

TAX BULLETIN

INCOME SPLITTING

With Canada's high personal tax rates, there's a great desire among many Canadians to find ways to save on taxes. However, over the past several years, the government has slowly eliminated many of the techniques previously used to minimize tax. Fewer tax shelters and deductions are available and more rules have been introduced to curtail tax planning.

As a result, the average taxpayer probably believes there is very little that can be done to reduce the tax burden. However, reductions are possible within the family unit with the right tax planning techniques. These techniques are known as "income splitting".

Income splitting is the process of redirecting income within a family group to take advantage of the lower tax brackets, deductions and credits available to each family member. Income is split by transferring income-earning assets from high-income to lower-income family members. Generally speaking, the total tax on family income will be lowest when each member earns approximately the same level of income.

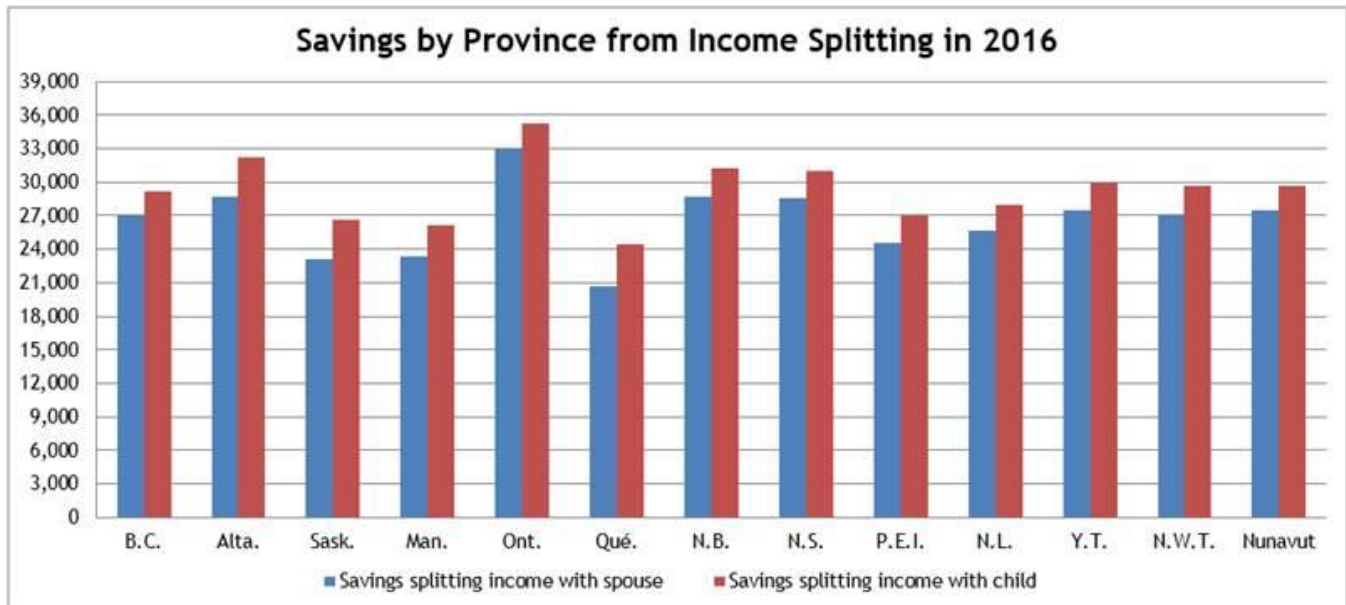
People are often surprised at the magnitude of tax savings that can be achieved through simple income splitting. As an example, assume an individual earns income which places him well into the top marginal tax bracket. By transferring enough income to another family member, he can bring that person's income up to the cut-off for the top marginal bracket. Income previously taxed at the top rates will now be taxed in the lower brackets, with more after-tax cash remaining within the family unit.

In October 2014, the former Conservative government introduced a much anticipated change in the tax rules allowing for a form of income splitting between spouses. Effective for the 2014 and subsequent taxation years, the "Family Tax Cut" allowed couples with children under the age of 18 to qualify for a non-refundable tax credit of up to \$2,000. However, in 2016, the new Liberal government eliminated the Family Tax Cut effective for 2016 and subsequent taxation years.

