



LOWER YOUR TAXABLE INCOME

Take advantage of income splitting and pay less tax by using a spousal loan

Effective July 1, 2020, the Canada Revenue Agency (CRA) lowered the prescribed interest rate for a spousal loan back to 1%.

If one spouse/partner earns income in a higher marginal tax bracket than the other, this strategy may be helpful to increase your family's take-home income.

How does it work?

A spousal loan is created when the spouse in the higher tax bracket loans money to the spouse in the lower tax bracket (who then benefits from earning income and capital gains at a lower rate).

Example:

- Sophie earns income in the highest marginal bracket in Alberta of 48% (2019).
- Justin is at home taking care of their young family, with no earned income.
- Sophie has amassed non-registered cash and investments of over \$1,000,000.
- Sophie initiates a spousal loan to Justin of \$1,000,000 of the non-registered money using the current prescribed rate of 1%, secured by a written promissory note.
- This rate is locked in at 1% for the life of the loan.
- The interest must be paid regularly and on time to avoid attribution penalties.
- The money is invested in a well-managed and diversified portfolio which offers a 4% income yield and growth potential.
- Justin pays Sophie \$10,000 a year in interest income, as an interest expense on the outstanding loan. This is a tax deductible expense to Justin.
- Sophie must claim \$10,000 in annual income as a result of the interest income paid to her by Justin.
- All income earned on the \$1,000,000 portfolio is taxed in Justin's hands.



	With Loan		Without Loan	
	Sophie	Justin	Sophie	Justin
Invested Assets	-	\$1,000,000	\$1,000,000	-
Income on Invested Assets (4%)	-	\$40,000	\$40,000	-
Tax Paid	\$4,800	-	\$15,800	-
Total Tax Paid	\$4,800		\$15,800	

Note: Justin pays zero tax based on the type of income earned and his ability to utilize tax credits. Tax paid from Sophie with the loan is interest income.

If you are currently in a situation where the marginal tax rates differ substantially between you and your spouse, a spousal loan is worth inquiring about with your tax professional.

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