Understanding Spousal RRSPs—Why You Should Use One

With fewer and fewer income splitting opportunities between spouses, it is important to understand the strategies that remain. Spousal RRSPs are an effective way to split income between spouses during retirement. However, it is important that you know the rules. What is a Spousal RRSP?

A spousal RRSP is an account to which you contribute, however your spouse is the annuitant of the account. This means that you receive the tax deduction for the contribution to the account, but your spouse will receive the proceeds from any withdrawals from the spousal RRSP. Once the contribution is made, your spouse becomes the owner of the funds within the account.

The Advantages of a Spousal RRSP

The biggest advantage of a spousal RRSP is the opportunity to split retirement income between spouses. Effective retirement planning would result with both spouses having equal income producing assets at retirement. This would allow the family to take advantage of splitting income instead of having it all taxed in one individual's hands.

Most people will not have equal assets at retirement so the spousal RRSP is a method to help ensure that you do have equal assets at retirement.

Usually, the higher income spouse (and therefore the spouse that is likely to have higher assets at retirement) will contribute to a spousal plan for the lower income spouse to allow them to accumulate assets for retirement. When you finally retire, the withdrawals from the spousal account will be taxed in the hands of your spouse, usually at an overall lower tax rate than would be the case if the withdrawal was taxed in your hands (please see the discussion of attribution rules below).

The advantage to this income splitting strategy is based on the fact that the contributor receives a tax deduction at a higher tax rate than the income will ultimately be taxed at.

Be Careful of the Attribution Rules

There are rules in the Income Tax Act called attribution rules that are designed to prevent abuse of spousal RRSPs.

The rules state that:

- withdrawals from a spousal account will be taxed in the hands of the contributor if a contribution has been made to **any** spousal account in the year of the withdrawal or the previous two years

What this means is that if you made a contribution to any spousal spousal account, you must wait three years before your spouse can withdraw it without it being taxed back to you.

The attribution rules do not apply in the following circumstances:

- if funds are transferred to a RRIF and only the minimum payments are withdrawn, there is no attribution. However, there is attribution on funds withdrawn in excess of the minimum payment as long as the three years is still in effect. After the three years has passed, there is no further attribution

- if funds are used to purchase a life annuity or a term certain annuity to age 90, there is no attribution

Why Should You Use a Spousal RRSP

One of the most popular questions relating to spousal RRSPs is, "Can my spouse co-mingle their own RRSP with that of their spousal RRSP that I contribute to?".

The answer is yes, however, once you co-mingle the accounts they are considered a spousal account and therefore subject to the attribution rules discussed above.

While co-mingling the accounts will save you an administration fee, there are reasons to keep the accounts separate, depending upon your circumstances. Having two plans provides you with extra flexibility with respect to withdrawals. For example, if your spouse was not working and wanted to withdraw funds out of their RRSP, they could withdraw them out of their own RRSP and have the income taxed in their hands. If however, the funds had been co-mingled and a spousal contribution had been made within the last three years, that income withdrawal would be taxed in the hands of the contributor.

Make Sure You Know the Rules

If you want to play the game, you need to know the rules...This is no different when it comes to any form of tax planning. Make sure you understand the spousal RRSP rules. Talk to your Investment Executive if you would like help.

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