

Registered Retirement Savings Plan

A pillar of retirement income planning



One of the pillars of retirement income planning in Canada is the Registered Retirement Savings Plan (RRSP). Introduced by the federal government as an alternative retirement saving vehicle for Canadians who did not have the benefit of an employer-sponsored pension plan, RRSPs have become a mainstay of saving for retirement.

RRSPs enable effective savings because contributions to a plan are not taxed until they are withdrawn, thereby reducing your present taxable-income. Second, investment income or capital gains arising from any investments held inside your RRSP grow on a tax-deferred basis until you withdraw them or the plan is deregistered.

The amount you can contribute every year depends on:

- your earned income from the previous year
- any unused contribution room from previous years that can be carried forward indefinitely
- the maximum contribution limit set annually by the federal *Income Tax Act (ITA)*
- any adjustments based on employer pension plan contributions

By the end of the year you turn 71, you are required to close your RRSP by either: withdrawing the funds; transferring them to a RRIF (Registered Retirement Income Fund), or using the funds to buy an annuity. One of these choices must be made by December 31st of that year.

What income counts toward your RRSP contribution room?

You can contribute to your RRSP up to and during the year you turn 71. You can make contributions at any time during the calendar year.

You can also claim contributions made in the first 60 days of the following calendar year — for either the preceding tax year or the present tax year. For example, Audley didn't make an RRSP contribution before the end of 2015, but he needed the tax deduction for the 2015 tax year. Therefore, he decided to make a large contribution to his RRSP in early January, and use it to claim a deduction on his 2015 tax return. Alternately, he could have claimed a deduction for the contribution on his 2016 tax return, or any future tax year.

RRSP contribution room is based on certain types of "earned income" as defined in the federal *ITA* including:

- Employment income
- Net rental income
- Net business income
- CPP/QPP disability pension income
- Spousal/child support received
- Research grants

Earned income does *not* include:

- RRSP/Registered Retirement Income Fund (RRIF) income
- Interest and Dividend Income
- Capital gains
- CPP/QPP income, other than disability benefits
- Old Age Security
- Workers' Compensation

If you benefit from an employer pension plan or deferred profit sharing plan, you are seen to be receiving benefits similar to an RRSP. Therefore, your annual RRSP

contribution room will be reduced. Following from the original intent behind creating RRSPs, this limitation is designed to level the retirement savings playing field.

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If, at any time, you withdraw funds from your RRSP, a federal withholding tax will be imposed (except in special cases such as the RSP Home Buyers' Plan or Lifelong Learning Plan). If you live in Quebec a combined federal/provincial withholding tax will be imposed.

Do you contribute the maximum amount to your RRSP every year? Do you know what your contribution limit is?

So how much can you contribute?

You can contribute 18% of your previous year's earned income up to an annual allowable maximum, which changes every year as set by the *ITA*. The annual limit is known as the "RRSP deduction limit" (or more commonly, your "RRSP contribution room"). Quite simply, if you have worked and created contribution room, you can contribute.

The quickest way to find out the amount you can contribute is to refer to the RRSP deduction limit on your *Notice of Assessment (or Reassessment)* from the Canada Revenue Agency (CRA), which you receive after filing your tax return, either in the mail or in your CRA online account: <http://www.cra-arc.gc.ca/esvc-srvce/tx/ndvdl/myccnt/menu-eng.html>.

Your Notice of Assessment will show the contribution limit for the present tax year, as well as any contributions you made but haven't deducted in previous years.

Perhaps you made a contribution but didn't have enough room to deduct it in a past year. You can carry forward the contribution room you build up and deduct any undeducted contributions then.

You are allowed to make a cumulative over-contribution of \$2,000 above your annual contribution room without incurring a penalty from the CRA. That \$2,000 over-contribution may be made in one tax year, or over a number of tax years. Note, however, that you cannot deduct that extra \$2,000.

Meanwhile, if you contribute more than this year's amount, including making up for your unused contribution room, you will be in an *over-contribution* position. The CRA may then impose a penalty of 1% per month on the excess amount, until you withdraw it. You will not be taxed on the withdrawal if you make it during the year the unused contribution was made, or the year following, provided that you reasonably expected you could fully deduct the excess.

