

BASICS OF TAX DEFERRED SAVINGS PLANS

- Examples of tax deferred plans include: **Registered Pension Plan (RPP), Registered Retirement Savings Plan (RRSP), Registered Retirement Income Fund (RRIF) and, Deferred Profit Sharing Plan (DPSP)**
- These plans grow tax free and are taxed upon withdrawal

Pension Adjustment :

- All of these Deferred tax savings plans are integrated. This means that Mary, who holds a RPP and a RRSP is no better off than John who just has an RRSP. The total Mary can contribute to her RPP and RRSP will be the same that John can contribute to his RRSP, assuming all else is equal. This adjustment to integrate all of the deferred savings plans is done through the “**Pension Adjustment**” amount
- Every policyholder of an RPP or a DPSP has a Pension Adjustment Amount; the Pension Adjustment for the current year is reported on the T4.

REGISTERED RETIREMENT SAVINGS PLAN (RRSP)

How RRSP works:

- Amount contributed to an RRSP grow on a tax deferred basis
- In order to contribute to an RRSP, one must have built up “contribution room” through generating “earned income”
- The amount contributed to an RRSP can be deducted for tax purposes by the person making the contribution
- RRSP proceeds get taxed when they are withdrawn
 - When you withdraw funds from an RRSP, your financial institution withholds the tax. The rates depend on your residency and the amount you withdraw. For residents of Canada, the rates are:
 - 10% (5% in Quebec) on amounts up to \$5,000;
 - 20% (10% in Quebec) on amounts over \$5,000 up to including \$15,000; and
 - 30% (15% in Quebec) on amounts over \$15,000.
- The RRSP must be collapsed by December 31 of the year the taxpayer turns 71; once the RRSP is collapsed:
 - The taxpayer can buy RRSP annuities **or**
 - Turn the RRSP into RRIF – in which the taxpayer must withdraw a minimum amount annually from the RRIF

RRSP Contribution Formula

RRSP Contribution Room = *(Unused RRSP Room Carry Fwd from Prior Year) + Min of (18% * last year's earned income, \$22,970) – Last Year's Pension Adjustment*

Earned Income

= *Employment income + deduction for employee RPP contribution*
 ± *Business income ± Rent Income + Royalty income*
 ± *Spousal Support received or paid + CPP disability income*
 + *net research grants*
 + *non federal (i. e. supplementary)unemployment benefits*

What's not included in earned income?

- Employment Insurance
- Dividends/Interest
- Scholarships
- severance payments
- pension income

When must the contributions be made in order to get a deduction for the current tax year?

- Contributions to an RRSP must be made within **60 days after year end** (i.e. March 1 during non-leap years; and Feb 29 for leap years)

Penalties for excess contributions:

- \$2,000 over contribution allowed without attracting any penalties
- Penalty = 1% * (excess contribution - \$2,000) per month

Spousal Contributions

- A taxpayer can make contributions into his or her spouse's RRSP account
- However, even if a taxpayer makes a spousal RRSP contribution – that taxpayer is still limited to his or her own contribution room
- The contributing spouse gets the RRSP contribution deduction

The 3 Year Attribution Rule on Spousal Contributions:

- Suppose Mary and John are husband and wife; in 2010, 2011, and 2012 John made spousal contributions to Mary's RRSP in the amount of \$1000 per each year. It is now 2012 and Mary pulls out \$5,000 from her RRSP.
- **According to the RRSP attribution rule**, the withdrawal the spouse makes (i.e. Mary) is attributed back to the contributing spouse (John) to the extent of current year contributions + the **last two** years' contributions.
 - In our example the current year contribution in 2012 (\$1,000) + the 2 years before that in 2011 and 2010 (\$2,000); for a total of \$3,000 will be attributed back to John and taxed in the hands of John. The remaining \$2,000 will be taxed in the hands of Mary.

Implications of Investing in Shares through an RRSP?

- When you withdraw from an RRSP all income: dividends and capital gains are treated just like interest income.
 - This means 100% of capital gains are taxed (as opposed to 50% outside of RRSP)
 - No Allowable Capital losses to offset capital gains
 - No dividend tax credits
- Therefore, from a tax standpoint, it is better to hold equity investments outside of an RRSP

Income Splitting Opportunities with RRSP

- RRSP spousal contribution is a way of splitting income with your spouse
 - RRSP income is taxed in hands of low income spouse (when the spouse withdraws the RRSP)
 - RRSP contributions are deducted in the high income spouse (when he or she makes the contribution)
- When you turn 65 convert some of the RRSP to RRIF or RRSP annuity because you get a \$2,000 tax credit on these withdrawals (through the **pension amount**); whereas, if you were to withdraw from your RRSP you don't get that credit.

Tax Implications of RRSP upon death of the policyholder

- See Death of a Taxpayer Notes