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## *Answering Your RRSP Questions*

RRSPs are an important component of an overall financial plan for most Canadians. As we struggle with high personal taxes and a fear that our government will not be able to provide adequate pensions for us in retirement, RRSPs offer a great opportunity to save taxes currently and provide for our retirement needs.

This bulletin explains the rules for RRSP contributions, the types of investments an RRSP can hold, and the ways in which RRSP withdrawals can be made. We have done this in a question and answer format, attempting to anticipate the questions that you might have about your RRSP.

Although we have tried to deal with as many issues as possible, you may have a question which is not covered by the materials in this bulletin. Contact your BDO advisor for help with any RRSP concerns you may have.

### *Abbreviations used in this bulletin:*

<b>CCPC</b>	Canadian-Controlled Private Corporation	<b>PA</b>	Pension Adjustment
<b>CRA</b>	Canada Revenue Agency	<b>PAR</b>	Pension Adjustment Reversal
<b>CDIC</b>	Canada Deposit Insurance Corporation	<b>RPP</b>	Registered Pension Plan
<b>DPSP</b>	Deferred Profit Sharing Plan	<b>RRIF</b>	Registered Retirement Income Fund
<b>GIC</b>	Guaranteed Investment Certificate	<b>RRSP</b>	Registered Retirement Savings Plan
<b>LSVCC</b>	Labour-Sponsored Venture Capital Corporation	<b>TFSA</b>	Tax-Free Savings Account

## What is an RRSP?

An RRSP is simply a contract or plan between you, the plan "annuitant", and the plan "issuer", usually a financial institution. You make contributions to the plan over a period of years; these contributions are invested and earn income, providing you with savings to live on in your retirement.

RRSPs provide three main benefits in helping you save for your retirement:

1. You get a tax deduction for the amounts contributed (up to certain limits). Therefore, you can effectively set aside a part of your income each year to save for retirement on a pre-tax basis.
2. Earnings on the assets in your RRSP accumulate tax-free. This helps the size of your RRSP grow faster—savings compound much more quickly if the return is not subject to tax.
3. RRSP funds are only taxed when withdrawn. This can mean real savings if you withdraw the funds in years when your income (and marginal tax rate) is lower, such as when you retire.

There are many different RRSP investment alternatives available to you. Through banks, trust companies, credit unions, and other financial institutions, you can put your money in interest-bearing investments such as guaranteed investment certificates (GICs) and daily interest savings accounts. As well, you can invest in mutual funds through most financial institutions and mutual fund companies. If you want to hold a wider variety of investments in a plan, you can use a self-directed RRSP.

## Contributing to your RRSP

### A1. How much can I contribute to my RRSP?

You can contribute as much as you want to your RRSP. However, there are limits on how much of your contributions are tax-deductible and there is a penalty tax for contributions over these limits. Therefore, you should generally limit your contributions to these amounts.

The amount which is tax-deductible for any year is referred to as your RRSP contribution room for that year.

The limit for a year is:

18% of your previous year's earned income  
up to a maximum amount for the current year

(see chart below)

Less

the previous year's pension adjustment (PA)

The PA is a measure of the benefits that accrued to you as a member of an employer-sponsored pension plan (see A3).

For instance, your 2009 RRSP contribution room is 18% of your 2008 earned income to a maximum of \$21,000. This is reduced by your PA for 2008. Your 2010 RRSP contribution room is 18% of your 2009 earned income, to a maximum of \$22,000, less your 2009 PA.

RRSP Contribution Limits		
Year	Maximum contribution allowed for the year	Earned income required in preceding year to make maximum contribution
2009	21,000	116,667
2010	22,000	122,222
2011	22,450	124,722
2012	<i>Indexed</i>	<i>Indexed</i>

### A2. What is "Earned Income"?

Your RRSP limit for a given year depends on your "earned income" for the previous year. Generally, this includes active income such as employment earnings and business income, but does not include most types of passive income including interest, dividends, and capital gains from investments.

Specifically, earned income includes:

- ♦ salaries and wages, net of employment expenses claimed,
- ♦ research grants,
- ♦ royalties (e.g. on patents),
- ♦ net income from self-employment,
- ♦ net rental income from real property,
- ♦ alimony and maintenance received, and
- ♦ supplementary unemployment benefit plan payments.

Your earned income is reduced by:

- ♦ rental losses from real property,
- ♦ losses from self-employment, and
- ♦ alimony or maintenance payments made.

### A3. What is a "Pension Adjustment" (PA)?

The PA is what puts everyone on an equal footing in terms of annual RRSP contribution room. It's the value of the pension benefits that accrue to individuals who are members of employer-sponsored Registered Pension Plans (RPPs) or Deferred Profit Sharing Plans (DPSPs).

PAs reduce their RRSP contribution limits since they are earning pension benefits through their employers' plans.

If you're not a member of an RPP or a DPSP, you can ignore PAs. Your RRSP limit is calculated as explained earlier. However, if you do belong to an RPP or DPSP, your employer must calculate your PA and report it to the Canada Revenue Agency (CRA) on your T4 each year. The CRA then takes 18% of your earned income for the year (up to the maximum limit) and reduces it by your PA to determine your RRSP contribution limit for the following year.

