Get an RRSP working for your retirement

RBC Insurance

While retirement is a desirable prospect for many, it's difficult to predict how long it will last and how much it will cost.

That's why it's so important to accumulate as much money while you're still working to fund the lifestyle you hope to lead when you're retired. And establishing — and building — an RRSP is one of the best ways to help you achieve your goals. This guide has been designed to help you better understand what RRSPs are and how to make the most of them.

WHAT IS AN RRSP?

RRSP stands for registered retirement savings plan. It's a special structure that enables you to set aside money with the goal of growing your investment over time in a tax-deferred environment.

WHY SHOULD I INVEST IN AN RRSP?

Aside from simply amassing funds for use in retirement, saving money within an RRSP offers two key benefits:

1. TAX DEDUCTIBILITY

Quite simply, eligible contributions to your RRSP are tax deductible. For instance, if you contribute $5,000 to your RRSP, you reduce your taxable income by $5,000. If your marginal tax rate were 40%, your $5,000 contribution would generate a tax benefit of $2,000, reducing the amount of income tax you pay, perhaps even resulting in a tax refund.

2. TAX-DEFERRED GROWTH

Because you don't pay taxes on assets held in your RRSP until you withdraw them, this money is considered tax-sheltered. Consequently, any income and growth earned on the investments held within your RRSP can also accumulate tax-free until they are withdrawn. Since most, if not all withdrawals will be made during retirement, your income and taxation rate may be lower than your peak earning years.

WHAT KIND OF INVESTMENTS CAN I PUT IN AN RRSP?

Depending on your investment goals, your RRSP may include any or all of the following:

- Cash
- Segregated funds
- Mutual funds
- Canadian and international equities (stocks)
- Fixed income securities (bonds, guaranteed investment certificates, T-bills, etc.)

IS THERE A LIMIT TO HOW MUCH I CAN CONTRIBUTE TO MY RRSP?

While technically you can contribute as much as you like to an RRSP, there is an annual limit set by the federal government (plus a $2,000 cumulative buffer to deal with unpredictable earning patterns), and any amount in excess of that prescribed amount is subject to a significant penalty tax. Throughout this brochure, "contribution limits" refers to the amount permitted excluding the buffer and without incurring penalty taxes. All amounts contributed up to your contribution limit are deductible.

YOUR ANNUAL CONTRIBUTION LIMIT

Contributions to an RRSP are generally deductible within the limits outlined below:

In a given calendar year, your RRSP contribution limit is equal to:

- Any Unused RRSP Contribution Room carried over from previous years
- Plus the lesser of 18% of your taxable income for the prior year or the RRSP Annual Maximum Allowable Contribution Limit for the current year
- Minus the Pension Adjustment (PA), reported on your prior year's T4 (indicating the value of benefits provided by your employer's pension plan, where applicable)
- Minus any Past Service Pension Adjustment (PSPA) reported in the current year, if applicable
- Plus any Pension Adjustment Reversal (PAR) reported in the previous year, if applicable

Bear in mind that the income used in this calculation is for the prior calendar year, not the current calendar year. That way, you can calculate your RRSP deduction limit in advance.

Your RRSP can be made up of common shares of corporations (stocks), Canada Savings Bonds, mutual funds or segregated funds, such as RBC Insurance Guaranteed Investment Funds (GIFs). Typically, if you'd like to include stocks, bonds and other types of alternative investments, you'll need to open what's commonly called a self-directed RRSP.

RRSP ANNUAL MAXIMUM ALLOWABLE CONTRIBUTION LIMITS

2006	$18,000
2007	$19,000
2008	$20,000
2009	$21,000
2010	$22,000

WHAT IS UNUSED RRSP CONTRIBUTION ROOM?

Unused RRSP contribution room is the cumulative difference between your RRSP contribution limit and the contributions that you've actually made starting from 1991. As of 1991, you can carry forward any unused RRSP contribution room indefinitely. So, if one year you don't contribute the maximum allowable limit, you can add the difference to your maximum allowable limit for the next year, the year after and so on.

Carrying forward RRSP contribution room provides added flexibility, allowing you to make contributions on your own schedule, but you need to keep thorough and accurate records to track your contributions. You don't have to claim all the contributions you make to an RSP in the calendar year that you make them, but if you make a contribution and don't deduct it, you still have to report the amount on Schedule 7 of your income tax return.

For example, Mark earned $50,000 last year, was a member of his employer's pension plan, but has never contributed to an RRSP. Mark now has $10,000 of unused contribution room and last year's pension adjustment was $3,000. So here's how to calculate his current RSP contribution limit:

Unused contribution room:	$10,000
Lesser of 18% of $50,000 ($9,000) and the current year's limit ($19,000):	$ 9,000
Sub total:	$19,000
Less Pension Adjustment:	($ 3,000)
Total available contribution room:	**$16,000**

HOW DO I DETERMINE MY ACTUAL RRSP CONTRIBUTION LIMIT?

