TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

Monthly Perspectives From The Daley Group Wealth Management

Are You Doing All You Can to Save Tax? Shift Income, Save Tax

Are you doing all you can to save tax? Here are some income-splitting strategies to consider.

Given Canada's progressive tax rate system, an individual's marginal rate of tax increases as their income surpasses various brackets. To fall into a lower tax bracket, individuals may look for ways to split income with family members such as spouses/common-law partners (CLPs) or (grand)children. In addition to income-tax savings, it may help preserve income-tested benefits such as Old Age Security (OAS).

Splitting Pension Income — Up to 50 percent of eligible pension income may be split between eligible spouses/CLPs on their respective tax returns. This may also allow both spouses to claim the pension income tax credit of up to $2,000 per year depending on the age of the couple. For those ages 65 or over, payments from sources such as a life annuity, registered pension plan or Registered Retirement Income Fund (RRIF) could qualify. For those under 65, payments from a registered pension plan and certain other payments received resulting from the death of a spouse could qualify. OAS payments do not qualify.

CPP Pension Sharing — Spouses/CLPs can also apply for pension sharing to have their Canada Pension Plan (CPP) pensions split between them. It is important to note that the CPP pension-sharing rules are separate from the pension income-splitting rules and work differently. For example, pensioners must apply proactively for CPP pension sharing, whereas a couple can elect to apply pension income splitting when they are filing their income tax returns after they have already received the pension income.

Transferring Unrealized Capital Losses — In some situations, it may be possible to transfer unrealized losses in a portfolio between spouses using the superficial loss rules. This could allow a spouse who cannot effectively utilize unrealized capital losses (i.e. due to lack of capital gains and/or being in a low tax bracket) to transfer those losses to a spouse who would be able to realize and utilize capital losses more effectively.

Gifting to Adult Kids — Gifting money to an adult child who is in a lower tax bracket can put subsequent capital gains and income in the hands of the child. The adult child may also be able to contribute the funds into their tax-sheltered account such as a Tax-Free Savings Account (TFSA). However, it is important to consider the loss of control over the funds once they have been gifted.

Spousal RRSP — By contributing to a spousal Registered Retirement Savings Plan (RRSP) for the benefit of a spouse who is expected to have lower income in retirement, future withdrawals may be taxed in the lower-income spouse's hands. While pension income-splitting rules allow you to allocate income drawn from the RRIF to a spouse for tax purposes, consider that this can only be done after reaching the age of 65 and is limited to 50 percent of the withdrawal. A spousal RRSP can provide income splitting at any age and may offer more flexibility, since the full amount can be included in the lower-income spouse's tax return.

Household Expense Allocation — The higher-income spouse/CLP may consider paying for the family's expenses, freeing up the lower-income earner's funds to be used for investment purposes to enable future investment income to be taxed at their lower marginal tax rate.

Business Planning — For family businesses, reasonable salaries for services rendered may be paid to lower-income family members. Business owners who operate through a corporation should also consider speaking with a tax advisor about succession planning, to identify potential tax-planning strategies which could reduce taxes associated with the eventual sale of the business or passing down the business to the next generation (which could be a significant taxable event without proper planning).

Plan Ahead

While some income-splitting techniques can be implemented without much advance planning (i.e. pension income splitting, gifting to adult children); others, such as maximizing spousal RRSP benefits, require planning well in advance. For more information or advice relating to your particular situation, please consult a tax advisor.

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