

# FineAnswers

## Answers to questions on Tax, Finance and Management

### RRSP 2007 - Volume VI Issue 3 January 2008

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#### 1) WHAT IS AN RRSP AND WHAT ARE ITS BENEFITS?

RRSP is a **PLAN** which enables Canadian residents with earned taxable income to save and reduce their taxes at the same time. This is achieved because such savings are tax deductible. Registered Retirement Savings Plans are special accounts registered with Canada Revenue Agency and managed by authorized financial institutions. Funds in these accounts can be used to earn interest, dividends or appreciate in value **tax free**.

#### 2) WHO CAN CONTRIBUTE?

Anyone 71 years or younger. There is no minimum age. However, the last year you can contribute is the calendar year during which you become 71 years old.

#### 3) WHO SHOULD CONTRIBUTE?

Anyone who, has a taxable income whether he or she pays tax or receives a refund, will benefit from this plan.

#### 4) HOW MUCH CAN ONE CONTRIBUTE?

Tax deductible contribution for 2007 cannot exceed 18% of your 2008 **EARNED INCOME**, (minus your **Pension Adjustment**) up to a maximum of \$19000 plus any **unused contributions** from 1991 to 2008. **Unused contributions** are what you could have contributed in 1991 to 2008; but you did not. If you are a member of your employer's Registered Pension Plan (**RPP**) or Deferred Profit Sharing Plan (**DPSP**) you may have an amount shown on your 2008 T4 as **Pension Adjustment (PA)**. This represents the increase in the value of your benefits in

the plan. This increase is mostly due to your contribution as well as your employer's. However, the value may also increase as a result of other factors such as people forfeiting their entitlement by prematurely dropping out of the plan. The **PA** reduces your contribution limit. Also **Past Service Pension Adjustment** could reduce your contribution limit as it also represents an increase in the participants future benefits in the pension plan. An increase in the benefits could result from changes to the formulas used in calculating the pension of members when they retire.

#### 5) WHAT IS EARNED INCOME?

The most important types of earned income are; salaries, business profits, EI supplementary benefits, alimony receipts, and rental income. Included on what is not earned income is Interest, Dividends, Capital Gains, EI benefits etc.

#### 6) WHAT IF THERE IS A BUSINESS OR A RENTAL LOSS?

Business losses and rental losses as well as alimony payments will reduce earned income.

#### 7) AT WHAT DATES SHOULD I CONTRIBUTE TO MY RRSP?

Allowable contributions made in a calendar year or within sixty days after the end of the year can be deducted from that year's taxable income. Therefore contribution made between January 1<sup>st</sup> 2008 and February 29<sup>th</sup>, 2008 could be used as a deduction from the taxable income of either 2007 or 2008. It is always better to contribute early in the year as the longer money stays in the plan the more tax free interest it accumulates in the plan.

**8) WHAT IS THE TAX EFFECT IF I RETIRE BEFORE 65?**

There is no difference if you retire before you are 65 except that you may not be able to claim the \$2,000 pension non-refundable tax credit.

**9) CAN ONE OVERCONTRIBUTE?**

Overcontribution occurs when you pay more than your allowable deductible amount into the RRSP. It may be a good thing as it will allow you to accumulate more interest or dividends tax free. However, when you draw it out of the RRSP it will be considered your income and you will pay tax on it. Overcontributions must not be more than \$2,000. So if you overcontribute make sure that you can use it as a deduction in future years. That is to say you have earned income in excess of \$11,111. This amount will generate room for deduction of \$2,000 so that once you used it your overcontribution disappears.

**10) IS THERE A PENALTY ON OVERCONTRIBUTIONS OF MORE THAN \$2,000?**

Yes. You pay 1% per month penalty on the excess over \$2,000.

**11) CAN I WITHDRAW FUNDS FROM MY RRSP?**

Whenever you withdraw funds from your RRSP it will be treated as income and you will have to include it in your taxable income and pay tax on it. Incidentally this income is not considered earned income for the purpose of calculating your contribution limit (see 4 above). Also note that when you make a withdrawal from your RRSP 10% tax is withheld on \$5,000 or less and 20% on \$5,001 or more. You will get credit for this tax when you file your return.