September 2016

CONTENTS

- The attribution rules
- Family income splitting
- Income splitting through unincorporated businesses
- Income splitting through corporations
- Income splitting in retirement
- Summary



The chart above sets out the maximum amount of tax that individuals in each province could save in 2016 by splitting income with a spouse or a child who has no income. This chart compares the actual amount of tax payable on \$600,000 of regular income earned by an individual to the amount of taxes payable if this income were to be evenly split (i.e. \$300,000 each) between that individual and either their spouse or their minor child. We selected \$300,000 of income to split as that is the threshold for the top personal tax bracket in Alberta. The maximum tax saving will be achieved at lower levels of income in the other provinces and territories. Your actual savings may be lower depending on the amount and type of income you earn and whether your spouse or child has other sources of income. Please note that references to a spouse throughout this bulletin include a common-law partner.

As you can see, the savings can be substantial and will multiply with each family member with whom you split income. Note the difference between spouses and children – when you split income with your spouse, you lose the marital tax credit.

Savings can be achieved in a number of ways: from strategies as simple as making interest-free loans to more complex arrangements involving corporations and trusts. The range of techniques

available to you depends on your particular financial situation.

Unfortunately, the Canadian government is well aware of the potential tax savings from income splitting and over time has enacted several rules to prevent it. The “attribution rules” cause income (or capital gains in some cases) to be attributed back to you to be taxed in your hands. In addition, an income splitting tax on minor children, known as the kiddie tax, was introduced in 1999 as a result of the government taking action to attack business income splitting arrangements after taxpayer victories in court (most notably the Supreme Court decision in Neuman). A basic awareness of all of these rules is necessary to carry out effective tax planning.

The attribution rules

The main idea behind income splitting is to transfer assets to low-income family members to enable them to earn income. The attribution rules potentially apply whenever a property is transferred or a loan is made at little or no interest to a family member. The most important rules are as follows:

- If you make a loan or give property to your spouse, any income or capital gains from the transferred assets will be attributed to you.

- If you make a loan or give property to a minor child (a son, daughter, niece or nephew under 18 or some other minor child with whom you do not deal at arm's length), income from the funds will be attributed to you, but any capital gains arising from the property will be taxed in the hands of the child.
- If you make a loan to an adult child or other adult relative, income from the funds may be attributed to you if the purpose of the loan was to reduce taxes. Any capital gains will be taxed in the hands of the relative.

Although the attribution rules for loans and gifts significantly reduce income splitting opportunities, many possibilities still exist. This bulletin lists the more common ways you can arrange your family finances to split income with family members. Note the ones that interest you and discuss them with your BDO advisor.

Family income splitting

The following opportunities exist to split income with other members of your family:

Make an interest-free loan to your spouse or children for investment purposes.

Under the attribution rules, income earned by your spouse or child on the funds will be taxed in your hands, just as it would have been had you not made the loan. However, that income becomes their property and can be reinvested without further attribution. Over time, family members can build up a large pool of funds which earn income taxed in their hands. Be sure to deposit the income in a separate bank account so that it can be properly tracked and separated from the funds advanced as a loan. Also, you may want to consider setting up a trust to manage the funds if minor children are involved.

Make a low-interest loan to your spouse or children for investment purposes.

The attribution rules do not apply to loans that bear interest at the prescribed rate—an interest rate set quarterly by the Canada Revenue Agency (CRA) that approximates short-term Treasury Bill rates. If you loan funds to your spouse or child and the funds are invested so that the rate of return is

higher than the prescribed rate, the excess income will be taxed in their hands. Note that interest on the loan must be paid no later than 30 days after the end of the year. Where the interest is not paid on time once, the loan will be subject to the attribution rules until repaid. The interest rate on the loan does not have to be adjusted each time the prescribed rate changes. At the time of writing, the prescribed rate was only one percent.

Loan funds to family members other than your spouse to invest in assets that produce capital gains.

Consider loaning funds interest-free to low-income family members other than your spouse. They can use the funds to purchase investments with low returns, but with the potential to produce capital gains. Capital gains arising on these investments will not be subject to attribution.

Many mutual funds invest in growth stocks with low dividend rates. Such investments are well-suited for this plan, as any distribution from these funds is often a distribution of capital gains.

If a child's in-trust account or a trust for the child has investments with accrued gains, consider triggering these gains each year to the extent the child's personal exemptions are not otherwise utilized. This will help ensure that the child won't have a large gain that will be taxed at some point in the future.

Make gifts to adult family members.