Alternately, you can leave the excess contribution in your RRSP if you know you will be generating sufficient new contribution room in the following year. However, in the meantime you will still pay the monthly penalty for an excess contribution.

Ensure you don't over-contribute to your RRSP. Review your Notice of Assessment (or Reassessment) to determine what your contribution room is.

Qualified investments for an RRSP

The federal *ITA* has rules to prohibit avoidance of tax. For RRSPs, the "Anti-avoidance Rules" will enable the CRA to impose tax if investments made within them are not "qualified". Qualified investments include money, guaranteed investment certificates, government and corporate bonds, mutual funds and securities listed on a designated stock exchange.

The impact of pension adjustments and past service pension adjustments

The amount you can contribute in a given year will be affected by any pension adjustments or past service pension adjustments you may have.

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The amount of pension benefits you earn in a year from an employer pension plan will comprise your "pension adjustment". It will reduce your RRSP deduction limit for the following tax year. The greater the amount put aside for you in your employer pension plan, the less you will be able to contribute to your RRSP.

Meanwhile, if you receive additional pension benefits because your employer has upgraded the company pension plan on a retroactive basis, or you have purchased pension credit for past service, that will result in a "past service pension adjustment" (PSPA). It will also reduce your RRSP contribution room.

The impact of an employer pension plan enhancement may sometimes be sufficient to reduce that year's contribution limit, and any unused carry-forward room. You will have "negative contribution room", which will not be decreased until you generate earned income and new contribution room.

If you leave your employment before retirement, you may be entitled to a "pension adjustment reversal" (PAR), which will restore some of the RRSP contribution room that was lost due to pension adjustments.

The amount of the PAR will be calculated by your pension administrator. It will differ depending on whether your employer plan was a defined benefit or defined contribution plan. Defined contribution (DC) plans involve contributions from the employee, and are viewed by the CRA to be similar to an RRSP. DB plans, on the other hand, generally involve contributions from the employer as well. Therefore, they are viewed as providing an added benefit on top of an RRSP. If you had a DB plan, you will only get a PAR if you give up the right to receive payments from the plan, or the commuted value of benefits earned under the plan to a locked-in RRSP, generally known as a “Locked-in Retirement Account”, are less the amounts considered to be a pension adjustment or PSPA.

The impact of a pension buyback

You may be able to buy back benefits from your employer pension for a time period when you were not participating in your employer pension plan, perhaps due to a leave of absence such as maternity leave.

Funding a buyback can be done as:

- A lump sum payment
- Installments
- Direct transfer from a registered plan such as your RRSP

If you, as an individual (rather as part of a group) decide to undertake a buyback, please note that the CRA must certify the PSPA calculated by the employer or pension administrator. It is the employer or pension administrator’s responsibility to submit a buyback for certification.

A PSPA cannot be certified if it creates more than \$8,000 of negative RRSP contribution room. If so, you will have to weigh the value of the future income generated by adding to your employer pension plan versus the income that could be generated by the funds you transfer from your RRSP.

Let’s look at an example: In this scenario, Sam decides to buyback \$30,000 in past service. It will result in a PSPA of \$30,000. If she is funding the buyback by transferring \$15,000 from her RRSP, this creates \$15,000 negative contribution room (more than the allowable maximum of \$8,000), so she will be required to make further RRSP withdrawal of \$7,000 to fund the buyback.

PSPA	\$30,000
Less: RRSP transfer	\$15,000
PSPA is reduced to	\$15,000
Allowable negative RRSP room	\$8,000
Requires an RRSP withdrawal	\$7,000

A pension buyback and its impact on your RRSP involve some tricky calculations, possibly a transfer from your RRSP to fund the buyback, and a withdrawal so you won’t end up penalized by the CRA. Review your buyback plan with your TD advisor to ensure you will benefit from doing it in the first place. If you will benefit, your advisor can assist with facilitating the buyback, and if necessary a withdrawal from your RRSP.

