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RRSPs: The Key to Saving for a Financially Secure Future

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A Registered Retirement Savings Plan (RRSP) is a savings plan that is registered with the government. This plan allows for you and your spouse or common law partner to make contributions to assist in saving for retirement. Any income that is earned in a RRSP is usually exempt from being taxes as long as those funds remain in the plan. However, you are generally required to pay taxes when you withdraw funds out of the plan.

There are three main tax advantages with a RRSP:

1. **Tax-deductible contributions:** You are able to receive immediate tax relief by deducting your RRSP contributions from the income you report to Canada Revenue each year. Your contributions are made with pre-tax dollars. This style of contributing is especially helpful to people who are in a higher tax bracket.
2. **Tax-sheltered earnings:** The money you earn on your RRSP investment will not be taxed as long as it stays within the RRSP plan.
3. **Tax-deferral:** Taxes are applicable when withdrawing funds from a RRSP plan, this includes investment earnings and contributions. However, you are able to defer this tax liability to the future when it is possible that your marginal tax rate will be lower in your retirement versus in your earning years.

Plan requirements and contributions

In order to open a RRSP plan and make contributions, you must be a resident of Canada, earn an income, and file an income tax return. However, there are limits on how much you can contribute. You can contribute the lower of 18% of your earned income in the previous year or the maximum contribution amount for the current tax year—which is $27,230 in 2020 plus any carry-forward contribution room you may have.

You can carry forward unused contribution room and use it in the future. A notice of assessment will contain the allowed contribution room from the previous year. March 2, 2020 is the deadline for contributing to a RRSP for the 2019 tax year.

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Investments you can and cannot hold under a RRSP

Investments that can be held in a RRSP include: cash, GICs (term deposits), savings bonds, treasury bills, bonds (government bonds, corporate bonds, and strip bonds), mutual funds, ETFs, equities, Canadian mortgages, mortgage-backed securities, and income trusts. However, the investments you cannot hold in a RRSP generally include precious metals, personal property such as art, antiques and gems, and commodity futures contracts. In addition, there are complex rules prohibiting certain debt investments and investments such as shares in private holding companies, and real estate which are deemed non-qualifying.

A good general principle for investing is to have a balance between safety, income, and growth and to allow for diversification of the portfolio. However, as you get closer to retirement, it's usually a better idea to invest in a more conservative portfolio, as your portfolio may not have enough time to recover in the event of market volatility.

How long can a RRSP stay open?

Plan holders are required to close their RRSP the year in which they turn 71 years of age. Closing a RRSP can be done in one of three ways:

1. The RRSP can be converted to a Registered Retirement Income Fund (RRIF);
2. The RRSP can be converted to an annuity; or,
3. All the funds can be withdrawn from the RRSP.

The latter is the most inefficient method because all monies withdrawn from the RRSP will be included in your taxable income for that year. The most common approach is to convert the RRSP to a RRIF. A RRIF no longer allows you to contribute to the plan. Instead, it keeps your investments sheltered from tax until you're ready to withdraw the funds.

You must withdraw a minimum annual distribution payment from your RRIF account. Typically, this payment can be withdrawn once a year or taken as a monthly payment. The monthly payment is meant to replace your employment income in retirement. Your financial institution will send you a notice telling you the minimum amount you need to take out each year. At age 71, you are required to withdraw a minimum of just over 5%, and that amount gradually increases to 20% by age 95. You can always withdraw more than the minimum withdrawal requirement; however, it is important to note withdrawals from your RRIF will be included in your taxable income.

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Making withdrawals

While the purpose of the RRSP is to save during your working years and withdraw from the account in your retirement, the funds are available for withdrawal sooner than retirement, if necessary. If you choose to withdraw funds from the plan before you retire, you will need to pay withholding tax. The amount of withholding tax depends on the amount that is withdrawn. In BC, the first $5,000 will incur 10% withholding tax, $5,000 to $15,000 will incur 20% withholding tax, and any amount over $15,000 will incur 30% withholding tax.

However, if you are purchasing your first home or attending college or university you may be able to take money from your RRSP without tax implications. Under the homebuyer's plan, you can withdraw up to $35,000, but you must repay the full amount within 15 years. For educational purposes, you can withdraw $20,000 (no more than $10,000 per year), but it must be repaid within 10 years.

Death of an RRSP annuitant

According to the Government of Canada, "An annuitant of a RRSP or a RRIF is the person for whom the plan or fund provides a retirement income. In certain circumstances, the surviving spouse or common-law partner may qualify as the annuitant when, because of the death, they become entitled to receive benefits out of the plan or fund." (Canada, 2020)

Under the Federal Income Tax Act, when a RRSP annuitant dies, they are deemed to have received their RRSP funds before death. This is to say, that the RRSP value at the time of death is included in taxable income of the deceased for the year of death. However, if the beneficiary is a spouse, common-law partner or a financially-dependent child or grandchild with a mental or physical disability, the beneficiary can request that the proceeds roll over to the beneficiary's RRSP or RRIF and are then reported on the beneficiary's tax return.

The election of a beneficiary provides flexibility in tax planning since partial rollovers are allowable (which can allow for use of a deceased annuitant's lower tax brackets or unused tax credits to minimize RRSP tax payable). A similar provision is available on death of a RRIF annuitant. But, annuitants should keep in mind that RRSPs and RRIFs paid to an estate are normally subject to probate tax, estate creditors and complex estate settlements where applicable.

A RRSP is a powerful tool for saving for your retirement and tax planning. To start a retirement plan or to learn more about registered retirement savings plans, you can contact Raman Takhar at 604-549-5384.