If you support adult family members, such as children at university or elderly parents, consider giving them assets which they can invest to earn their own income. The income will be taxed in their hands, not yours, and they'll have more after-tax funds than if you had earned the income and paid their expenses.

This situation can arise where an adult child needs money for his or her education, or where your parents are dependent on you for support. Bear in mind that a gift means you give up control of the asset. If making gifts to low-income parents, you may want to ensure that the assets will be left to you in their wills. Also, if you give property other than cash to any relative, you're deemed to

dispose of it at fair market value, which could result in a taxable capital gain.

Contribute to a Tax-Free Savings Account (TFSA).

TFSAs were introduced in 2009, and allowed for a \$5,000 annual contribution for each year through to 2012. Due to indexing, the annual limit increased to \$5,500 for the years 2013 and 2014. As a result of changes introduced in the 2015 federal budget, the TFSA annual contribution limit increased to \$10,000, effective January 1, 2015. However, in December 2015, the new Liberal government announced that the TFSA annual contribution limit will return to \$5,500 beginning in 2016, and will be indexed in subsequent years. Note that the TFSA annual contribution limit for 2015 remains at \$10,000 and any unused contribution room will carryforward.

Not only are TFSAs a good way to accumulate investment income, the income earned in a TFSA is not subject to the attribution rules. Therefore, it is possible for you to loan or gift funds to your spouse or adult child and then for your spouse or adult child to contribute such funds to their TFSA. There will be no attribution of the income earned on those funds within the TFSA. For more information on TFSAs, see our tax bulletin titled [Answering Your TFSA Questions](#).

Ensure the high-income spouse pays all family expenses, while the low-income spouse saves.

Often, both spouses contribute equally to household expenses, where each has a source of income. This may seem fair and reasonable, but it's poor tax planning. To the maximum extent possible, the low-income spouse's salary and other earnings should be saved for investment purposes, while the higher income spouse pays for expenses such as food, clothing, mortgage payments etc. You can even pay your spouse's taxes. This ensures that the family's total investment income is taxed at the lowest possible rate.

Loan or give funds to family members to purchase a principal residence.

If you support a child in residence at university or pay rent for elderly parents, consider loaning or giving them funds to purchase a separate residence. This will reduce your investment income

subject to tax and, since the funds aren't earning income, there's no attribution. Also, if the property increases in value, the family member may be able to use the principal residence exemption.

Invest inheritances for the benefit of your children.

If your child inherits money, make sure that you segregate these funds and invest them in the name of the child. If you or your spouse will inherit funds from a relative you can split income from that inheritance as well, if your relative names your child as a beneficiary. Keep in mind that if a child's inheritance from a relative who is not their parent includes shares of a private company, the dividends will likely be subject to the kiddie tax (which we discuss later in the section entitled "Income splitting through corporations").

Treat educational support to your spouse as a loan.

If you're supporting your spouse while he or she is in attendance at a school, college or university and the spouse is expected to eventually be the high-income earner, treat the amounts spent on his or her education as a loan. Later, when the individual earns income, the amount can be repaid to you for investment purposes. You should document the amounts spent and have a written loan agreement.

Shift assets between spouses.

The attribution rules don't apply if you transfer assets to your spouse in return for assets of equal value. If your spouse has non-income-producing property (such as a cottage for example), consider purchasing these assets for cash (or other income-producing assets) at their fair market value. You and your spouse can continue to enjoy the assets, as your spouse earns income from the funds.

Usually, assets can be exchanged between spouses with no tax consequences. However, to avoid attribution, you and your spouse must elect to have the sale occur at fair market value. If the assets transferred have accrued gains that will be subject to tax, a capital gain will result. If the election is made, any future income or capital gains on the income-producing property would not be attributed back to the transferring spouse.

Contribute to a Registered Education Savings Plan (RESP).

An RESP is a vehicle through which you can defer taxes, split income with your children and save towards their post-secondary education all at the same time. Unlike a Registered Retirement Savings Plan (RRSP), contributions to the plan are not deductible. However, income earned in the plan is not taxed until distributed as educational assistance payments to someone named by you as a beneficiary under the plan. At such time, the income is taxable in the hands of the recipient, presumably at a lower rate, and the original contributions are returned tax-free.

