TAX MATTERS

Your spousal status affects your taxes – for better or worse

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In his first 30 years of marriage, my friend Mike didn't forget a single wedding anniversary. In year 31, for whatever reason, he forgot the all-important date. He's forgotten several since. Hey, he's getting older and his memory is not as good as it used to be. So, his wife has adopted an effective plan. She reminds him of their anniversary in both January and June – and gets two gifts each year instead of one.

All kidding aside, marriage can come with many benefits – and challenges, including from a tax point of view. Today, I want to share some of the advantages that our tax law will bestow on anyone who is married – or living in a common-law relationship.

THE DEFINITION

The fact is, the same rules that apply to married spouses under our tax law also apply to those who are common-law partners (CLPs). You should have a pretty good idea as to whether you're legally married (well, I hope you're clear on that). As for those who are considered to be CLPs, the rules are not as clear.

Under our tax law, two individuals are CLPs if they have been living together in a conjugal relationship for at least 12 continuous months. If they were living apart for 90 days or more because of a breakdown in the relationship, then they're no longer CLPs as of the start of that 90-day period.

There's an exception to the 12-month test: If two people have a child together, by birth or adoption, then they're considered CLPs even if they haven't lived together for 12 months yet. And by the way, the rules under our tax law that define a spouse or CLP may differ from the rules in your province that apply to family law issues – just to complicate things.

THE GOOD

If you're a spouse or CLP, there are some areas of our tax law that can work to your benefit:

Tax credits available: The following credits may be available because you have a spouse or CLP if the criteria for each credit are otherwise met: the spousal or CLP amount, the Canada caregiver amount, the home accessibility tax credit and the first-time homebuyer's amount.

Tax credits transferrable: The following credits can be transferred fully or partly from one spouse or CLP to the other, which can make sense if one doesn't have sufficient income to fully use these credits: the age amount, Canada caregiver amount, pension income amount, disability amount and the tuition amount. In addition, the following credits can be claimed on either person's tax return: political contributions, charitable donations and medical expenses.

Pension splitting: If you receive eligible pension income, you can report up to one-half of that income on the tax return of your spouse or CLP, which could result in tax savings as a couple if one is in a lower tax bracket. But make sure you do the math on this first, because it may not always be best for you.

CPP pension sharing: You and your spouse or CLP have the opportunity to split your combined CPP benefits so that those benefits are added together, then split so you each receive a share. In most cases you will each receive half – which could result in less tax to pay if it puts more income into the hands of the lower-income person.

Rollover on death: When you die, you're deemed to have sold most of your assets at fair market value. This can trigger a tax bill. You can defer that tax bill by leaving assets to a spouse or CLP. In this case, your spouse or CLP inherits those assets with the same adjusted cost base that you had. This is a tax-deferred rollover. No tax will be owing until your spouse or CLP sells the assets, gives them away, or dies.

Registered plan contributions: Having a spouse or CLP will allow you to make contributions to a spousal registered retirement savings plan (RRSP) to split income. Further, if you name your spouse as the beneficiary of your RRSP or registered retirement income fund (RRIF), taxes will be deferred on those plan assets when you pass away. As for tax-free savings accounts, you can name your spouse as a "successor holder" (a more efficient transfer than a "beneficiary"), which will allow the assets of your TFSA to move directly into the plan of your surviving spouse to continue avoiding tax on any growth or income. Whether it's an RRSP, RRIF or TFSA, the assets can transfer to a plan for your surviving spouse without eroding his or her contribution room to those plans.

Next time, I'll share more on this topic, including some tax challenges – the bad – you might face as a spouse or CLP.

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