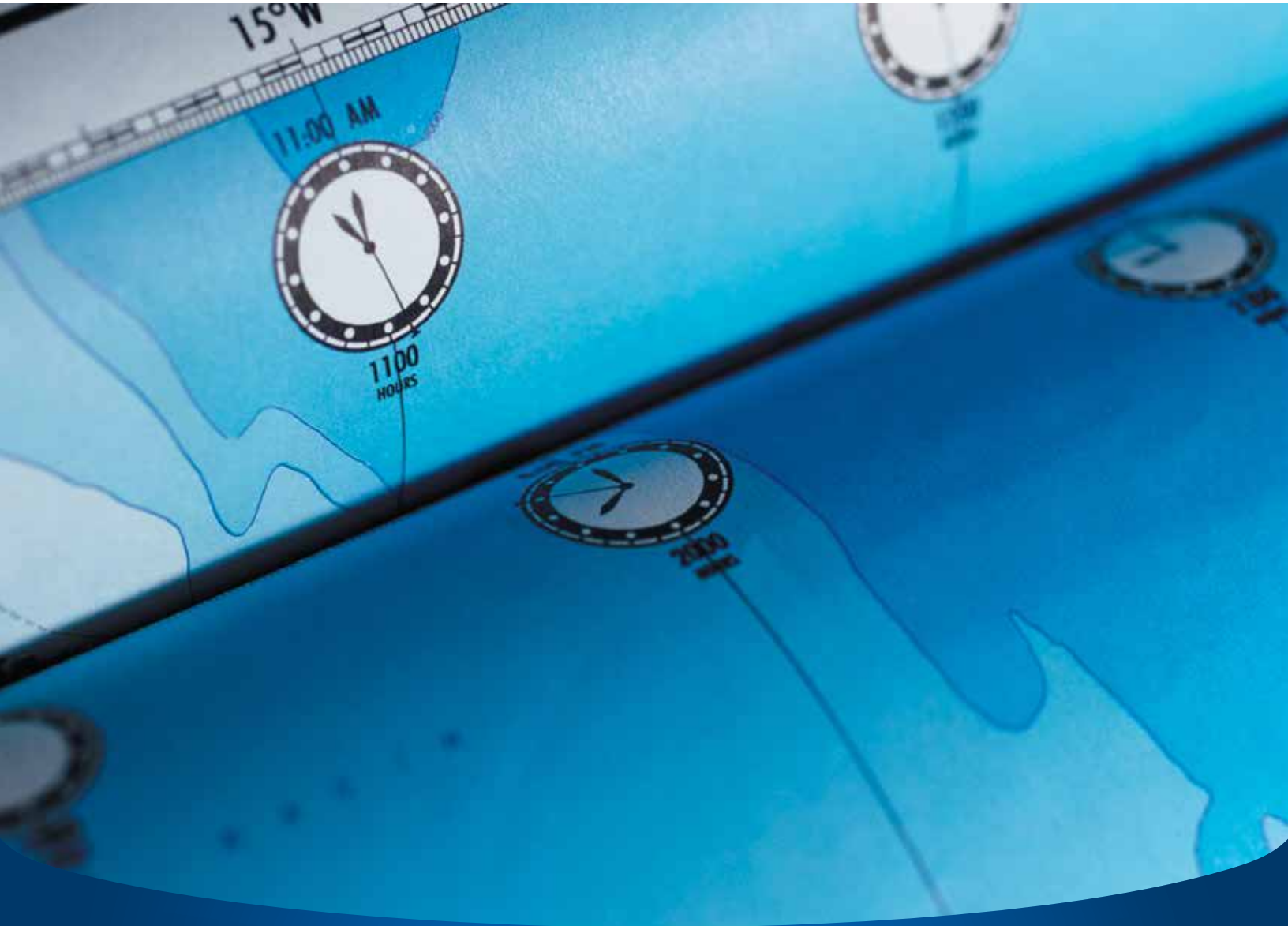


# Registered Retirement Savings Plans



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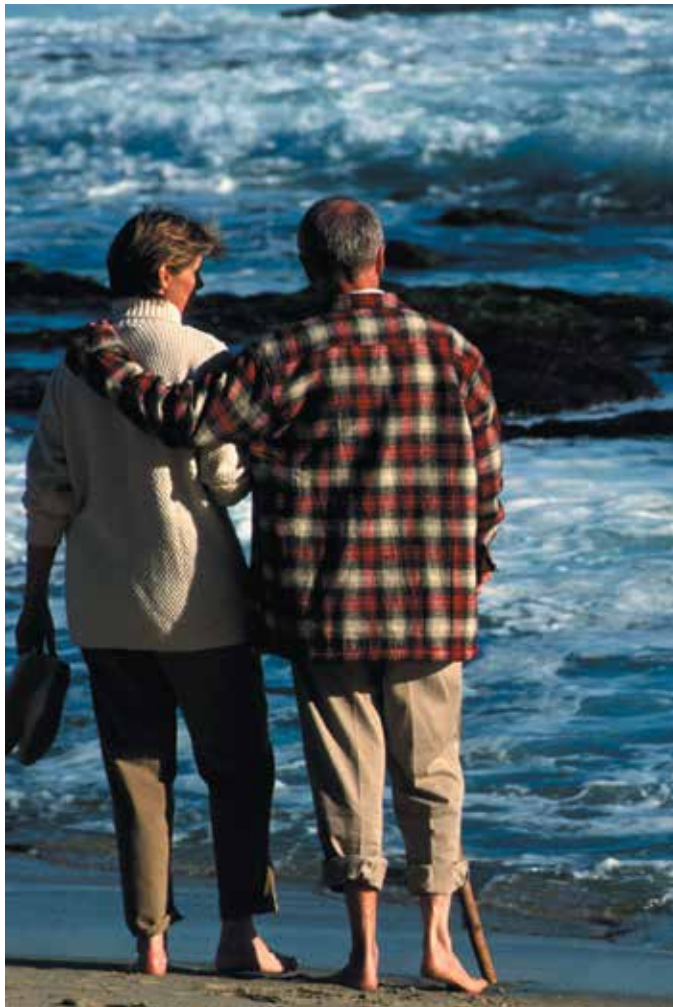
Ask your advisor for more information.

