Saving Tax: 10 Strategies for Income Splitting

TIM CESTNICK

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There’s still time to take advantage of this pillar of tax planning in 2012 if you act now.

I had lunch with an old friend recently. Paul and I were talking about our kids. His son is now 18 years old and heading to university. “What’s your son going to be when he graduates?” I asked. “A very old man,” Paul replied. “He’s not motivated,” he continued. “The problem is that he sees friends graduating from school who are highly educated but are having problems finding work.”

“He’ll likely have a low income for the next few years,” I said, “so why not take advantage of that while you can?” I spoke to Paul about the idea of shifting income to family members who aren’t going to pay as much tax as he will. This is the concept of income splitting, and it’s one of the pillars of tax planning. There’s still time to create tax savings in 2012 if you act now. Here are some income splitting strategies to consider:

Employees

1. Pay the household expenses. If you’re the higher income earner in the family, consider paying as much of the household expenses as possible. This will free up the income of your spouse or other family members to invest. They will then pay the tax on the investment income – not you.

2. Hire a family member. As an employee you may be entitled to a deduction for the salary of an assistant if your employer requires you to pay this cost. Enter an agreement with your employer that requires you to hire this person and then hire a family member. This will shift income from you to him or her.
3. **Contribute to registered plans.** If you make a contribution to a spousal registered retirement savings plan (RRSP) or a registered education savings plan (RESP) it’s generally the case that withdrawals from those plans, to the extent they are taxable, will be taxed in the hands of your family member – the beneficiary.

**Retirees**

4. **Split CPP benefits.** You can arrange for up to one half of your CPP benefits to be reported on your spouse’s tax return rather than your own. Contact Service Canada at 1-800-277-9914 or visit their website at [servicecanada.gc.ca](http://servicecanada.gc.ca) to apply.

5. **Split pension income.** It’s possible to report up to one half of your eligible pension income on your spouse’s (or common-law partner’s) tax return. File Form T1032 with your tax return each year to do this. Go to [cra.gc.ca](http://cra.gc.ca) and do a search for “pension income splitting” for more.

**Investors**

6. **Make a gift to your child.** If you invest assets in the name of an adult child then any income will be taxed in your child’s hands – not yours. In the case of minor children, capital gains (but not interest or dividends) can be taxed in the hands of your child when investing in his or her name.

7. **Swap assets with family.** You can transfer an income-producing asset to a lower-income family member and take back something of equal value that doesn’t produce an income (jewellery, or his half of the family home, for example). This will shift income to your family member. The transfer will be considered a disposition at fair market value, which could result in some tax to pay, so count this cost first.

8. **Transfer capital losses to your spouse.** While this idea doesn’t transfer income, it does transfer losses, which can also save tax. If you have unrealized capital losses and no capital gains to apply the losses against, it’s possible to transfer those capital losses to your spouse if he or she has gains that can be sheltered with the losses. I’ve outlined the steps in my article dated Oct. 28, 2006, which you’ll find in the resources section at [waterstreet.ca](http://waterstreet.ca).

**Self-employed**

9. **Pay family wages.** If you own a small business, full- or part-time, you can pay family members reasonable wages for work performed. In my friend Paul’s case, he’s paying his son $10,000 this summer to help in the business. Since his son has no other income, he won’t pay any tax on this amount and he’ll use the funds to pay for university next year. Effectively, Paul has deducted the cost of his son’s university education.
10. Enter a partnership with family. If you’re in business and partner with a family member you’ll be able to share the profits of the partnership in some predetermined fashion that will cause a portion of the income to be taxed in the hands of that family member.

I’d suggest visiting a tax pro to talk over these ideas before implementing!

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