1. If your tax return has been prepared using an approved computer software package, it should include a page showing the calculation and your contribution limit.
2. Your RRSP contribution limit is displayed on your Income Tax Notice of Assessment for the previous calendar year.
3. Access your account online on the Canada Revenue Agency (CRA) website: **http://www.cra-arc.gc.ca/eservices/tax/individuals/myaccount/menu-e.html**
4. Call CRA.
   General information: 1-800-959-8281
   TIPS (Tax Information Phone Service): 1-800-267-6999

CAN I CARRY FORWARD MY TAX DEDUCTION?

Yes. Contributions made to your RRSP in 1991 or later can be carried forward and deducted in future years. If you expect to earn less this year than next, you may want to hold off claiming your deduction because if your marginal tax rate is higher the next year, claiming the deduction may yield a higher tax refund. This strategy is especially useful for maximizing funds available during retirement because you can carry forward deductions to the age of 71. By bulking up your contributions when you turn 71 and carrying forward the deductions, you can actually lower your taxable income during retirement.

WHEN AND HOW OFTEN CAN I CONTRIBUTE TO AN RRSP?

You can contribute to an RRSP as often as you like throughout the year, but for the contributions to be considered tax deductible, they have to be within your contribution limit and made on or before the 60th day of the following calendar year — typically between January 1st of the taxation year and on or before March 1st of the following year. These dates are always well publicized in the media.

THE THREE ESSENTIALS OF CONTRIBUTING: REGULAR, FREQUENT AND EARLY

Making regularly scheduled contributions to an RRSP makes it easier to stay on track with your goals and can help increase your retirement savings. Contributing more frequently can be useful in establishing a routine. But most important is making contributions — preferably large contributions — as early as possible in the calendar year so those funds can potentially grow tax-deferred for up to 14 months (the current calendar year, plus the first 60 days of the following calendar year).

If you feel making large lump-sum contributions isn't the best approach for your needs, you may want to consider a Pre-Authorized Payment (PAC) Plan, where you authorize regular withdrawals from your bank account to be applied toward your RRSP. These automatic contributions may offer added convenience and enable you to budget for them in advance.

If you're part of your employer's registered pension plan (RPP), tax-deferred contribution amounts you can make to an RRSP will be less. Even so, it's still a good idea to make the maximum allowable contributions to your RRSP to help supplement your pension benefits.

STARTING EARLY CAN REALLY ADD UP LATER

Establishing a habit of making regular RRSP contributions early in your working years enables you to take advantage of the tax-deferred compounding of investment returns. The following example shows how.

Janet and Susan are both 25 years of age. Janet starts now and contributes $1,200 each year to an RSP for 15 years, totaling $18,000.

Susan waits 10 years until she's 35 and starts contributing $1,200 each year for 30 years, for a total of $36,000.

So while Susan has contributed more money over a longer period of time, Janet has actually earned more. All the more reason to start making contributions early.

	Janet	Susan
Contributions beginning	Now (age 25)	In 10 years (age 35)
Contributes for	15 years	30 years
Annual contribution	$1,200	$1,200
Total Contributions	$18,000	$36,000
Difference in contributions	> Susan contributes $18,000 more	
Estimated rate of return	7.5%	7.5%
RSP Value		
Age 35	$18,250	$0
Age 45	$48,370	$18,250
Age 55	$99,693	$55,863
Age 70	$294,978	$191,492
Difference in final value	> Janet earned $103,486 more	

WHAT ABOUT BORROWING MONEY TO MAKE RRSP CONTRIBUTIONS?

In order to make your maximum allowable annual RRSP contribution, it may make sense to borrow money to do so. While the interest on the loan isn't tax deductible, taxes saved on the contribution amount, along with any earnings on your investments, can help offset the cost of borrowing. Additionally, if minimizing your taxes generates a refund, you can apply these funds toward paying down the loan. This strategy should be reviewed annually to ensure it continues to make sense and help you achieve your goals.

CAN I TAKE MONEY OUT OF MY RSP BEFORE I RETIRE?

Your RRSP may be terminated any time prior to maturity, but any amount withdrawn will be taxed as ordinary income in that same year. You can also choose to make partial withdrawals without actually terminating the plan, but the same tax conditions apply.

When you withdraw money from your RRSP, your financial institution will withhold tax from the total amount, effectively reducing the amount received, much like regular salaried payroll. The tax withheld may be claimed as a credit on your income tax return as income tax paid during that year.

THE HOME BUYER'S PLAN AND LIFELONG LEARNING PLAN

You can also withdraw funds from your RRSP without paying taxes in either of these two scenarios:

HOME BUYER'S PLAN

This plan allows you to "borrow" up to $20,000 from your RRSP to use toward the purchase of a home in Canada, without having to pay tax when the money is withdrawn.

The money you borrow from your RRSP must be returned in annual instalments over a 15 year period, commencing with the second year following the withdrawal.

The Home Buyer's Plan is intended for first time buyers (or if you have not owned a home in the last five years).