A total of \$50,000 can be contributed to an RESP for each beneficiary, and such contributions can generally be made at any time while the plan is active; there is no annual limit. What this means is that you can contribute \$50,000 immediately to an RESP, although, there are certain restrictions when a beneficiary is between the ages of 15 and 17. As well, consideration should be given to lower annual contributions to take advantage of the Canada Education Savings Grant (CESG) which is discussed below. Note that if more than one plan has been set up for a particular beneficiary, you and the other contributors must share the \$50,000 lifetime contribution limit. Generally speaking, the plan itself must be wound up after 35 years.

There are two types of plans—individual plans and group plans. In addition, there are two kinds of individual plans - non-family plans and family plans. A non-family plan is a plan you set up for just one beneficiary, and there are no restrictions on who can be a beneficiary of such plan. A family plan can have more than one beneficiary; however, each beneficiary must be connected by blood or adoption to each living subscriber under the plan or have been connected to a deceased original subscriber.

A group plan (also referred to as an “Education Fund” or a “Scholarship Fund”), is a set of individual non-family plans that are administered based on a specific age group. Individual plans are more flexible, as they give the contributor more control over the investments made and the timing and amount of educational assistance payments made to beneficiaries. It is important to review all

plans carefully to fully understand the provisions of the plan in the event that beneficiaries do not attend college or university within the required time period.

An added benefit of using an RESP is the CESG, which is a federal grant that is added to your eligible contributions. The maximum annual CESG per beneficiary is 20% of \$2,500, or \$500. The maximum CESG for a year is \$1,000 if there is unused grant room because of contributions of less than the maximum amount in previous years. An additional CESG for low and middle-income families is also available. The lifetime CESG limit is \$7,200, which includes both the basic and additional CESG.

Note that the federal government also provides the Canada Learning Bond to certain RESP beneficiaries, and the British Columbia, Saskatchewan and Québec governments provide RESP related educational savings incentives to qualifying residents.

Despite these benefits, it may still make sense to use both an RESP in conjunction with the other income splitting ideas discussed in this bulletin when saving for a child’s education. For more information, see our tax bulletin titled [RESPs: Saving for Your Child’s Education](#).

Contribute to a Registered Disability Savings Plan (RDSP).

RDSPs provide a tax assisted way to help taxpayers save for the long-term financial security of dependents with disabilities. In addition to providing a way for investment funds to earn income without tax while accruing in the plan, RDSPs can achieve income splitting by taxing the investment income earned in the plan in the hands of the disabled beneficiary at the time that payments are made from the plan. Also, the Canada Disability Savings Grant and the Canada Disability Savings Bond can be received as additional benefits when these plans are established. In many ways, RDSPs are similar to RESPs in terms of tax benefits. However, contributions to an RDSP can be made until the end of the year in which the RDSP beneficiary turns 59, and RDSPs for a particular beneficiary can accumulate up to \$200,000 in lifetime maximum contributions, with no annual contribution limit.

A further benefit of RDSPs is that when a parent dies, the balance of their RRSP or Registered Retirement Income Fund (RRIF) can be transferred directly to an RDSP of which their financially dependent disabled child or grandchild is a beneficiary, allowing a further deferral of income tax, and the potential for additional income splitting. These rollover rules may also apply to Pooled Registration Pension Plan proceeds, certain lump-sum amounts paid from Registered Pension Plans and certain amounts from Specified Pension Plans.

To find out more about RDSPs, please consult with your BDO advisor.

Pay your spouse's interest-bearing debts.

If your spouse has incurred interest-bearing debts such as a car loan, consider paying off these debts on behalf of your spouse. The reduction in interest expense is not subject to attribution. Your spouse will then have more funds to invest in the future.

Note that this plan does not work if the debts were incurred to acquire income-producing properties. If you pay off these debts, any income from the properties will attribute to you.

Income splitting through unincorporated businesses

If you carry on a business, other income splitting opportunities are available to you:

Make your spouse a partner of your unincorporated business.

If you operate an unincorporated business in which your spouse is active, you may be able to establish that he or she is your partner, eligible to share in the profits or losses of the business. To be considered a bona fide partner, your spouse must either devote a significant amount of his or her time, specified skills, or training to the business or must have invested his or her own property in the business. You must ensure that your spouse's share of income is reasonable compared with the amount of work or capital put into the business. You also must be able to demonstrate that a bona fide partnership was created and therefore, a written partnership agreement is recommended.

Pay your spouse and children a salary.

If your spouse or children work in your business, consider paying them a salary. The salary must be reasonable given the services performed. A good rule of thumb is to pay them what you would have paid a third party for the same services. This is the test the CRA will use if they audit your business. A record should be kept of the time actually spent and the services actually performed.