Spousal RRSPs

A “spousal RRSP” can be set up by one spouse or common-law partner for the other. Generally, it is established by the higher income-earner for the lower income-earner. Some couples have both individual and “spousal RRSPs”. Some individuals eventually combine both types of their RRSPs into one spousal RRSP to make managing their investments easier or to cut down on administration costs.

For example: If Rahim sets up a spousal RRSP for Kala, when he contributes to the spousal RRSP, his own contribution room will be decreased. He may deduct a contribution based on his contribution room, even though Kala is the annuitant and has full control of the plan.

When income is withdrawn from the plan, it will be taxable to Kala. The exception would be if she makes a withdrawal within three years from when Rahim makes a contribution. The “attribution rules” in the federal *ITA* will be applicable and Rahim will be taxed on the withdrawal. The attribution will apply on withdrawals up to the total amount of contributions made to all spousal RRSPs in the same year as the withdrawal, and the two previous years.

The attribution rule will not apply if the partners are not living together due to relationship breakdown or the annuitant’s partner has died.

While the contributions made to a spousal RRSP are based on the contributor’s contribution room, ultimately, a spousal RRSP will enable the couple to split income when withdrawals are eventually made.



Possible Spousal RRSP Issues: Dominic and Fabriana

1. When Dominic turns 71, his spouse Fabriana is 63. He can still contribute to her spousal RRSP, while collapsing his individual RRSP, as long as he has contribution room.
2. Dominic and Fabriana separate. Under certain conditions, they could ask the CRA to remove the spousal designation of any spousal RRSPs, if they provide written proof that their marriage has broken down, e.g., a legal separation agreement or divorce order.

3. If they get divorced, a tax-free transfer of RRSP funds can be made from one spouse to the other as part of the legal proceedings to settle the division of property or fund spousal support.

**Is a spousal RRSP right for you and your partner?
Talk it over with your partner and TD advisor to
ensure you know the benefits and tax rules.**

Taxation of an RRSP when you die

It’s likely that your RRSP will present the largest tax liability for your estate. It will be included as income on your “terminal tax return” at fair market value. Tax will be payable unless you undertake one of a few strategies prior to death.

The most common is to name a “qualified beneficiary” for your RRSP. That includes your spouse or common-law partner, a dependent minor child or grandchild. The usual practice is to choose your partner. Please note that Quebec residents must name beneficiaries in their Will. They cannot do so in registered plan documents.

The RRSP funds are transferred to that person as a “refund of premium”. The full amount could be taxed as your partner’s income. Usually, however, your partner would transfer the funds into an RRSP or RRIF, continuing the deferral of tax until the funds are withdrawn, or passed on again when he or she dies.

If the beneficiary is a dependent child or grandchild and is named your beneficiary, the funds could be used to purchase an annuity. The only caveat imposed by the CRA is that annuity must end by the time the child or grandchild turns 18 years of age. This results in spreading the tax over several years, when the annual income from the annuity is received, allowing the child or grandchild to take advantage of personal tax credits to lower his or her tax bill. If the child or grandchild suffers from a physical or mental infirmity your RRSP funds can be transferred to the child’s RRSP, RDSP, RRIF, Pooled Registered Pension Plan or used for the purchase of an annuity. (The infirm child can be an adult child.)

You can name a registered charity as your beneficiary. Then your estate will be entitled to a charitable tax donation credit. It is likely to offset any tax owing upon deregistration of your RRSP at the time of death.

If you name neither a charity, nor a “qualified beneficiary” such as a partner, child or grandchild, your estate will be responsible for paying the tax owed upon the collapse of the plan. If there are insufficient funds in your estate, the beneficiary may have to pay a share of the taxes owing in situations when the estate and beneficiary share responsibility for the tax liability.

Talk to your TD advisor about a possible beneficiary for your RRSP. Make sure you know the tax impact of your choice.

Now you are ready to:

- Take advantage of the benefits of an RRSP to accumulate for your retirement
- Consider the implications of a buyback of your employer pension based on your RRSP
- Review the implications of naming a beneficiary

