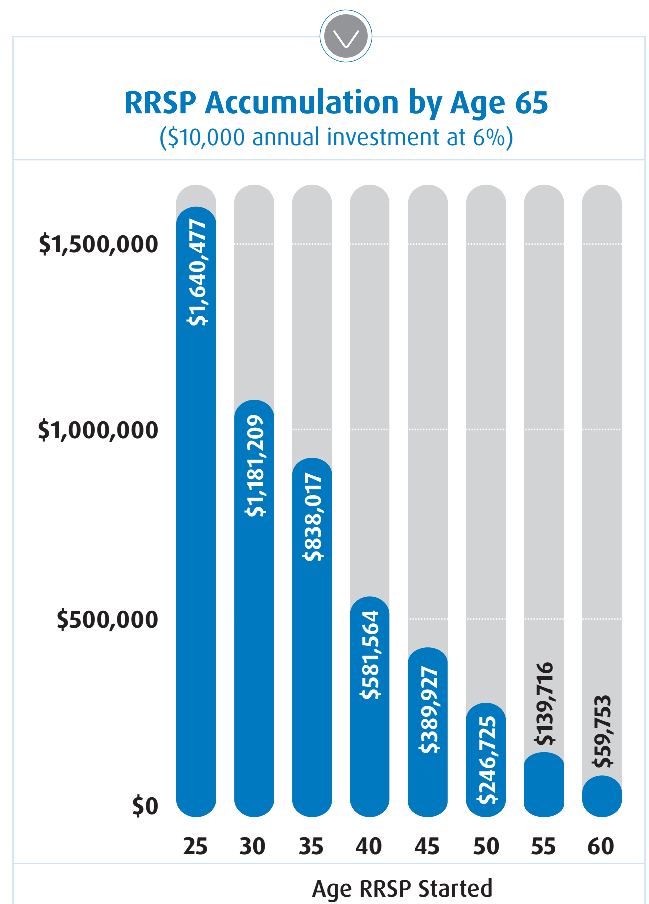
RRSPs – Saving Tips and Strategies

A Registered Retirement Savings Plan (RRSP) remains the cornerstone of most retirement plans, particularly if you don't have a company pension plan. An RRSP is a tax-deferred plan designed to help you save for retirement. With an RRSP, contributions are tax deductible and once in the plan, continue to grow on a tax-deferred basis until the funds are withdrawn. Any funds removed from the RRSP are taxed in the year they are withdrawn. At retirement, the money in the plan may be rolled into any of the RRSP maturity options where they continue to be tax sheltered, except for withdrawals made from the plan – which are treated as income – each year.

Start early

Many people do not get serious about building their retirement assets until 10 or 15 years before they plan to retire. However, because of the tremendous impact that compounding has on the growth of your RRSP, you should start your plan as early as possible, contributing as much and as often as you can.

The following chart compares the difference between starting your RRSP at age 30 and age 50. Assume that you contribute $10,000 each year until age 65 and earn six per cent annually. If you started at age 50, you would accumulate $246,725 by the end of the year in which you turn age 65. By starting at age 30, your RRSP would be worth $1,181,209 by the end of the year in which you turn age 65. Even though you contributed an additional $200,000 by starting 20 years earlier, your RRSP would have accumulated an extra $934,484.



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Contribute early

Many RRSP owners make their contributions during the first 60 days of the year in order to meet the contribution deadline for the previous tax year. By doing so, you effectively lower the value of your RRSP. By contributing on January 1 rather than March 1 of the following year, the money is invested in the RRSP for an additional 14 months. Compounding, especially over a number of years, can have a profound effect on the total value of your RRSP. If you contributed $10,000 on January 1 each year for 30 years and earned a six per cent rate of return, you would have $64,799 more in your RRSP than if you made your annual contribution on March 1 of the following year.

Contribute longer

As long as you continue to have earned income or unused RRSP room, you may continue to contribute to your RRSP up to, and including, the end of the year in which you turn 71 years of age. RRSP contributions are deductible against any type of income, including pension or investment income. Once you turn age 71, you have until the end of that year to mature your RRSP. However, if your spouse is still young enough to have an RRSP, you may contribute to a Spousal RRSP if you continue to have earned income or unused RRSP contribution room. You are entitled to the tax deduction for your Spousal RRSP contribution, even though you may no longer contribute to an RRSP yourself.

Make an early RRSP contribution at age 71

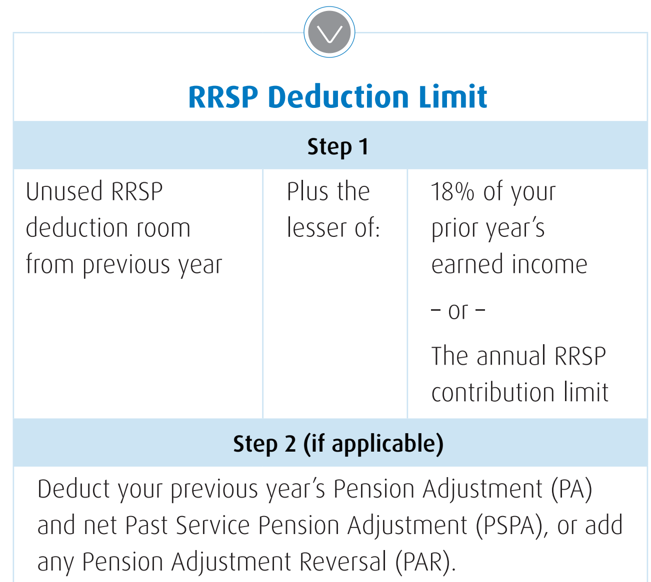
If you are still working at age 71, you will generate RRSP contribution room for the following year. If you won't be able to make a Spousal RRSP contribution, you can still take advantage of this contribution room by making an early RRSP contribution by the end of your 71st year.

Here's how it works. Let's assume that you turn age 71 this year, and based on this year's earned income, you're eligible to make a $10,000 RRSP contribution next year. Because you will no longer have an RRSP next year, you can make an early contribution in December of this year based on this year's earnings. This will cause an over contribution and a penalty tax of $80 for the month of December (1% x $8,000, since the first $2,000 of an overcontribution is not subject to the penalty tax).

On January 1 of next year, you will no longer be in a penalty position, since the new contribution room becomes available. You will be able to claim a $10,000 tax deduction on your next year's tax return and will have sheltered an additional $10,000 inside your RRSP. The benefit of the tax deduction, along with the continued taxdeferred growth in a Registered Retirement Income Fund (RRIF), or the increased annuity payment (if you use your RRSP to purchase an annuity), should exceed the one month penalty tax.

Maximize your contributions

The ability to save with an RRSP is affected by many factors, including the annual deduction limit, your earned income and your Pension Adjustment. The easiest way to find your RRSP deduction limit is to refer to the Notice of Assessment that the Canada Revenue Agency (CRA) sends to you after you file your income tax return each year. Here's how to verify that figure for yourself:



RRSP Deduction Limit

Step 1		
Unused RRSP deduction room from previous year	Plus the lesser of:	18% of your prior year's earned income – or – The annual RRSP contribution limit
Step 2 (if applicable)		
Deduct your previous year's Pension Adjustment (PA) and net Past Service Pension Adjustment (PSPA), or add any Pension Adjustment Reversal (PAR).		

RRSP Contribution Limits

Year	Lesser of:	
2019	$26,500	or 18% of prior year's earned income
2020	$27,230	
2021	Indexed to inflation	

Contributing securities to your RRSP

Your RRSP contribution does not have to be made in cash. You may deposit any qualified RRSP investment you already own into your RRSP instead of cash – referred to as an "in-kind" contribution or transfer. You will need to report any capital gains accrued to the date of transfer on your tax return. Any capital loss accrued is denied for tax purposes. Qualified RRSP investments include Guaranteed Investment Certificates (GICs), Canada Savings Bonds, mutual funds, common and preferred shares and bonds (issued by corporations, provincial and federal governments).

