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Spousal RSPs now can be seen in a whole new light

NEW RULES | They can provide income-splitting opportunities well before the age of 65

BY FIONA ANDERSON
VANCOUVER SUN

The best way to split income in retirement used to be through a spousal registered retirement savings plan. But now with the new pension-splitting rules announced last month, spousal RSPs are being considered passé.

But take out the word retirement and a spousal registered savings plans can be viewed in a whole new light and provide income splitting opportunities well before the age of 65.

For example, a couple planning to start a family may at the same time want to plan a spousal RSP, so that the stay-at-home spouse can draw down some low-tax income when the time comes.

Or those hoping to retire before the age of 65 can use a spousal RSP to lower the overall tax burden before some of the new pension income-splitting rules kick in.

The new rules — which were announced on Oct. 31 at the same time as the new tax on income trusts — will allow couples to split their pension income starting in 2007. David Ablett, senior tax and retirement planning specialist with Investors Group estimates that a B.C. couple with combined income of $80,000, $60,000 of which comes from one spouse's pension, will save $3,600 in tax.

"In the future that's going to become a very important component of financial planning for couples," Ablett said.

Although legislation is not yet in place, the current proposal allows a spouse to allocate up to 50 per cent of his pension income, including money from his own registered retirement income fund, to his spouse or common-law partner.

New pension-splitting rules announced last month will allow couples to split their pension income starting in 2007.

Company pensions can be shared as soon as they are received but individuals will have to be 65 years old before they can share money taken from their RRIF, said Sandy Cardy, senior vice-president of tax and estate planning at Mackenzie Financial Corp.

So while that makes spousal RSPs seem obsolete as a retirement planning tool, they still can serve a purpose for those who want to income split before the age of 65, especially if they don't have a company pension, Cardy said.

And with people changing jobs throughout their careers and converting company pensions into locked-in RSPs when they leave, "a big bulk of the population" will likely not be relying solely on a company pension, she said.

The key to whether a spousal RSP makes sense is still unequal incomes and unequal RSPs between partners, said Robert Radloff, a chartered accountant with Investaflex Financial Group in Vancouver.

If one of the spouses is in the top tax bracket and the other isn't, it makes sense for the one in the higher tax bracket to make the spousal contribution and get the tax break, which could be as high as 43.7 per cent, Radloff said. Then when the lower income-earner draws money from the spousal RSP, it will be at a much lower rate. And with the basic exemption nearing $10,000, some of the money will be tax-free, he said.

"So it makes sense for people who are maybe in their 40s so they're not going to retire for another 20 years or so, so there's a period for them to utilize that splitting," Radloff said.

But using a spousal RSP to income split does take some planning because if the money is withdrawn too soon, the tax burden will fall back on the higher-income spouse. In general, money should not be withdrawn until three years after the contributions are made. If money is withdrawn earlier the contributing spouse will be handed the tax bill, wiping out any tax savings.

Erik Tung, who lives in White Rock, has been contributing to a spousal RSP because he makes more money than his wife and has a better pension plan.

"What we were planning to do was prevent the government from getting a bigger share of our retirement dollars," Tung said.

And Tung hopes to retire at 52, 57 at the latest, he said.

But most of his income will come from a company pension, so whenever he retires he'll be able to split that income with his wife, making the spousal RSP less important.

But Tung's financial planner, Grant Gamble with Coast Capital Savings in Semiahmoo, said while the pension-splitting rules are wonderful, he still encourages his younger clients, like Tung, to use a spousal RSP, not only to split income before retirement but also "because you never know what legislation may come down the road."

"I don't think [the government] would take it away, but you can never be sure," Gamble said.

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