How are PAs calculated? If you're a member of a money purchase RPP or DPSP, your PA is the total of your contributions to the plan and those of your employer. If your RPP is a defined benefit plan, your PA is determined by a formula designed to reflect the pension benefit entitlement you earned in the year.

**A4. I've just left a job where I was a member of a defined benefit RPP. The pension benefits I am entitled to are far less than the total PAs which have reduced my RRSP contribution room over the years. Is there any way to correct this problem?**

In many cases, the accumulated PA that has reduced your RRSP contribution room has not been fair. If you leave an employer where you were a member of a defined benefit RPP, the accumulated PAs are often greater than the pension benefits to which you are entitled. This is usually the case for younger individuals — your former employer's contributions to the plan on your behalf are very low because they would not have had to provide you with pension benefits for many years.

The Pension Adjustment Reversal (PAR) is intended to address this inequity. The PAR is the amount that the PA exceeds the actual amount of contributions that you will realize if you quit. In other words, this is the amount of lost RRSP contribution room that you should get back. Your PAR will be calculated by your pension plan administrator and added to your RRSP contribution room in the year your participation in the pension plan ends. This means that it could be used to top up your RRSP contribution to defer tax on any severance package you may be getting.

**A5. Do I have to calculate my RRSP limit each year?**

No. The CRA calculates your contribution limit for the upcoming year and reports this limit to you on the Notice of Assessment that you receive from them after you file your income tax return. The CRA will also include any amounts you can contribute because of under-contributions in prior years (see A11).

**A6. When does my contribution room for a given year become available?**

Your contribution room for a given year generally arises on the first day of the year. This is because the amount is based on information from the prior year, and can be determined on January 1<sup>st</sup>. For instance, your contribution room for 2010 arises on January 1, 2010. From that point on, you are entitled to contribute this amount to your RRSP without penalty. Once the contribution is made, you can deduct it in the current year or any future year. As discussed in A4, an exception to this general rule does apply for PARs which are added to contribution room during the year as they arise.

As a practical matter, however, you may not know your RRSP limit until a few months into 2010. Remember, it's based on your PA and earned income for 2009. Your PA will only be available when you get your T4, which is normally in late February 2010. Also, you'll generally only calculate your earned income for 2009 when you prepare your income tax return, which is due April 30, 2010 or June 15 if you have business income. If you rely on the CRA to advise you of your RRSP limit, you'll have to wait until your tax return for 2009 has been assessed, which could be several weeks or months after you file.

However, if you know your earned income for 2009 is high enough and you're not a member of an employer-sponsored RPP or DPSP, your RRSP limit for 2010 will be the maximum amount of \$22,000. You could contribute this amount on January 1, 2010.

	<b>2009 Contribution</b>	<b>2010 Contribution</b>
<i>Based on:</i>	18% of 2008 earned income (max. \$21,000) less 2008 PA	18% of 2009 earned income (max. \$22,000) less 2009 PA
<i>Arises:</i>	January 1, 2009	January 1, 2010
<i>Contribution deductible in year if made by:</i>	March 1, 2010	March 1, 2011

**A7. When should I make my RRSP contribution?**

Deductible RRSP contributions for the current year can be made at any time during the year or the first 60 days of the following year. However, to take full advantage of the tax-deferred compounding of income in your RRSP, your contribution for a particular year should be made as

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early as possible in the calendar year. If you make your contribution for the year in early January instead of at the end of February of the following year, you will benefit from more than an extra year's compounding of income for each contribution which could make a significant difference in the value of your RRSP when you retire.

Assume that you contribute \$10,000 to your RRSP annually and that you will earn a 6% return on these funds. If you contribute the \$10,000 at the start of each year, your RRSP will be worth about \$390,000 at the end of the 20<sup>th</sup> year. However, if you wait until the end of each year to contribute, you will only have about \$368,000 in your RRSP at the end of the 20<sup>th</sup> year. By contributing at the start of the year, your RRSP will be larger by \$22,000.

You might find it difficult to come up with a lump-sum RRSP contribution all at once. You can pre-arrange monthly contributions with most RRSP issuers. You can also reduce the money you need to make your contributions by getting the benefit of your tax deduction when you make the contribution. In order to have your income tax withholdings reduced, you must make a written request for a letter of authority from the CRA. This request can be made by completing and sending Form T1213 with evidence of your contributions, such as receipts. The CRA will then provide a letter to you which you can give to your employer authorizing them to reduce the income tax withholdings from your salary. If you contribute to a group RRSP at work, your employer can automatically reduce your income tax withholdings, taking your contributions into account. Finally, if your employer will agree to pay part of your salary or an amount, such as a bonus, directly to your RRSP, they will not have to withhold tax on this payment provided that the amount contributed does not exceed your RRSP deduction limit (as reported to you by the CRA each year on your Notice of Assessment).

#### **A8. When can I deduct my contribution?**

To be deductible for a particular taxation year, a contribution must be made on or before the 60<sup>th</sup> day of the following year. The last day an RRSP contribution can be made to be deductible for 2009 is March 1, 2010.