When you pay salaries to your spouse or children, you usually must make withholdings for income tax, Canada/Québec Pension Plan (for individuals over 18 years of age) and any applicable provincial payroll taxes. There will generally be no liability for employment insurance (EI) on remuneration paid to members of your family. However, if you employ a family member on the same basis that you would an arm's length person, then you could elect to remit EI premiums on the same basis as for an arm's length employee. This would require getting a ruling from the CRA before proceeding. If you are interested in exploring this possibility, please contact your BDO advisor.

Pay a guarantee fee to your spouse.

If your spouse is required to pledge assets or to otherwise guarantee a business loan, he or she can be paid a fee by the business.

Again, the amount paid must be reasonable in the circumstances. In determining reasonableness, one would look at the amount of the loan, subsequent ability of the business to repay the loan and the amount that would have otherwise been paid to an arm's-length party to guarantee the loan. The fee will also help in establishing deductibility of the loan for your spouse, should the debt become bad and the guarantee ever be called.

Loan funds to your spouse to start-up a business.

Only income from property is subject to attribution. Income from a business is not. If your spouse has a promising business venture, you can provide interest-free financing without any attribution. If the venture is risky, you should consider that an interest-free loan would not qualify for capital loss treatment should the venture fail. If this is the case, you might want to make a capital contribution to the business as a

partner and share in the start-up loss. When the business becomes profitable, you can make interest-free loans to the business for further expansion. A gift could also be used to finance a new venture. Your spouse's share of profits from the venture can be invested by your spouse and would not be subject to income attribution.

Income splitting through corporations

The ideas that were discussed in the previous section will also work if you carry on business through a corporation. However, there are additional issues to consider when contemplating a corporate income splitting plan.

In the past, income splitting was possible with all members of your family through your corporation by issuing shares to your spouse and children, as long as you were careful to overcome certain obstacles. Dividends paid by the corporation to the shareholders would be taxed in their hands, provided you did not give or loan them the funds interest-free to acquire the shares. However, with the introduction of the kiddie tax, the government created yet another obstacle when it comes to income splitting with minor children. In order to implement a corporate income splitting plan that is successful, you must be aware of all of the obstacles that prevent income splitting.

Before implementing any income splitting ideas involving a corporation, you should be aware of a set of tax rules that pertain to a "personal services business" or PSB. Generally, if you provide services through your corporation and, if not for the corporation, you would be considered an employee of the entity to which you provide the services, your corporation may be earning PSB income. If a corporation is considered to be carrying on a PSB, the income tax consequences can be very onerous. First, the PSB rules severely restrict the ability of the corporation to deduct expenses against the PSB income by essentially limiting allowable deductions to salaries and wages paid to the "incorporated employee" plus certain amounts that would have been deductible by an individual against employment income. Furthermore, the federal tax rate on PSB income will reach 33% when changes proposed in the 2016 federal budget are fully

implemented. Finally, for provincial purposes, the small business deduction will not be available on PSB income. Consequently, if you are subject to income tax at the higher PSB rate, income splitting doesn't generally make sense.

If your corporation was set up to provide consulting or other services, speak to your BDO advisor about the risk of being running afoul of the PSB rules before undertaking any corporate income splitting planning.

PSB rules aside, the first obstacle that may prevent corporate income splitting is a set of rules commonly referred to as the corporate attribution rules. Without these rules, you could avoid attribution by simply making interest-free loans to a corporation where your spouse and children are shareholders, instead of directly to them. The corporate attribution rules provide that, if you make a low-interest or interest-free loan or transfer any property to a corporation with the main purpose of reducing your income and benefiting your spouse or minor children, you are deemed to receive interest on the loan or the value of the property transferred at the CRA's prescribed rate. This income inclusion to you is reduced by any interest, by 118% of any ineligible dividends and by 138% (for 2014 and subsequent years) of any eligible dividends you actually receive from the corporation. This deemed interest arises even if no income is earned by the corporation and no dividends are paid to your spouse or children. Consequently, it is a penalty provision that should be avoided.

The rules do not apply during any period that the corporation is a small business corporation (SBC). An SBC is a Canadian-controlled private corporation (CCPC) in which at least 90% of the assets (on a fair market value basis) are used in operating an active business in Canada. Therefore, as long as your corporation carries on business and does not accumulate significant investment assets, your spouse and children, particularly those 18 years of age and older, can be a shareholder and receive dividends.

