

## Registered Retirement Savings Plan

A fundamental vehicle to accumulate retirement savings



The Registered Retirement Savings Plan (RRSP) was introduced by the federal government as an alternative retirement savings vehicle for Canadians who did not have the benefit of employer-sponsored pension plans. It remains a significant method for individual Canadians to build retirement savings. RRSPs enable effective savings because contributions to a plan are not taxed until they are withdrawn, thereby reducing your present taxable-income.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 Registered Retirement Income Fund (RRIF), or using the funds to buy an annuity. One of these choices must be made by December 31<sup>st</sup> 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 a calendar year — for either the preceding tax year, the current tax year or a future tax year. For example, Audley didn't make an RRSP contribution before the end of 2018, and he decided to make a large contribution to his RRSP in early January 2019. Since the contribution was made within the first 60 days of the following calendar year, he may use it to claim a deduction on his 2018 tax return. Alternately, he may claim the deduction for the contribution on his 2019 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
- Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) disability pension income
- Spousal support received
- Research grants

Earned income does *not* include:

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

If you benefit from an employer pension plan or deferred profit sharing plan, your annual RRSP contribution room will be reduced by a pension adjustment.

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

## 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 earned income and therefore created contribution room, you can contribute subject to potential pension adjustments.

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.

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. For example, perhaps you made a contribution but chose not to deduct it in a prior year. You can carry forward the contribution and may deduct it in a future year however be wary of over-contributing (discussed below).

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Canadians over 18 are allowed to make a cumulative over-contribution of up to \$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 from your taxable income.

Meanwhile, if you contribute more than this year's contribution limit and exceeded the cumulative \$2,000 over contribution, you may be in an excess contribution position. The CRA may then impose a penalty of 1% per month on the excess amount, until you withdraw it. You may not be taxed on it if you withdraw the excess amounts, and can show your excess contributions were due to reasonable error. The CRA will require a written request with supporting documents to consider canceling or waiving the tax on the excess contributions. You should speak with your tax advisor to determine the necessary documents to send to the CRA in your request for canceling or waiving the tax.

If you leave the excess contribution in your RRSP you will be required to file the necessary forms and pay the monthly penalty for the excess contribution.

## 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 (PA) or past service pension adjustments (PSPA) you may have.

The annual PA is generally the value of pension benefits you earn in a year from an employer pension plan. 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 increases, the less you will be able to contribute to your RRSP.

A PSPA can occur if you have purchased a pension credit for past service, or receive additional pension benefits because your employer has upgraded the company pension plan on a retroactive basis. A PSPA will also reduce your RRSP contribution room.

If you stop being a member of an employer pension plan, you may be entitled to a "pension adjustment reversal" (PAR). The purpose of a PAR is to restore RRSP contribution room when an employee's membership to a pension plan stops and the termination benefit is less than the total PAs or PSPAs that have been reported to CRA.

If you belonged to a Defined Contribution (DC) plan, your PAR will include the total of all the PAs reported by your employer since 1990, which have not yet vested.

If you belonged to a Defined Benefit (DB) plan, your PAR will generally be equal to the total PA amount since 1990, less any lump sums transferred to you, an RRSP or a money-purchase pension plan (if you have reported any PSPAs, the calculations will be more complex). With a DB plan, if you maintain entitlement to periodic pension payments, you will not be entitled to a PAR. PAR is only available if the commuted value of a DB plan is transferred to a locked-in RRSP, (generally known as a "Locked-in Retirement Account"). The amount of PAR will be calculated by the pension administrator.

## Qualified investments for an RRSP

The federal *ITA* has rules to prohibit avoidance of tax. For RRSP and RRI's, "anti-avoidance rules" enable the CRA to impose tax if investments made within them are not "qualified or prohibited". Qualified investments may include, but are not limited to, money, guaranteed investment certificates, government and corporate bonds, mutual funds and securities listed on a designated stock exchange.

## 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.

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**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 contributions up to his deduction contribution limit for the year, 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 the year Rahim makes a contribution or in the next two years. The "attribution rules" in the federal *ITA* 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, and the amount would be taxable income to Rahim.

The attribution rules will not apply if the spouses are not living together due to relationship breakdown or the annuitant's spouse has died.

While contributions made to a spousal RRSP are based on the contributor's RRSP contribution room, ultimately, a spousal RRSP is designed to enable a 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.
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.

## Taxation of an RRSP when you die

Your RRSP may present a significant tax liability for your estate. Typically it will be included as income on your "terminal tax return". Tax will be payable unless the RRSP is left to a "qualifying survivor" (or qualified beneficiary),

such as the taxpayer's spouse or common-law partner, or financially dependent child or grandchild.

Please note that Quebec residents must name beneficiaries in their Will; they cannot do so in the registered plan documents.

When the RRSP funds are transferred to a qualified beneficiary (or "qualifying survivor"), the full amount may be taxed in the hands of the beneficiary as income. However, if the transferred funds are considered to be "refund of premiums", the beneficiary can defer tax by purchasing an annuity or transferring the funds into an RRSP (or other eligible plans such as RRIF, pooled registered pension plan (PRPP), specified pension plan (SPP) or registered disability savings plan (RDSP)).

If the beneficiary is a dependent minor child or grandchild, the funds could be used to purchase an annuity. The annuity must end by the time the child or grandchild turns 18 years of age. This enables spreading the tax liability over several years, while 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 child or grandchild (regardless if they are minors or adults) suffers from a physical or mental infirmity your RRSP funds may be transferred to the child's RRSP, RDSP, RRIF, PRPP, a lifetime benefit trust or used for the purchase of an annuity.

You can also name a registered charity as your beneficiary. Your estate will then be entitled to a charitable tax donation credit. It may reduce or offset any tax owing on your RRSP at the time of death.

### Consider:

Establishing an RRSP as a vehicle for saving for your retirement. If you have further questions about your annual RRSP contribution room, what investments you can purchase within an RRSP, the impact of any employer pension plan you may belong to, or the impact of naming a beneficiary, please speak to your TD advisor.



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