#### **A9. Can I make an RRSP contribution now and deduct it in a future year?**

RRSP contributions do not have to be deducted in the year in which they are made. The contributions can be deducted in that year or in any future year. You should consider deferring the deduction of your contribution if you don't have much taxable income in the current year. By deferring the deduction to a year when your marginal tax rate is higher, you will save more in taxes. Remember, however, that delaying the deduction has a

cost in prepaid tax as you will not be getting the benefit of the deduction until the future. Therefore, you also have to consider the time value of money when making the decision to defer the deduction of your RRSP contributions.

#### **A10. Should I borrow to make my RRSP contribution?**

Interest on money borrowed to make your RRSP contribution is not deductible for tax purposes. Therefore, whenever possible, you should use cash to make your RRSP contribution and borrow to make other investments where the interest paid will be deductible.

In some cases, however, it can make sense to borrow to contribute to your RRSP. Remember that the income earned on an RRSP investment accumulates on a tax deferred basis. If you can pay off your loan quickly, particularly if you are getting a tax refund, the non-deductible interest expense can be minimized.

For example, let's assume that you want to make a \$10,000 RRSP contribution for 2009 by the deadline of March 1, 2010. Assuming a top marginal rate of 45% and that you will be otherwise receiving a refund, this will generate a tax refund of about \$4,500 for you. If you borrow the \$10,000 to make the contribution, you will be able to pay back 45% of the loan as soon as you get your refund.

#### **A11. Can I carryforward my unused RRSP contribution room to a future year?**

If you don't make an RRSP contribution this year or you contribute less than your maximum limit, the unused amount is carried forward and can be used in any future year. The carryforward rules began with the 1991 contribution limit. The RRSP contribution room that the CRA shows on your Notice of Assessment includes all your unused room that carries forward from prior years.

#### **A12. How many RRSPs can I have?**

There is no limit on the number of RRSPs you can have. The limits are on the total amount you can deduct. However, most people find it simpler to have only one or two plans, making it easier to keep track of their RRSP investments.

If you are investing in assets which are insured by the Canada Deposit Insurance Corporation (CDIC), it may make sense to have more than one RRSP with different RRSP issuers. The CDIC only insures up to a specified limit of assets with each member financial institution. Therefore, by having RRSPs with more than one institution, you can increase the amount of your investments that are covered by the CDIC. Assets covered usually include bank or trust company deposits and GICs, but not mutual funds.

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### **A13. Can I contribute to my spouse's RRSP?**

If you have available RRSP contribution room, you can make a contribution to your RRSP or to an RRSP for your spouse (often referred to as a spousal RRSP). A contribution to a spousal RRSP will qualify as a tax deduction for you as long as your total contributions to your plan and a spousal plan do not exceed your contribution limit for the year. For 2001 and subsequent taxation years, a spouse includes a same-sex partner.

### **A14. Is it better to contribute to my spouse's RRSP?**

The main benefit of a spousal RRSP is that it will allow income splitting in the future, at retirement, since withdrawals will usually be taxable in the hands of your spouse.

When deciding whether to contribute to either your RRSP or to a spousal RRSP, you should attempt to estimate both your and your spouse's income from all sources in retirement. Your goal should be to equalize these incomes at that time — by doing so you will achieve income splitting which will minimize your taxes in your retirement years.

Note that with the pension income splitting rules, it is possible to split eligible pension income for taxation years after 2006. However, if both spouses have an RRSP on retirement, you will have more flexibility when splitting income (see C2 for more information).

### **A15. What happens if my spouse makes an RRSP withdrawal?**

If you have made a contribution to your spouse's plan in the current year or in either of the two preceding years, a withdrawal by your spouse from a spousal RRSP is taxable to you to the extent of the contributions made during the three-year period.

Note that this rule does not apply to all RRSPs held by your spouse. The attribution of RRSP withdrawals to you will not apply if you contribute to a spousal plan and your spouse withdraws funds from an RRSP that he or she contributed to (i.e. not a spousal RRSP). For this reason, it is usually a good idea to set up a new plan for spousal contributions.

This attribution rule also does not apply if, at the time of withdrawal, and as a result of the breakdown of your marriage, you and your spouse are living separate and apart pursuant to a court order or written separation agreement. In addition, the rules do not apply where your spouse receives funds from the RRSP in the form of a regular annuity which cannot be commuted.

If your spouse is planning to make an RRSP withdrawal from a spousal plan, you should not make a contribution to a spousal RRSP. This may be the case if your spouse will have low taxable income in the near future (for example, a maternity or paternity leave).

However, if you're sure the attribution rule will not be a concern, you may want to use only one RRSP for your spouse (to which you and your spouse can contribute) to reduce RRSP fees that you have to pay (see B2).

### **A16. What happens if I overcontribute to my RRSP?**

If you contribute more than your contribution limit, you will be subject to a 1% penalty tax per month to the extent that the overcontribution amount exceeds \$2,000. This penalty tax is expensive, ensuring that it is not worthwhile to make overcontributions above this limit.