The second obstacle is the kiddie tax, which prevents the transfer of income from high-income individuals to their children under the age of 18. Rather than redirecting income and taxing it in the

hands of the high-income family member, the rules provide for a tax on minors who receive income under an income splitting arrangement.

Minor children are taxed at the top federal personal tax rate on dividends or certain types of business income received from a family business. As well, certain capital gains will be treated as dividends and taxed at the highest rate.

Specifically, this tax applies on the following sources of income:

- Taxable dividends received directly by a minor, or indirectly through a trust or partnership. Dividends from publicly traded corporations and mutual fund corporations are excluded.
- Income inclusions required under the Income Tax Act, in respect of the ownership by any person of shares of the capital stock of a corporation. Shares of a class listed on a designated stock exchange are excluded.
- Business income from a partnership or trust, where the income is from property or services provided to, or in support of, a business carried on by:
 - a person related to the minor, including a relative who is a partner of the partnership earning business income,
 - a corporation where a relative of the minor owns 10% or more of the corporation's shares, or
 - a professional corporation where a relative of the minor is a shareholder.
- Capital gains realized by, or included in the income of, a minor from the disposition of shares of a corporation to a person who does not deal at arm's length with the minor, if taxable dividends on the shares (if paid) would have been subject to the tax on split income.
- Applicable to 2014 and subsequent taxation years, certain types of business and rental income from third parties that is allocated to a minor from a trust or partnership where a person related to the minor is engaged in the activities of the partnership or trust to earn that income.

Personal tax credits cannot be claimed to reduce this tax. However, the minor will be allowed to claim dividend tax credit and foreign tax credits, where applicable, to reduce the tax.

Although limited, there are some exceptions to the kiddie tax:

- the tax will not apply where both of the minor's parents are non-residents of Canada,
- the tax will not apply on income from property inherited from a parent, and
- if the child is going to college or university, or is disabled, income from property inherited from others won't be subject to the tax.

With the kiddie tax, it is difficult to achieve business income splitting through a corporation with minor children. However, income splitting with your spouse and children who are 18 years of age and older is alive and well. In a typical corporate income splitting arrangement, shares with nominal value are issued to the spouse and children. Dividends are later paid on these shares as income is earned by the corporation. The dividends paid often exceed the amount paid for the shares. Since different classes of shares are usually issued to different family members, it's possible to determine the dividend amount to each person to minimize tax. (Note that the dividends paid to minor children will be subject to the income splitting tax.)

This process, called "dividend sprinkling", was the subject of a 1990 Supreme Court case (*The Queen v. McClurg*). The following guidelines were drawn from the outcome of that case:

1. If you're setting up multiple classes of shares, you should ensure each class is different in some respect from the others—for example, one class of shares can be voting while the others are not, some shares can share in growth while other shares are redeemable at a set price. By varying the attributes of the shares, it is possible to have several unique classes of shares.
2. Fair market value consideration must be paid by your family members in exchange for the shares issued. This may be difficult if the shares have high value and the family members

have no independent source of funds. Income splitting arrangements are often accompanied by a “freeze” in the value of the company. This is accomplished by having the owner-manager exchange their common shares for preferred shares having a redemption amount equal to the value of the company. Provided the preferred shares have attributes that support this fair market value, any new common shares issued should then have only a nominal value.

3. Each shareholder should pay for the shares using his or her own funds and not funds provided by the owner-manager.

As shown, great care is required when developing a corporate income splitting plan. Your BDO tax advisor should be consulted prior to undertaking any arrangement.

One further point to consider when contemplating corporate income splitting is whether it makes sense to pay your spouse a director’s fee. If your spouse is an active director of your corporation, consider paying your spouse a director’s fee for services performed. A director’s services usually include attending directors’ meetings, directing the management and affairs of the business, approving financial statements, declaring dividends, approving changes to share capital and electing officers of the company. When determining whether the fee is reasonable as a deduction, the CRA will apply the same test that we just described for salaries. Note that your spouse will also be jointly liable with the other directors for the fulfillment of certain regulatory requirements, such as salary withholdings and HST/GST collections.

Income splitting in retirement

Split pension income with your spouse.

Since 2007, it has been possible for a recipient of eligible pension income to transfer up to one-half of this income to his or her spouse. Where the pension recipient is in a higher tax bracket than the transferee or the transferee does not have a source of pension income eligible for the pension credit, this splitting of the pension income can result in a tax saving. If the pension income is eligible for the pension credit, it is eligible for the pension income splitting rules.

