TAX & ESTATE PLANNING

BY JAMIE GOLOMBEK

Lowering Tax Burdens

Investigate income splitting opportunities for all demographics

While the new Family Tax Cut credit, which provides a form of income splitting, has been getting a lot of attention since its introduction last fall, there are other income splitting methods, some of which have been around for a long time and provide much more significant tax savings. With marginal tax rates for high-income earners approaching 50 per cent in several provinces, now is a great time to revisit some income splitting strategies with your clients.

As we know, income splitting is the transferring of income from a high-income family member to a lower-income family member to reduce the overall tax burden of the family. Since our tax system has graduated tax brackets, by having the income taxed in the lower-income earner's hands, the overall tax burden of the family can be reduced.

FAMILY TAX CUT CREDIT

The Family Tax Cut credit can be claimed for the first time for the 2014 taxation year. The credit provides a version of income splitting that allows an individual to notionally transfer up to $50,000 of income to his or her lower-income spouse or partner, provided they have a child who was under 18 at the end of the year.

The credit is capped at $2,000, presumably to limit the governmental cost of the program. If there was real income splitting with no cap to the credit, the true federal tax savings of moving $50,000 of income from a top federal tax rate spouse at the 29 per cent marginal rate to a bottom tax rate spouse at the 15 per cent to 22 per cent marginal rates would be almost $6,600.

PENSION SPLITTING

Another form of more traditional income splitting is the ability to split up to half of an individual's pension income with their spouse. Any pension income that qualifies for the $2,000 federal pension income credit also qualifies to be split. Specifically, this would include annuity-type payments from a Registered Pension Plan (RPP), regardless of age, and also includes Registered Retirement Income Fund (RRIF) or Life Income Fund withdrawals upon reaching age 65.

If you have clients who are at least 65 years of age, you may want to consider suggesting they convert a portion of their RRSP to a RRIF (if they don't already have a RRIF) so the couple can benefit from pension splitting. Any withdrawals from a RRIF, whether minimum withdrawals or other amounts, would qualify for pension splitting once the client is 65, while RRSP withdrawals are not considered to be pension income.

Splitting pension income may have benefits beyond the taxes that are saved.

Splitting pension income may have benefits beyond the taxes that are saved by having pension income taxed at a spouse's lower tax rate. Pension splitting also has the ability to affect credits and benefits that are solely based on one spouse's net income. For example, in 2015 the federal age amount is worth about $1,050 but is phased out with income between about $35,500 and $82,400. Although the maximum total amount of Old Age Security (OAS) pension benefits is about $6,600 in 2015, these benefits are clawed back with net income between $73,000 and $118,000. If pension splitting allows your client to lower their net income, they may be able to preserve some (or all) of the benefits.

SPOUSAL RRSPS (RRIFS)

If upon retirement you think that one of your clients will have a higher income or have accumulated more retirement assets than his or her spouse, it may be beneficial to encourage them to contribute to a spousal RRSP. It is often used to accomplish post-retirement income splitting since withdrawn funds are taxed in one spouse's (the annuitant's) hands instead of the other's (the contributor's). If one spouse is in a lower tax bracket than the other in the year of withdrawal, there may be an absolute and permanent tax savings.

But are spousal RRSPs still relevant given the ability to income split RRIF income, as discussed above?

The pension splitting rules have not, in fact, heralded the demise of spousal RRSPs. First of all, spousal RRSPs allow an individual to split more than 50 per cent of pension income. With a spousal RRSP, one could theoretically "split" up to 100 per cent of RRSP (RRIF) income with a lower-income spouse.

Second, prior to age 65, eligible pension income typically only includes annuity payments from an RPP and will not generally include amounts paid from an RRSP or RRIF. So anyone who wants to income split before age 65 and does not have an RPP should still consider the use of spousal RRSP contributions, which would allow the ultimate withdrawals to be taxed in a lower-income spouse's hands without having to wait until age 65.

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