LIFELONG LEARNING PLAN

You may make tax-free withdrawals from an RRSP of up to $10,000 per year (not exceeding $20,000 overall), over a period of up to four calendar years. RRSP funds may be withdrawn under this plan where the recipient or their spouse is enrolled, or committed to enrol, as a "full-time student" in a "qualifying educational program" of at least three months' duration at an "eligible educational institution".

RRSP withdrawals under this plan must be repaid to an RRSP in equal instalments over a period of 10 years. Repayments must commence in the fifth year following the year of first withdrawal.

WHEN I REACH RETIREMENT AGE, WHAT HAPPENS TO MY RRSP?

While you don't have to wait until you retire to start withdrawing funds, your RRSP must mature by the end of the year in which you turn 71 years of age, at which time the funds must be withdrawn.

It's possible to take the funds in the form of a lump-sum payment, but they're subject to tax at your marginal rate when they're withdrawn. As such, many choose to purchase one — or a combination — of RRSP maturity options that offer a variety of options for how and when you receive retirement income. And because you don't pay tax until you actually receive funds, you can leave more of your money invested, tax-deferred, for a longer period of time.

WHEN I COLLAPSE MY PLAN, WHAT ARE MY RRSP MATURITY OPTIONS?

The three most popular RRSP maturity options for Canadians are:

REGISTERED RETIREMENT INCOME FUNDS (RRIFS):

- Enable easy transfer of your RRSP investments, along with opportunity for continued tax-deferred growth
- Can encompass a variety of investments and offer flexible withdrawal options
- Have mandatory minimum annual withdrawals

FIXED-TERM ANNUITIES:

- Provide guaranteed income until you or your spouse reach age 90, depending on option selected
- Offer fixed rate of income, or set payments that can be indexed over time

LIFE ANNUITIES:

- Provide income for life for you or you and your spouse's life
- Offer term options that guarantee a minimum number of payments in the event of your premature death

WHAT HAPPENS TO MY RRSP WHEN I DIE?

If you die before your RRSP has matured, the proceeds are paid to either the beneficiary named in your plan or to your estate in a lump sum.

Generally speaking, the deceased is taxed on the value of the registered plan on the date of death, but there are provisions for tax deferral if the proceeds are transferred to an eligible individual.

PROCEEDS TO YOUR SPOUSE

If your spouse is named beneficiary of the RRSP, they may transfer the proceeds of your RRSP, referred to as a "Refund of Premiums", to either an eligible registered plan or to an issuer for the purchase of a qualifying annuity in their name. While your spouse will be taxed on the Refund or Premiums, they will be able to deduct a similar amount transferred into their registered plan or annuity, thereby deferring taxes until they start receiving funds from these new plans.

Where your estate is beneficiary of the RRSP and your spouse is beneficiary of the estate, they will also incur tax on proceeds from an RRSP to your estate if they and the legal representatives of your estate file a joint tax election. Similar rollovers are available to the spouse to defer taxes in this situation. If this election is not filed, the RRSP proceeds will be considered income for the year in which you die and taxed as part of your terminal tax return.

A best practice is to have your spouse named as beneficiary for your RRSP, as opposed to filing the election after death, thereby minimizing probate fees.

PROCEEDS TO SOMEONE OTHER THAN YOUR SPOUSE

If you elect to have someone other than your spouse receive the proceeds of your RRSP when you die, for tax purposes, the funds are considered income for the year in which you die.

Exceptions include:

- A financially dependent child or grandchild under the age of 18
- A financially dependent child or grandchild with physical or mental infirmity

If this is the case, it's possible to have all or a portion of the proceeds considered taxable income for the child or grandchild. If the child or grandchild is under 18 and financially dependent, they can transfer the Refund of Premiums to an annuity payable to age 18, thereby gaining some potential tax deferral. If the child or grandchild is both financially dependent and physically or mentally infirm, they have all the rollover options available to a spouse.

If you name someone other than your spouse, qualified dependent child or grandchild as beneficiary, you will incur the full tax liability. If there are not enough assets in your estate to pay the taxes on your terminal tax return, the beneficiaries will be jointly liable.

WHAT IS A SPOUSAL RRSP?

A spousal RRSP is a plan established in your spouse's name where you make contributions and claim the tax deduction.

If you are married or in a common-law relationship, a spousal RRSP may enable you to split income with your lower-earning spouse and reduce your family tax bill in retirement.

When your spouse makes withdrawals from the plan in retirement, the assets are taxed in their hands, not yours. If your spouse is in a lower tax bracket than you, the savings can be significant.

TAX SAVINGS OPPORTUNITIES THROUGH INCOME SPLITTING

Under new pension income splitting rules effective for 2007 and beyond, the recipient of pension income from a registered plan may elect to have a portion of that income allocated to their spouse for tax purposes. This will enable them to split income to take advantage of differing marginal tax rates and to utilize the pension tax credit without requiring the use of a spousal plan.

Among the many eligible investment options for your RRSP are RBC Insurance Guaranteed Investment Funds (GIFs). To learn more, speak with your advisor today.

And remember, the sooner you start, the more time your money will have to grow — and the more likely you are to achieve your retirement goals.

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