Income eligible for pension splitting is based on whether you are over or under age 65:

- For taxpayers who are 65 years of age or older, eligible pension income includes annuity payments from a registered pension plan (RPP), RRSP or a deferred profit-sharing plan (DPSP), and payments from a RRIF.
- Effective for 2013 and subsequent taxation years, certain amounts received from a retirement compensation arrangement (RCA) may be eligible for pension splitting where the taxpayer is 65 years of age or older. In order to qualify for pension splitting, amounts paid out of an RCA must be in the form of life annuity payments and be supplemental to amounts received out of an RPP. Furthermore, the RCA payments to be split cannot exceed a specified limit (\$101,150 for 2016), less any of the taxpayer’s other eligible pension income for the year.
- For taxpayers under 65 years of age, eligible pension income includes annuity payments from an RPP and certain payments received as a result of the death of your spouse.

Regardless of your age, eligible pension income will not include:

- Old Age Security (OAS) benefits;
- Guaranteed Income Supplement (GIS) benefits;
- RRSP withdrawals; or
- Canada Pension Plan (CPP)/Québec Pension Plan (QPP) benefits. (CPP recipients can elect to combine and split CPP benefits.)

You and your spouse can take advantage of this income splitting opportunity when you file your personal income tax returns. At that time, as part of a joint election, the higher-income spouse can elect to transfer up to one-half of his or her eligible pension income to the lower-income spouse. The amount transferred reduces the higher-income spouse’s net income, and increases the lower-income spouse’s net income. The joint election you make only applies for that taxation year. In other words, you can determine whether

a transfer is beneficial annually and make the election (or not) accordingly when you and your spouse file tax returns for that year.

Contribute to a spousal RRSP.

It's possible to make contributions to an RRSP for the benefit of your spouse while deducting the contribution on your return. Although contributing to a spousal RRSP does not result in current income splitting, it can result in a large pool of funds available for future withdrawals by your spouse which would allow for income splitting when you and your spouse retire. Generally speaking, you should make your RRSP contributions to a spousal plan if your spouse's income at the intended time of withdrawal will be lower than your income.

Withdrawals by your spouse from a spousal plan will be taxed in your spouse's hands if you have not made a contribution to any spousal RRSP in the current year or the previous two years, or if the RRSP has been converted to an annuity. If your spouse also has earned income, he or she should contribute to his or her own RRSP.

Spousal RRSPs allow a different way to income split than the pension splitting rules. With pension splitting, a maximum of 50% of the pension income of the higher income spouse can be taxed in the hands of the lower income spouse. Spousal RRSPs are more flexible as they allow more control over the amount and timing of income that will be taxed in your spouse's hands, and the amount is independent of the amount of pension income taxed in your hands. If your spouse has a spousal RRSP, the full amount of the withdrawal will be taxed in the hands of your spouse (subject to the three-year rule discussed above).

Split CPP benefits with your spouse.

Since 1987, recipients of CPP benefits have been able to elect to split CPP benefits with their spouse. Once the election is made, the benefits are split 50/50. This will be beneficial in situations

where one spouse has a higher pension than the other (for example, where only one spouse has worked and is receiving a pension). Diverting half of your benefits to your spouse will not result in income attribution as this is specifically excluded from the rules. Also, remember to invest the benefits received in your spouse's name since income earned on the accumulated CPP benefits will not be subject to the income attribution rules.

Remember that CPP benefits don't qualify for the pension income splitting rules, and you must continue to use the CPP election that we just discussed.

Summary

Although the government has put a number of rules in place to prevent income splitting, there are still a number of legitimate ways to split income within the family group and achieve lower overall taxes for you and your family. Most of the income splitting techniques described in this bulletin are fairly straightforward and inexpensive to implement. Other techniques, such as splitting income earned through a corporation, are more complex. In some cases, the plans provide immediate benefits, while others will only result in tax savings over the long-term. It is important that you start now to arrange your family finances to take advantage of as many of these income splitting opportunities as possible. Discuss your personal financial situation with your BDO advisor.

The information in this publication is current as of September 1, 2016.

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact BDO Canada LLP to discuss these matters in the context of your particular circumstances. BDO Canada LLP, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

BDO Canada LLP, a Canadian limited liability partnership, is a member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms.