to a minor. However, income attribution rules will apply on interest and/or dividend income earned. Furthermore, at age 18 the investment becomes the property of the child.

6. **Child Tax Benefit invested for Child**

The child tax benefit cheque can be deposited in a bank account in the child's name and any income earned on those funds is not subject to attribution to the parent.

7. **Substitute or Swap Non-Deductible Debt for Deductible Debt.**

Try and arrange your affairs such that if you have both mortgage debt and an investment portfolio, you use the proceeds of the investment portfolio to pay off the non-deductible mortgage debt, and then you borrow to fund assets in the investment portfolio. You are still borrowing the same amount, however, now the interest is being borrowed for investment purposes and it is therefore tax deductible.

