The Spousal RRSP

When using it makes sense

BY LYNN BISCOTT

Since the federal government introduced provisions allowing for the splitting of pension income between spouses or partners (see "Pension Income Splitting" by Jamie Golombek in this issue), many clients have wondered if there is any point in starting or continuing with a spousal RRSP. To answer this question, we should first look at the situations where the new pension splitting mechanism will benefit clients.

As of this year, any Canadian resident who receives income that qualifies for the pension income tax credit is allowed to allocate up to half that income to his or her spouse or common law partner as long as that individual is also a resident of Canada.

What income qualifies for this credit? That depends on the age of the client receiving the income. If he or she is under 65, only income from a registered pension plan (defined benefit or defined contribution) is eligible. If the client is 65 or older, the eligibility list is expanded to include income from RRIF and LIF withdrawals as well as annuity payments.

While these new provisions provide some tax relief for spouses or partners who have not been able to achieve equal incomes in retirement, it would be a mistake for couples to rely exclusively on this mechanism when planning for the future. Using a spousal RRSP throughout a couple's working life with the aim of building equal retirement assets (employer pensions included) is still a smart move for most clients.

Consider the following situations:

The higher income earner has no employer pension. In this case, there is no opportunity for splitting income with the lower income-earning spouse until age 65. Let's say that Joe is the higher income earner and Sally is his spouse. If Joe wants to retire before age 65, he won't be able to assign any of his income to Sally in order to reduce his taxes until he reaches 65 and converts his RRSP to an annuity or a RRIF. Now that the government has recently extended the RRSP maturity date to 71, Joe would be required to mature his RRSP six years early in order to take advantage of the pension splitting opportunities since cash withdrawals from an RRSP are not considered eligible income. If Joe and Sally both retire at 55, a spousal RRSP might make it possible for them to draw equal income from their plans for the 10 years before the pension splitting provisions kick in and it also allows them to keep their RRSPs intact until they reach age 71.

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One spouse is planning an extended leave from the workforce. Sean and Megan are a young couple just starting out. They expect that when they start a family several years down the road, Megan will stay at home for a few years until the kids are in school full time. Although Sean has a good income, it may not be enough to fully cover the family expenses at that time. Setting up a spousal RRSP for Megan could be one way of ensuring that she, too, will have an adequate source of income when she stops working. Of course, she can also contribute to an RRSP in her own name, but these accumulations may not be enough to produce the income needed.

The RRSP Home Buyers Plan or Lifelong Learning Plan will be used in the near future. Under these plans, up to $20,000 may be withdrawn tax-free from an RRSP for specific purposes. For couples just starting out, using a spousal RRSP could ensure that each partner would have the maximum amount available for purchasing a home or funding post-secondary education for one of the partners.

One spouse or partner becomes disabled and is unable to continue working. John and Maureen are both employed, although Maureen earns about double John's wages. Neither one has a pension plan at work. John suffers from severe depression and has recently had to leave his job. If John's disability insurance doesn't cover depression or coverage is inadequate, he may have to draw on his RRSP to help cover the family expenses. Once again, the use of a spousal RRSP might have helped to give him a larger nest egg to draw on.

In short, the use of a spousal RRSP can help to ensure that each partner has an adequate amount of capital that can be drawn on in a variety of circumstances. Of course, if finances permit, non-registered funds should be used in many of these situations. However, for many clients, this isn't a realistic possibility.

While the new rules for pension splitting are helpful for many retired couples, they shouldn't be relied upon as an alternative to prudent planning. F

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