Understanding the Basic RRSP Rules

2023 Edition

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Investing in a Registered Retirement Savings Plan ("RRSP") is one of the soundest ways to ensure you enjoy a financially secure retirement. In order to maximize the benefits of an RRSP, it's important to have a basic understanding of the rules that govern them.

RRSP deduction limits

The easiest way to find your RRSP deduction limit is to look it up on the Notice of Assessment provided by the Canada Revenue Agency ("CRA") after you file your annual income tax return[1]. However, if you'd like to verify this amount, here's how to calculate the deduction limit for yourself.

For 2023, your RRSP contribution amount is based on any carry forward amount from 2022, plus your current year's contribution amount, which is the lesser of $30,780 or 18% of your 2022 earned income.

If you are a member of a Deferred Profit Sharing Plan ("DPSP") or Registered Pension Plan ("RPP"), you must deduct your pension adjustment and, if applicable, your net past service pension adjustment ("PSPA").

Relatively few taxpayers will have a PSPA. However, if you do, your company will provide you with these details.

Earned income

Sources of income which qualify as earned income when calculating your deduction limit include:

- Net employment and business income;
- Disability payments from the Canada Pension Plan or the Quebec Pension Plan;
- Royalties;
- Net rental income;
- Taxable support payments (i.e., alimony and separation allowances) received;
- Net research grants;
- Employee profit sharing plan allocations; and
- Supplementary unemployment benefit plan payments.

Items that reduce earned income include:

- Net rental losses;
- Deductible support payments (i.e., alimony or separation allowances) paid;
- Union or professional dues; and
- Employment expenses.

Previous year's earned income

Your RRSP deduction limit is calculated using your previous year's earned income. This means that your 2023 RRSP contribution is based on your 2022 earned income.

There are two groups of taxpayers for whom this rule has some interesting implications. Anyone who had earned income in 2022 but not in 2023, such as recent retirees, will get a bonus contribution year. Unfortunately, individuals who will have earned income in 2023, but had no earned income in 2022, will not be able to make a 2023 RRSP contribution unless they have unused contribution room to carry forward from a previous year.

Similarly, your 2023 earned income will form the basis of your 2024 RRSP contribution.

Pension adjustment

If you are a member of a Registered Pension Plan or Deferred Profit Sharing Plan, your employer is required to calculate the value of the benefit which accrued to you during the year. You will find the amount of this benefit – called the pension adjustment – on your annual T4 or T4A. Your 2022 pension adjustment reduces your 2023 RRSP deduction limit. The pension adjustment attempts to add an element of fairness to the pension system since some pension arrangements are more lucrative than others.

If you have a generous pension plan, your pension adjustment will be higher than if you are in a less attractive plan.

Pension adjustment reversal

Pension adjustments are calculated assuming that you will remain with your employer until retirement. If you change jobs prior to retirement, you may find that the termination benefit from your pension plan is less than the amount of RRSP contribution room you lost due to the pension adjustment.

The pension adjustment reversal (“PAR”) restores lost RRSP contribution room if your termination benefit is lower than your accumulated pension adjustments. Your pension plan administrator will calculate the amount of your PAR and notify both you and the CRA of any adjustment; allowing the CRA to add the value of the PAR to your RRSP contribution room.

The tables to the right summarize how to calculate your RRSP deduction limit.

RRSP Deduction Limit

Step 1		
Unused RRSP deduction room from previous year(s)	plus the lesser of:	18% of your prior year’s earned income – or – the CRA’s maximum annual RRSP contribution limit
Step 2 (if applicable)		
Deduct your previous year’s pension adjustment (“PA”) and net past service pension adjustment, or add any pension adjustment reversal.		

RRSP Contribution Limits

Year	Lesser of:	
2022	$29,210	or 18% of prior year’s earned income
2023	$30,780	
2024	$31,560	

Contribution room carry forward

If, for any reason, you are unable to take full advantage of the RRSP contribution room available to you this year, you can defer making use of it until a future year. For example, let’s say that you are eligible to make the full $30,780 RRSP contribution for 2023; but instead contribute only $10,000. The balance ($20,780) will be added to your contribution limit and can be used in 2024 or some later tax year.

Despite being able to carry forward unused contribution room, if you are in a high tax bracket, you should plan to maximize your RRSP contribution each year.

If you don't, you lose out on the tax-deferred compounding on the income earned – and it won't be any easier to make a double contribution the following year.

If you are not sure whether you have any unused contribution room, check your Notice of Assessment that you receive from the CRA after filing your 2022 tax return.[1]

Tax deductibility carry forward

You don't hear much about this second carry forward provision; however, provided you have available unused RRSP contribution room, it allows you to make your RRSP contribution but does not require you to claim the tax deduction until some future year when you decide it would be more advantageous from a tax perspective. Being able to carry forward the tax deduction can be very useful in a year when you have the financial ability to make a contribution, but the tax deduction will not be of significant value.

Remember, you use the previous year's earned income to determine your current year's RRSP deduction limit (i.e., your 2022 earned income helps determine how much you may contribute to your RRSP for 2023). This provision proves useful for taxpayers who have income which fluctuates widely from one year to the next.

For example, a professional who took a sabbatical in 2023 would have no 2023 earned income, but would be able to make an RRSP contribution in 2023 based on their 2022 income. Unfortunately, the tax deduction would be of little use in 2023. However, in 2024, when they return to the workforce, their RRSP deduction limit would be zero because they had no 2023 earned income. However, if a contribution was made in 2023 and the tax deduction carried forward, it could be claimed against their 2024 taxable income when the deduction will be of most value.

Examples of individuals who might benefit from this provision include commissioned salespeople, anyone transferred outside of Canada temporarily, and individuals who lose their job or take an extended maternity leave.

The $2,000 over-contribution limit

You are allowed to exceed your RRSP deduction limit by $2,000 without attracting a penalty tax.

The over-contribution limit exists because the CRA understands that taxpayers may inadvertently overcontribute to their RRSPs. There is a one per cent, per month tax penalty for contributions which exceed the combination of your maximum deduction limit and the $2,000 lifetime over-contribution limit.

The over-contribuition is not tax deductible when contributed to your RRSP, and is taxed when withdrawn. The benefit of over-contributing is that all of the income the over-contribution earns stays in the RRSP and compounds on a tax-deferred basis. If you deliberately over-contribute, be sure to use up the over-contribution as part of some future year's regular RRSP contribution room, so that the over-contribution is not doubly taxed.

For example, let's assume that your RRSP deduction limit for the current year is $8,000, but you contributed $10,000 to your RRSP. In a future year – perhaps just before retirement – let's assume your RRSP deduction limit for the year is $10,000. You could contribute just $8,000 to your RRSP, but would be entitled to claim a total RRSP deduction of $10,000 ($8,000 for the current year's contribution plus the $2,000 that was previously contributed, but not deducted for tax purposes).

Please note, the $2,000 over-contribution room is not available to anyone who is under the age of 18, at any time during the calendar year.

RRSP contribution deadline

You have 60 days after the end of the year to make your RRSP contribution for the previous tax year. The deadline for making your 2023 RRSP contribution is expected to be February 29, 2024. You can make your 2023 RRSP contribution as early as January 1, 2023.

In fact, a $10,000 annual RRSP contribution made on January 1 of each year for 30 years and earning a six per cent rate of return, will be worth almost $65,000 more than if the contribution was made 14 months later at the RRSP contribution deadline.

Beginning and maturing your RRSP

If you have qualifying earned income, you can open and contribute to an RRSP. Even a minor child who has earned income may contribute to an RRSP. However, to generate earned income for RRSP purposes you must file an income tax return, even if there is no tax liability.

Your RRSP may continue until the end of the year in which you celebrate your 71st birthday. At that time, you must collapse your RRSP and either take the proceeds in cash or transfer the funds to one or more of the RRSP maturity options available, such as a Registered Retirement Income Fund ("RRIF") which allow you to withdraw funds over a period of years to fund your retirement.

Taxation of RRSPs

Your RRSP contributions are tax deductible and continue to grow on a tax-deferred basis until they are withdrawn from the plan. When a withdrawal is made from your RRSP, the funds are included as taxable income on your tax return for that year and you will pay income tax on the withdrawal at your marginal tax rate.

Investment options

Qualified RRSP investments include: Guaranteed Investment Certificates ("GICs"), Canada Savings Bonds ("CSBs"), mutual funds, exchange-traded funds ("ETFs"), common and preferred shares and bonds (issued by corporations, provincial and Federal governments). Investors should be aware of the RRSP anti-avoidance rules, which are designed to deter individuals from gaining inappropriate tax advantages through their RRSPs. Non-qualified investments, prohibited investments and advantage rules (including swap transactions and RRSP strips) are subject to penalties and taxes will apply to these investments.

Keep good records

When you take advantage of the carry forward provisions or make a deliberate over-contribution, it's important to keep good records. A clear audit trail not only comes in handy during discussions with the CRA, but also serves as a way of refreshing your own memory or alerting your executor to some potentially unclaimed tax deductions.

Understanding the rules is important to ensure you take full advantage of all of the benefits of an RRSP.

For more information, please speak with your BMO financial professional.

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[1] Information regarding your personal RRSP contribution limit is available through the CRA's My Account eService at: https://www.canada.ca/en/revenue-agency.html

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