### **A17. Should I make a \$2,000 overcontribution to my RRSP?**

You can make an extra one-time \$2,000 overcontribution to your RRSP without being subject to the 1% per month penalty tax on overcontributions. This will enable you to shelter the income on the \$2,000 from tax.

The \$2,000 cushion is intended as a protection from inadvertent overcontributions. Therefore, if you use up the cushion, you have absolutely no margin for error left. This would usually only be a concern for members of pension plans, but it could also cause problems for other individuals. Another issue to keep in mind is that the CRA has stepped up its monitoring of RRSP overcontributions in recent years.

Also note that if you decide to take the \$2,000 out of your RRSP, the withdrawal will be taxable without you ever having received the benefit of a tax deduction for the contribution. Although it is possible to remove inadvertent overcontributions from an RRSP without tax (an offsetting deduction is provided), this remedy is not available where the overcontribution was made intentionally.

There is a solution to this problem. You can deduct any contribution made in a prior year to the extent it was not previously deducted, provided you have unused contribution room. Therefore, the \$2,000 could be deducted in a subsequent year by treating it as part of that year's contribution limit. In fact, you could even deduct it after you reach 71 (which is the year in which you must collapse your RRSP — see A18) if you still had earned income in the prior year. Of course, if the \$2,000 stays in your RRSP long enough, the advantage of tax-free compounding of income will outweigh even the disadvantage of having the undeducted amount taxed on withdrawal.

### **A18. How long can I continue to contribute?**

At the end of the year in which you reach age 71, your RRSP will mature and the funds in your plan must be removed. Under rules that applied before 2007, an RRSP matured by the end of the year in which an individual reached age 69. We discuss the options you have under

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"Making withdrawals from your RRSP." However, if you still have unused RRSP contribution room or will continue to generate earned income, you can make RRSP contributions to a spousal RRSP after the year in which you turn 71. Remember that your spouse must be under 72 for this to be possible—at the end of the year in which your spouse turns 71, his or her RRSP will mature as well.

### **A19. Should I pay down my mortgage, invest in a Tax-Free Savings Account or make RRSP contributions?**

This is not an easy question to answer and we have outlined a number of considerations below. You will, however, probably want to discuss your situation with your BDO advisor.

- ◆ If you make an RRSP contribution, this will, for most employed individuals, create a tax refund that you can use to pay down your mortgage. Many financial advisors suggest this approach as you are making progress toward both paying off your mortgage and saving for your retirement. A Tax-Free Savings Account (TFSA) contribution will not produce a tax refund.
- ◆ The issue of whether an RRSP or TFSA is better for you will really depend on what your marginal income tax rate is now and what it will be in retirement:
  - If you are in a high tax bracket now, and will be in a lower bracket later, RRSP contributions effectively move income that would be taxed at a high rate now into a lower tax bracket later. This produces both a tax deferral and a tax saving.
  - If you are in a lower tax bracket now, and expect to be in the same lower tax bracket later on retirement, a TFSA might make more sense than an RRSP, as the use of an RRSP could put you into a higher bracket in retirement while a deduction arises now at a low marginal rate. Also, having lower income in retirement may allow you to keep more of your government benefits that are income-tested such as Old Age Security, Guaranteed Income Supplements, GST credits and other benefits/credits.
- ◆ When comparing a TFSA contribution to making a mortgage repayment, your mortgage is really just another TFSA. That is, any non-deductible interest that you don't have to pay due to the mortgage repayment is effectively tax-free income earned with a fairly good return on your money. Therefore, in terms of limiting risk, many individuals will concentrate on repaying their mortgage first, especially since the accumulated TFSA room should

still be there when they finish paying off their mortgage. If your investment rate of return is less than the mortgage rate, then paying down your mortgage will definitely be more beneficial.

- ◆ If you have funds now, but you may need them again later, using a TFSA temporarily could make sense. Contributing money to an RRSP now and withdrawing it soon after is usually not a good idea. Although the income and deduction may offset each other (i.e. if the contribution and withdrawal fall within the same year), this eliminates RRSP room. If you're in this situation, a better plan could be to put the money into a TFSA and then later transfer the funds to an RRSP as a contribution once you're sure you won't need the money until retirement.

With all of the considerations above, there are a number of questions to ask when making this decision.

Keep in mind that having the discipline to save money, by paying down your mortgage, putting money in your RRSP or possibly a TFSA, will help to increase your net worth in the long run. Paying off your mortgage and saving for your retirement, as well as keeping a reserve fund, are important components of a good financial plan.

For more information on TFSAs, see our tax bulletin titled "*Answering Your TFSA Questions*".

### **A20. Can I transfer pension income or retiring allowances to my RRSP?**

Prior to 1995, it was possible to transfer up to \$6,000 of pension income annually to your spouse's RRSP. However, this transfer is no longer available.

A retiring allowance, which is an amount received by you on retirement or as compensation for the loss of employment, can be transferred to an RRSP. The eligible amount that can be put into your RRSP is equal to \$2,000 for each year of employment before 1996 (due to changes announced in the 1995 budget, no amounts can be transferred for years of service after 1995). An additional \$1,500 can be transferred for each year before 1989 where your employer's contribution to an RPP or DPSP had not vested at the time of your retirement or termination. This transfer can be made directly by your employer to your RRSP, eliminating the requirement that tax be withheld at source. You can also transfer amounts you actually received during the year. Any eligible amount must be contributed to your RRSP in the year or within 60 days of the end of the year.

In addition to this special rollover, you may want your employer to contribute more of your retiring allowance to your RRSP, if you have unused RRSP contribution room. You do not have to get a waiver to reduce tax on these amounts provided that the employer contribution to your RRSP does not exceed your RRSP deduction limit. When the two rules are combined, no

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income tax has to be withheld if the amount your employer transfers directly to your RRSP does not exceed the total of your special rollover and your RRSP deduction limit.

## Investing and managing your RRSP

### B1. How do I set up an RRSP?

Setting up an RRSP is easy. Most banks, trust companies, credit unions and other financial institutions can act as a plan issuer.

You can have different types of RRSPs. The plan you choose should suit your investment needs.

Depository RRSPs are the most basic; your RRSP funds will be on deposit with your RRSP issuer and you will be able to invest in any type of eligible product they sell. For example, you can have a depository RRSP with your bank and invest your money in the bank's GICs. These investments are usually insured by the CDIC up to specified limits.

You can also have a trustee RRSP. Your RRSP issuer will appoint a trustee who will hold your RRSP assets "in trust" for you. With these types of RRSPs, you have more flexibility in the types of investments you can make. With certain trustee plans, you are limited to the investment products and mutual funds that your RRSP issuer offers. Under fully self-directed RRSPs, you can invest in any eligible RRSP investment; these types of RRSPs are generally held with securities brokers who can sell you any qualifying security or investment product. Investments held in trustee RRSPs, such as mutual funds or specific securities, are usually not insured by the CDIC.

### B2. What kind of fees apply to RRSPs?

There can be several types of fees associated with RRSPs. These fees are usually higher for trustee plans.

Fees are usually charged if you make withdrawals from your plan or your plan is wound up or transferred to another RRSP issuer. These fees usually range from \$25 to \$100.

In addition to these fees, there are annual administration fees associated with trustee RRSPs. For self-directed plans, these fees usually range from \$100 to \$200 annually. These fees are not deductible for tax purposes. If they are paid with RRSP funds, this will simply reduce the amount available for future withdrawal.

You should always be clear as to what fees will apply to your RRSP before you invest in order that you will know the annual costs and the cost of winding up your plan.

### B3. What investments can I hold in my RRSP?

Your RRSP can hold any type of investment. However, you should restrict your RRSP holdings to qualified investments only in order to avoid adverse tax consequences. Fortunately, a wide range of investments qualify for your RRSP which include:

- ◆ cash and bank, trust company, or credit union deposits, including GICs;
- ◆ shares listed on the TSX Venture Exchange, and the Toronto and Canadian National Stock Exchanges;
- ◆ shares listed on most foreign stock exchanges;
- ◆ units of mutual fund trusts;
- ◆ shares of Canadian public corporations which are not listed on the stock exchanges above;
- ◆ options on the purchase of eligible investments;
- ◆ most government debt and debt of corporations listed on the Canadian stock exchanges described above;
- ◆ investment-grade gold and silver bullion coins, bars, and certificates on such investments (effective after February 22, 2005 where certain conditions are met); and
- ◆ certain other qualifying debt obligations.

If a non-qualifying investment is acquired by your RRSP, the value of this investment will be included in your taxable income. Any income you earn on this investment will also be taxable. You will get a tax deduction when your RRSP disposes of the non-qualifying asset.

### B4. Should tax considerations affect my RRSP investment strategy?

Normally, you will want to choose RRSP investments that maximize your return and stay within your risk tolerance. While equities hold out the promise of higher returns, they are more volatile than bonds or GICs. Most people prefer to hold a larger percentage of equities in their RRSP when they are younger and are willing to take more risks and then gradually convert to more stable, income producing investments as they near retirement.

Tax can, however, play a part in your investment decisions if you have investments inside and outside of your RRSP. Remember that income earned and capital gains realized in your RRSP are not taxed until they are withdrawn from your plan, usually after you retire. Therefore, from a tax point of view, there is a bias to hold income-producing investments such as GICs inside your RRSP as the interest income will be fully taxed if they are held outside of your RRSP. Similarly, it makes sense to hold investments that produce capital gains outside of your RRSP as tax only has to be paid on 50% of the gain. Also, there will be a bias towards holding stocks and other investments that produce eligible

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dividends outside of your RRSP due to the low tax rate that applies on these dividends.

You can break down your investment decisions from a tax perspective even further. Capital gains are only taxed when they are realized (that is, when you sell your investment). If you invest in stocks that you expect to sell in the short-term outside of your RRSP, capital gains will be realized that will be taxable, reducing the funds you have to invest. However, if you invest in stocks that you expect to hold for several years, any capital gains that accrue will not be subject to tax until you sell. Therefore, from a tax perspective, it makes sense to hold stocks that are short-term holds in your RRSP, where the tax on capital gains will be deferred, and to hold stocks that are long-term holds outside of your RRSP.

Keep in mind that tax advantages can sometimes conflict with other objectives for your RRSP investments. Although it may make sense to invest in stocks that are short-term holds in your RRSP, these investments usually are more risky and may conflict with your objective to have stable investments in your RRSP. In addition, if you incur losses on investments held in your RRSP, the losses will not be tax deductible—they will reduce the size of your RRSP that will be available to you in your retirement.

Your primary concern in choosing investments for your RRSP should be to maximize your return while staying within your risk tolerance. However, tax can play a part in making these investment decisions. Contact your BDO advisor if you have any questions about the type of investments that you should be making in your RRSP.

### **B5. How much of my RRSP can be invested in foreign property?**

Foreign property generally includes foreign currency, shares and debt obligations of companies listed on most foreign stock exchanges, including mutual funds that invest in these assets, and debt obligations of certain foreign governments. These assets are qualifying RRSP investments. Prior to 2005, there were restrictions on the amount of your RRSP that could be invested in this type of property. However, with the elimination of these restrictions for 2005 and subsequent years, you no longer have to worry about staying within certain limits when investing in qualified foreign property within your RRSP.

### **B6. Can my RRSP hold real estate?**

Your RRSP cannot have a direct investment in real estate. However, it is possible to invest indirectly in real estate by buying shares of publicly traded companies which invest in real property or units in a publicly traded Real Estate Investment Trust (REIT).

### **B7. Can my RRSP hold a mortgage on my home?**

It is possible to invest RRSP funds in a mortgage on your own home. While this offers a feeling of comfort knowing that you, in effect, owe the funds to yourself (and it may be easier to obtain funds from your RRSP than from a commercial lender), there may not be any significant advantage to be gained by doing this. The mortgage must provide for commercial interest and repayment terms. Consequently, your monthly payments would not change. There will be a benefit if the rate of return on the mortgage exceeds the return you would have otherwise received on your RRSP funds. However, you will also have to take into account that a mortgage of this sort is generally more expensive to arrange.

The mortgage must also be administered by an approved lender under the *National Housing Act*, as well as insured under that act or by a corporation that is approved as a private insurer and offers such services to the public.

Note also that there is no requirement for the mortgage to be a first mortgage or residential mortgage in order to be a qualified investment. However, if you or someone with whom you do not deal at arm's length is the mortgagor, all of the above noted requirements must be met.

If you are a first-time home buyer, it is possible to withdraw up to \$25,000 from your RRSP under the Home Buyer's Plan (HBP) when you buy a qualifying home. The limit for HBP withdrawals was previously \$20,000, applicable for withdrawals prior to January 28, 2009. Your spouse can also withdraw up to \$25,000 from his or her RRSP. Generally, amounts withdrawn must be repaid to your RRSP in 15 equal instalments, starting with the second taxation year following the year of withdrawal. If the required payments are made, there won't be an income inclusion for the withdrawal. Contact your BDO advisor for more information on the HBP.

### **B8. Can my RRSP invest in my own business?**

It is possible to use your RRSP to invest in a Canadian-controlled private corporation (CCPC). However, if you, together with persons related to you, own 10% or more of the shares of the CCPC, the investment may not be a qualifying RRSP asset. If you deal at arm's length with the CCPC and the cost of the shares you hold in the CCPC or a related corporation is less than \$25,000, you can invest your RRSP in shares of the company. If you own less than 10% of the shares, there are generally no restrictions on the amount you can invest.

In determining the amount and cost of the shares that you own, you have to consider shares owned by persons related to you, both inside and outside their RRSPs. Also, all or substantially all of the company's

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assets must be business assets at the time the shares are purchased by your RRSP.

Contact your BDO advisor for more information on how you can use your RRSP to invest in your business.

### **B9. Are Labour-Sponsored Venture Capital Corporations (LSVCCs) qualified investments for my RRSP?**

LSVCCs are investment funds which are mandated to invest in small and medium-sized privately held businesses with the potential for high returns. However, the investment risks can be high.

The federal government offers attractive tax credits for LSVCC investors. The tax credit is 15% on a maximum investment of \$5,000. Several provinces offer matching or similar credits. Note that the Ontario credit for labour-sponsored investment funds will be eliminated for 2012 and later taxation years.

These credits are available to you if you contribute cash to your RRSP to buy the investment in the LSVCC. The credits can lower the after-tax cost of a \$5,000 investment in an LSVCC to \$3,500. However, generally you must leave your money in the LSVCC for at least eight years or you will have to repay the credits (five years for investments acquired before March 6, 1996).

In the past, some brochures have claimed that the after-tax cost of an LSVCC is only about \$1,000 for a \$5,000 investment. These calculations take into account the value of the \$5,000 RRSP deduction at the highest marginal tax rates. However, the real cost of the LSVCC is \$3,500, as you would get the benefit of the RRSP deduction for any RRSP contribution, whether the funds are used to purchase units in an LSVCC or another investment such as a GIC.

Contact your BDO advisor before investing in an LSVCC if you have any questions as to the potential risks and rewards.

## **Making withdrawals from your RRSP**

### **C1. When can I withdraw money from my RRSP?**

Generally, you can withdraw money from your RRSP at any time. There are no tax rules preventing you from doing so. The only exception to this is if the funds in the RRSP were originally transferred in from a pension plan. In certain cases, these funds must be transferred to a locked-in RRSP, which can only be accessed as allowed under provincial pension legislation.

From a practical perspective, you may have difficulty in withdrawing funds from your RRSP if it has

invested in securities which cannot be liquidated, such as non-redeemable GICs. There may also be a cancellation penalty for early redemptions.

If you withdraw an amount from your RRSP, the full amount of the withdrawal is taxable. This is true whether the withdrawal represents money you contributed to your RRSP or income earned on these funds.

It's generally not advisable to withdraw RRSP funds unless you have an emergency or your income is exceptionally low in one particular year. The purpose of your RRSP is to save for your retirement — withdrawing funds from your RRSP will only undermine this goal. Also, once funds are withdrawn, you will only be able to recontribute them as part of your normal RRSP contribution room.

### **C2. When should I start to withdraw money from my RRSP?**

This depends on your personal situation. In order to take full advantage of the tax deferrals offered by an RRSP, you should wait until the end of the year in which you turn 71 (see C3) and then either purchase an annuity or transfer your RRSP assets to a Registered Retirement Income Fund (RRIF), depending on which best suits your needs (see C4).

However, you may require retirement income from your RRSP prior to age 71. When you do need money, you can withdraw the funds you need (remembering that withdrawals are fully taxable). You could also purchase an annuity or transfer your RRSP assets to a RRIF at any time prior to the end of the year in which you turn 71.

Also, it may make sense to purchase an annuity with some of your RRSP funds or transfer funds to a RRIF when you turn 65, if you don't have other income that will qualify for the federal pension income tax credit of \$2,000 each year. Income from an annuity or RRIF at age 65 or over is considered to be pension income for purposes of this credit. To date, not all of the provinces or territories match the federal credit amount. So, keep in mind that not all of the extra income will qualify for a provincial/territorial pension credit.

In addition, income eligible for the pension credit is eligible for the pension income splitting rules. Under these rules, a recipient of eligible pension income can transfer up to one-half of their pension income to his or her spouse. Where the pension recipient is in a higher tax bracket than the transferee, this splitting of the pension income can result in a tax saving. Also, a benefit can arise if the transferee spouse can claim the pension credit on the income transferred. However, it is also important to consider the impact of the pension income transferred on tax credit amounts that are based on net income. Finally, when creating a source of eligible pension income (by using a RRIF or annuity), remember that you will have to pay tax on at least one-half of the income.

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### **C3. What is the deadline for collapsing my RRSP?**

You cannot have an RRSP past December 31<sup>st</sup> of the calendar year in which you turn 71. Prior to that date, you must collapse your RRSP and pay tax on the fair market value of the plan's assets at that time, purchase an annuity, or transfer your RRSP assets to a RRIF. If you purchase an annuity or transfer the assets to a RRIF, no tax is paid on the conversion.

### **C4. What are my options when withdrawing money from my RRSP?**

As mentioned in question C3, there are basically three ways you can take money out of your RRSP. First, you can collapse all or part of your RRSP. Any amounts withdrawn will be fully taxable to you in the year of withdrawal. Your RRSP issuer will withhold tax on your withdrawal (the withholding tax rate varies with the size of the withdrawal).

You can also purchase an annuity or a RRIF with your RRSP. Generally you would do this when you want to receive retirement income from your RRSP. Withdrawals from an annuity or a RRIF would be taxable only when received by you.

#### ***Annuities:***

An annuity is a right to receive periodic payments of income, either for life or a fixed number of years. Several types of annuity products are available, such as annuities which will continue to pay income until the later of your death or the death of your spouse. The size of your periodic payment will depend on the length of the annuity term; the longer the term of your annuity, the smaller the payment.

You can use your RRSP to buy an annuity, usually from a life insurance company, to give you a stream of income in your retirement. This income will be fully taxable to you when you receive it as pension income.

The advantage of an annuity is that it gives you a guaranteed stream of income for the annuity term. In exchange for this income stream, you will, in effect, give up the control of your investments to the issuer of the annuity. Also, your purchasing power will be at risk for inflation unless the annuity has inflation adjustments.

#### ***RRIFs:***

A RRIF is similar to an RRSP with two main exceptions. The first difference is that, with the exception of certain transfers, contributions cannot be made to a RRIF. Secondly, a minimum amount must be withdrawn from the plan each year. Your RRIF can hold the same investments as your RRSP. As well, you can have a self-directed RRIF in the same manner as your self-directed RRSP.

A minimum percentage must be withdrawn each year, depending on your age. The percentage is applied to the fair market value of plan assets as of January 1<sup>st</sup> of each year to determine the dollar amount of the mandatory withdrawal for that year. More than the minimum can be withdrawn, if so desired.

Another option for calculating minimum RRIF withdrawals is to use your spouse's age in place of your own, even if their age is less than 71. This option is for purposes of determining the minimum withdrawal amount only and does not apply for other purposes such as determining when your RRSP matures. This alternative does allow you to defer the taxation of plan assets to the extent that your spouse is younger than you.

The main advantage of a RRIF over an annuity is that you maintain control over your investments. With that, however, comes the risk that your investments will not perform to your expectations.

### **C5. I'm returning to college to upgrade my skills. I heard that I can withdraw money from my RRSP tax-free to help pay my expenses. How does this work?**

The Lifelong Learning Plan (LLP) allows you to "borrow" up to \$10,000 per year, to a maximum of \$20,000 over a period of up to four calendar years, from your RRSP to help you finance full-time training or education for you or your spouse/common-law partner.

The amount withdrawn will not be taxed as a normal RRSP withdrawal. It will be treated like an interest-free loan, generally repayable to your RRSP in equal instalments over a 10-year period. Your first payment is due in the second consecutive year, after the year of withdrawal, in which the eligible student is not entitled to the full-time education credit for a period of at least three months, or in the fifth year following the first year of withdrawal, whichever is earlier. If you don't make the required payment in a year, the unpaid amount will be included in your income for that year. As is the case for RRSP contributions, a payment made in the first 60 days following a given year will qualify as a repayment for that year.

In order to qualify, the LLP student (you or your spouse/common-law partner) must be enrolled in full-time training or higher education for at least three consecutive months at a designated educational institution, before March of the year after the LLP withdrawal. If the LLP student is disabled, he or she can enroll on a part-time basis.

If you have recently made a contribution to your RRSP, there is another rule to keep in mind. RRSP contributions may not be deductible if they are made less than 90 days before an LLP withdrawal is made.

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## **C6. What happens to my RRSP when I die?**

On your death, you are deemed to have collapsed any RRSPs that you have. Therefore, you will be taxable on the fair market value of the plan at that time.

After your death, your property will be distributed to your beneficiaries. Historically, where the fair market value of your RRSP investments decreased after your death, but before the distribution of property, there was no rule to provide for the recognition of this loss. The 2009 federal budget announced a relieving measure applicable to final distributions from an RRSP after 2008. This measure allows the amount of a post-death decrease in these investments to be carried back and deducted against the RRSP income inclusion on your final return upon the final distribution of property to your beneficiaries from your RRSP. The amount that can be carried back will generally be the difference between the amount of the RRSP income inclusion as a result of death and the total of all amounts paid out of the RRSP after your death. The final distribution will generally need to be made before the end of the year that follows the year in which you died.

In certain cases, the value of your RRSP will not be included in your income. If your spouse is the beneficiary of your RRSP, the value of your RRSP can be included in their income instead of being included on your final tax return. They can then transfer this amount to their own RRSP, meaning that they will not have to pay any tax on these funds until they withdraw the funds from their plan.

Where a financially dependent child or grandchild (referred to here as a child) is the beneficiary of the RRSP, the income from the collapse of the RRSP will be taxable to them. Financial dependence is a question of fact. However, if the child's income for the year before your death is under the basic federal credit amount for that year (for 2009 deaths, the applicable amount is \$9,600), the child will be deemed to be financially dependent. Note that for an infirm child, the deemed dependence income threshold is higher at \$16,621 for 2009. Finally, where the child is either infirm or under 18, it may be possible for the child to defer some or all of this income inclusion.

For dependent infirm children, the amount received can be transferred to an RRSP set up for the child,

meaning the funds will not be taxed until the funds are withdrawn. Alternatively, the funds can be transferred to an annuity for the benefit of the child and will be taxable when received.

If the dependent child or grandchild is not physically or mentally infirm and is under 18, the RRSP can be rolled into an annuity for the benefit of the child as long as it is a fixed-term annuity that does not extend beyond the year in which the child turns 18. The annuity payments will be taxable to the child in the years they are received.

## **C7. What happens to my RRIFs and annuities on my death?**

The rules for RRIFs are similar to the rules for RRSPs. If you die and the plan assets are not payable to your spouse or to a dependent child or grandchild, the fair market value of the plan is included in your income. As well, the relieving measure discussed in C6 for value decreases in RRSP investments between death and the distribution of property to beneficiaries will also apply to allow for the carryback and deduction of post-death value decreases in RRIF investments.

If your spouse is entitled to the plan assets, he or she can simply become the annuitant of the RRIF or the RRIF assets can be transferred to a RRIF for the spouse. This gives your spouse the ability to base the remaining payments on his or her own age or on your age.

If the RRIF balance is payable to a child or grandchild who was financially dependent on you for support at the time of your death, the RRIF balance is taxable to the recipient in the same manner as an RRSP, as described in C6.

The treatment of an annuity on your death depends on the type of annuity you have purchased. If a life annuity was purchased with no survivor benefit, your estate will have no entitlement to any amount after your death and therefore, no amount will be taxable. If the annuity calls for a continuation of the benefits to your spouse, the amounts will be treated as taxable income to him or her, as received. If the annuity contains a provision where a lump-sum is payable to someone other than your spouse if you die prior to the end of the term, the lump-sum is treated in the same way as the balance of an RRSP on death (see C6).

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## Summary

RRSPs are an important and effective way to save for your retirement. You should take full advantage of this planning opportunity to ensure that you have sufficient retirement income in the future.

Contact your BDO advisor if you have any questions about your RRSP.

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