**12) DO I PAY CANADIAN TAX ON MY RRSP IF I BECOME A NON-RESIDENT?**

No. As long as you have not withdrawn any amounts you do not pay tax. If you withdraw funds from your RRSP while you are not a resident of Canada you would have to pay 25% tax on the withdrawn amount. Usually the financial institution where your RRSP is will deduct the tax before paying it to you. The 25% could be lower depending on which country you are residing in.

**13) WHAT IS THE TAX EFFECT WHEN I RETIRE AFTER 65?**

If you withdraw the entire amount you will have to pay tax on it. You can leave it in the plan until you are 71 or you can take out an **ANNUITY** and receive a fixed amount every year for the rest of your life or a predetermined number of years. You can also transfer it to another type of plan called the **RRIF**. This plan will allow your savings to continue to accumulate tax free but you have to withdraw a minimum amount based on your age which should be included in your taxable income. In both cases you can take advantage of the \$2,000 pension deduction (non-refundable tax credit).

**14) CAN I CONTINUE TO CONTRIBUTE IF I AM OVER 71 YEARS OF AGE?**

No! All RRSP plans should be closed in the year when you turn 71. For an individual who turns 71 in 2007, the plan should be closed in 2007 and you must do as in (12) above or the entire amount becomes your taxable income for that year.

**15) WHEN SHOULD I NOT CONTRIBUTE TO AN RRSP?**

You should not contribute to an RRSP:

a) When you have no taxable income in the foreseeable future as there is no tax benefit when you contribute while when you withdraw the same amount you may have to pay tax on it. However, this draw back may be compensated if you leave your contribution in the plan for a long time or deduct it when you have taxable income.

b) When you know your tax rate is going to rise significantly in the future; it is better to contribute while deferring your right to deduct contributions and use it when tax on your top slice of income is higher.

c) If you have a debt that has a non-deductible or a high interest it may sometimes be better to pay it off and use your RRSP deduction privilege later on.

**16) WHAT CAN I INVEST MY RRSP FUNDS IN?**

Some of the more important ones are bank deposits, GIC's, Treasury Bills, Government of Canada Bonds, Mutual Funds, CMHC (Canada Mortgage Housing Corporation) insured Mortgages, Canadian Stocks quoted on stock exchanges recognized by Canada Revenue Agency. The 2007 Budget eliminated the 30% limit in respect of foreign investments in your RRSP. You can invest in mortgages **including your own** as well as shares of private companies - subject to conditions and limitations.

**17) CAN I INVEST IN MY OWN PRIVATE COMPANY?**

No, you must have less than 10% of the share capital of this corporation and the company should not be an investment corporation.

**18) SHOULD I PAY DOWN MY NON-DEDUCTIBLE HOME MORTGAGE OR CONTRIBUTE TO MY RRSP?**

That usually depends on the interest you earn inside the RRSP, the mortgage interest and your marginal tax rate. As a rule of thumb, it is better to contribute to your RRSP and use the tax refund to pay down the mortgage.

**19) IS THERE AN ADVANTAGE IN MORTGAGING MY OWN RESIDENCE AND BORROWING FROM MY RRSP?**

Bearing in mind that there is a set-up charge an annual administration charge and an insurance premium payable to CMHC; it may be beneficial if you can charge an interest high enough to justify the costs. The interest on these mortgages should reflect the market rates.

**20) WHAT IS A SELF DIRECTED RRSP?**

A self directed plan is one that you have control over your investments and you can buy and sell as you choose.

**21) CAN I CONTRIBUTE ASSETS OTHER THAN CASH?**

Yes, **if your plan is self directed!** You can transfer eligible stocks bonds etc. to your RRSP. The transfer should be at market value. The transfer is considered a sale of the bonds, stocks etc. If a capital gain results it should be included in your income. However, a capital loss is not allowed.

**22) CAN I EXCHANGE ELIGIBLE ASSETS OUTSIDE THE PLAN WITH THE ONES INSIDE?**

Yes, if your plan is self directed and the outside assets are eligible you can. You may, however, trigger a capital gain by doing this.

**23) SHOULD I BORROW AND INVEST IN AN RRSP?**

Interest paid on borrowed money invested in an RRSP is not deductible. If you do not withdraw funds from your RRSP for a number of years it is usually to your advantage to borrow and contribute. You should also take into consideration your level of taxable income, interest you receive on your RRSP funds and the interest you pay the lender.

**24) CAN I HAVE SEVERAL RRSP'S?**

Yes! You can have as many RRSP's as you wish; but it may not be advisable as it will be difficult and expensive to administer.