Accumulate contribution room

Since RRSP contribution room for the current year is based on the previous year's earned income, you're unable to make an RRSP contribution in the first year you begin working. So, if you have children who are working part-time jobs, consider having them file an annual tax return even if they don't owe income tax. By filing a tax return, they will accumulate RRSP contribution room that can be carried forward and used when they eventually begin working full-time.

While the amounts may seem small, this strategy can produce significant results. If your child works throughout high school and university, they could easily accumulate $3,500 in RRSP contribution room. Assume that they begin working full-time at age 23, they could use their accumulated RRSP contribution room to make a contribution that year. If the contribution earns an annual six per cent rate of return, their $3,500 RRSP contribution could be worth $42,877 when they reach age 65. And, perhaps more importantly, your children will develop good savings habits.

Transfer a qualifying retiring allowance to your RRSP

These days most people will change employers more than once throughout their careers, at which time you may be offered a "retiring allowance" (which is a defined term in the tax legislation). Depending on the size of the retiring allowance and when you worked for your employer, you may be able to transfer all or part of it directly into your RRSP and defer the immediate payment of income tax.

If the payment represents a retiring allowance, you can create additional RRSP contribution room equal to $2,000 for each year – or part year – of service with your employer before 1996, plus an additional $1,500 for any years of service prior to 1989 for which you were not a member of a vested company pension plan or Deferred Profit Sharing Plan (DPSP). No rollover is allowed for years of service after 1995. The rollover amount is in addition to your normal contribution room which is calculated based on earned income.

There is a tremendous advantage to tax sheltering as much of your retiring allowance as possible in a RRSP; however, this rollover can only be made to your own RRSP and not a Spousal RRSP. You have up to 60 days after the end of the year that you're paid your retiring allowance to make the RRSP contribution. To the extent that you have any unused, normal RRSP contribution room, you can also use the funds from the retiring allowance to top up this contribution room.

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Income splitting with a Spousal RRSP

A Spousal RRSP is the same as a regular RRSP, except that a Spousal RRSP is registered in your spouse's name. However, you take the full tax deduction for all contributions you make (as the contributing spouse) to the plan. The primary benefit of establishing a Spousal RRSP is to allow for income splitting at some time in the future, since the assets in the Spousal RRSP are considered the property of the planholder (your spouse). Generally, when the funds are withdrawn from the plan, they are taxed at the planholder's marginal tax rate. Typically this strategy is used when the planholder would otherwise have little retirement income, while the contributing spouse would maintain the majority of the couple's income.

Despite the opportunities created by the pension incomesplitting rules, the use of a Spousal RRSP as an incomesplitting tool may still be beneficial. Spousal RRSPs allow for additional income-splitting opportunities prior to age 65, and also provide further opportunity to increase the amount of income splitting beyond the 50% limitation permitted under the pension income-splitting rules.

Designate a beneficiary for your RRSP

A beneficiary designation is made in writing, either directly on the RRSP application form, on a beneficiary change form, in a letter, or in your Will, and can be changed only by the plan holder. In Quebec, beneficiary designations are made in your Will. You should review your beneficiary designation whenever there is a change in your personal circumstances such as marriage, divorce, death or a birth.

If you name a charity as the beneficiary of your RRSP, the payment will be considered a charitable donation and your estate entitled to a donation credit for the value of the plan. Although your estate will be taxable on the value of the plan, the donation credit should completely offset the tax owing on the value of the RRSP plan.

Your RRSP is an important component of your retirement plan. Depending on your situation, one or more of the strategies discussed in this publication may help maximize the benefits of your RRSP.

For more information, speak with your BMO financial professional.

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