**25) CAN I CONSOLIDATE MY RRSP'S INTO JUST ONE RRSP?**

Yes! You can transfer your RRSP from one institution to another or consolidate two or more RRSP's into one.

**26) WHAT IS THE HOME BUYERS PLAN?**

If eligible you are allowed to withdraw up to \$20,000 from your RRSP in 2007 provided you buy a home in Canada for your own residence. You do not have to pay any tax on funds withdrawn provided, before 1st October 2008, you either purchase a house or return the money to your RRSP. If you purchase a house you must repay the \$20,000 over fifteen years starting in 2007. Any repayment not made on time will be treated as a taxable withdrawal. To be **eligible** you should not have owned a principal residence during the past five years. The five years includes the year of withdrawal. You are not qualified if during the past five years you lived in a house owned by your spouse while you were married to that spouse.

**27) CAN I USE THE HOME BUYERS PLAN AFTER I BOUGHT THE HOUSE?**

Yes, as long as you withdraw the funds within thirty days.

**28) IF MY RRSP IS SHORT OF THE \$20,000 CAN I CONTRIBUTE THE SHORTFALL?**

Yes, as long as your contribution and withdrawal are more than 90 days apart.

**29) WHAT IS A SPOUSAL RRSP?**

It is a plan similar to your own except instead of your deposit going to your RRSP it will go to the one owned by your spouse. This would allow income splitting at retirement and therefore alleviating the effect of high progressive tax on one spouse by splitting the income between the two spouses and therefore reducing the top tax rate. It will also allow both spouses to take full advantage of **\$2,000** pension non-refundable credit. Remember! If a withdrawal is made in the year of contribution or in any of the two calendar years after the contribution it will be added to the income of the contributing spouse and be subject to tax.

**30) ARE ADMINISTRATIVE FEES PAID FOR RRSP DEDUCTIBLE AND IS IT BETTER TO PAY SUCH A ADMINISTRATIVE AND MANAGEMENT FEES FROM FUNDS OUTSIDE THE RRSP?**

No, they are no longer deductible. However, it is better to pay administrative fees from funds outside the RRSP. The reason is that funds left in the RRSP accumulate tax free while interest earned or gains realized outside the shelter of RRSP is taxed.

**31) WHAT ARE THE CONDITIONS RELATING TO TAX FREE WITHDRAWAL FROM RRSP'S FOR EDUCATIONAL PURPOSES?**

- It must not exceed \$10,000 per annum.

- The withdrawal period must not exceed four calendar years.
- The total of all withdrawals must be less than \$20,000.
- The funds should be used for full time education at a qualified institution.
- Withdrawal must be made in the year of enrollment or following January. Tip! Always withdraw in the following January.
- Repayment must start sixty days after the fifth year following the first withdrawal.
- Must be repaid over a maximum of ten years in equal monthly instalments.
- The person receiving the education must be the annuitant or his spouse and must be resident in Canada at the time of withdrawal. If they become non-resident they must repay the entire amount within sixty days from the date of emigration.
- No deduction is allowed for contributions made less than ninety days from the withdrawal date.
- Once fully repaid new withdrawals can be made.
- The annuitant and the spouse cannot both take advantage of this provision at the same time.

**32) ARE FUNDS IN THE RRSP PROTECTED FROM CREDITORS IN THE EVENT OF BANKRUPTCY?**

No, usually they are not. However, certain RRSP's kept with insurance companies are immune from creditors.

**33) SHOULD I PAY-DOWN MY MORTGAGE OR CONTRIBUTE TO MY RRSP.**

The answer to your question depends on variety of factors and there is no rule of thumb answer. Among the factors are your:

- age,
- Marginal tax rate,
- mortgage interest.

Try our free on line software to check out your scenario at:

<http://www.tavana.ca/onlineUtils/RRSP.asp>

**34) SOME TAX PLANNING IDEAS?**

- a) Name your spouse as the beneficiary of your RRSP this will save probate fees and the funds will roll automatically into your spouse's RRSP.
- b) Use contributions to spousal RRSP's to equalize the withdrawals from say a RRIF or payment of an annuity. This may provide a lower tax rate on the withdrawals from the RRSP's and use up both spouse's **\$2,000** pension deduction credit.
- c) Defer contribution and / or deductions from years of low income to year of high income. You would normally get higher tax reduction for the same contribution to your RRSP.
- d) Keep income generating investments in your RRSP while keeping capital appreciating assets outside the RRSP.
- f) If you have dividend paying US stocks in your RRSP, remember that you cannot claim the US withholding tax as a credit on your personal tax return. You would normally be allowed to do that if your stocks were held outside your RRSP. However, under the US/Canada tax treaty you now can request the institution paying the dividend to your RRSP, not to deduct it.
- g) File tax return for children if they have earned income. Doing this will create

RRSP room for future deductions when their income is high.

h)

If your employer pays you a bonus, it is better to have it paid directly into your RRSP. Withholding taxes on this bonus could be avoided.. Also if your employer pays the bonus in the following tax year, you have achieved a double dip into the tax pot. You have a deduction available from your income in the current year if the bonus is paid into your RRSP in the first sixty days of the following year and you have achieved a one year deferral of tax on your bonus.

i)

You can contribute to your spousal RRSP even if you are over 71 years old and have RRSP room or earned income. You will get the deduction and the income earned on the contributions is sheltered in your spouse's RRSP until he / she is 71 years of age.

j)

Consider investing in Labour Sponsored Venture Capital Funds. In addition to the normal deductions the Federal Government provides a 15% tax credit on the amount of your investment. There is also a similar credit from the Ontario Government. However, there is a limit of \$5,000 on this investment and there are restrictions on the subsequent sale of this investment. Please check with your investment advisor before you take any action.

k)

Make an overcontribution in the year you reach 71 and if you have sufficient earned income in that year you can deduct the overcontribution on your next year's tax return.

### 35) SOME Q & A's from CRA's website

**Can an employer, issuer, or carrier implement the proposed increase in the age limit before the proposed changes to the *Income Tax Act* are enacted?**

Yes, it is parliamentary convention that budget measures take effect as soon as a notice of Ways and Means motion is tabled in the House of Commons even though they have not yet been passed into law. As a result, employers, issuers, and carriers can amend and administer their plans in accordance with the proposed legislation. However, a taxpayer remains potentially liable to the effects of the current law in the event that the budget is not ultimately adopted.

**Amendment to take advantage of the increase to the age limit**

**Will my RPP, DPSP, or RRSP have to be amended to take advantage of the increase to the age limit?**

Possibly. If your plan makes specific reference to the age limit being 69 years of age, the plan will have to be amended to take advantage of the increase in the age limit to 71. If the wording is general in nature and only refers to the age limit as defined in the *Income Tax Act*, the plan does not need to be amended.

**Contribution to RRSP in 2007 if you are 70 or 71**

**Can I make a contribution to an RRSP in 2007, if I'm 70 or 71 years of age?**

Yes, you can make contributions to an RRSP until the end of the year in which you become 71 years of age. You should verify your RRSP deduction limit to ensure that you have room to make contributions so they are not considered excess contributions. Your RRSP deduction limit can be obtained from your Notice of Assessment or Notice of Reassessment or by contacting us at 1-800-959-8281.

**Transfer from RRIF to RRSP**

**If I'm 70 or 71 years of age at the end of 2007, under the proposed changes to the age limit, can I transfer the funds from my RRIF to an RRSP?**

Yes, you can transfer the funds from your RRIF to an RRSP. However, you must convert the RRSP to a RRIF before the end of the year in which you become 71 years of age.

**Financial institutions that do not allow making RRSP contributions if you are 70 I'm 70 years of age and my financial institution will not allow me to make a contribution to my RRSP. With the proposed changes to the budget, why won't they allow me to make contributions?**

The CRA has advised employers, issuers, and carriers that they can amend and administer their plans in accordance with the proposed legislation. It is up to employers, issuers and carriers to decide whether they will do so.

**Minimum RRIF withdrawal**

**If I'm 70 or 71 years of age at the end of 2007, do I still have to make my minimum RRIF withdrawal?**

No. The minimum RRIF withdrawal requirement will be waived in 2007 for those turning 70 or 71 in 2007, and in 2008 for those turning 71 in 2008.

**RRIF tax withholding rules**

**Are there any changes to the RRIF tax withholding rules on account of these changes?**

No, notwithstanding that the minimum RRIF withdrawal will be waived for certain

eligible individuals, withdrawals up to the minimum amount that would otherwise be determined under the normal rules will continue to be exempt from tax withholding.

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