<sup>s†</sup> Please see back cover for more information.

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## 1 > INTRODUCTION



For most Canadians, their registered retirement savings plan (RRSP) represents a key source of retirement income—a source that will be accumulated over many years to guarantee the attainment of their retirement objectives. While recognizing the importance of this resource is a good first step, fully understanding the rules specific to RRSPs and the saving strategies available is essential. A thorough understanding, accompanied by effective management of your RRSP assets, will help you accumulate the largest possible retirement savings.

The purpose of this publication is to review the basics of RRSP investing and provide an outline of strategies available to maximize your RRSP savings. If you have a locked-in RRSP, ask your advisor at RBC® for more information on this topic.

And remember, maximizing the growth of your RRSP requires your ongoing attention and effective management. You and your advisor at RBC can work together to meet your RRSP, and ultimately, your retirement objectives.

## 2 › BASIC RRSP CONCEPTS

An RRSP is a tax-sheltered investment vehicle that provides individuals with an effective means of saving for retirement. Contributions to an RRSP result in a tax deduction, and the income earned in the plan compounds on a tax-deferred basis. Individuals with RRSP contribution room in Canada may contribute to an RRSP up to the end of the year in which the planholder reaches age 71. The maximum age was increased from 69 to 71 in 2007.

### THE BENEFITS OF RRSP INVESTING

While most individuals recognize the benefits of investing in an RRSP, many do not exploit its unique advantages to their fullest potential. There are three primary benefits to investing in an RRSP:

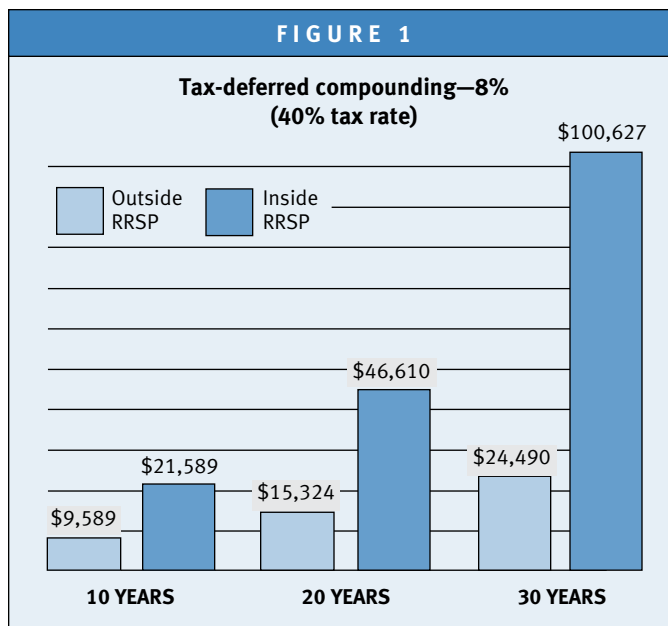
#### 1. Tax savings

Contributions to an RRSP are deductible for tax purposes within certain prescribed limits. In the year a contribution is made to an RRSP, you can choose to deduct the contribution from your taxable income. This deduction reduces your amount of taxable income and thus your taxes payable. The actual tax savings will depend on your marginal tax rate. The table below outlines the amount of tax saved and the after-tax cost of a \$1,000 RRSP contribution based on various marginal tax rates.

Marginal tax rate	Tax saved	After-tax cost
25%	\$250	\$750
40%	\$400	\$600
45%	\$450	\$550

#### 2. Tax-deferred compounding

The most significant opportunity offered by the RRSP is the tax-deferred compounding of income earned within the plan. The term “tax-deferred” refers to the fact that all income earned within the RRSP accumulates tax-free until withdrawn. If you have \$10,000 to invest and have the choice of making an RRSP contribution or not making an RRSP contribution, consider that if you invest the money in an RRSP, you will save \$4,000 in tax (assuming a 40% tax rate). Therefore, a \$10,000 contribution to the RRSP is comparable to a \$6,000 investment outside the



RRSP, assuming the tax savings are reinvested. As you can see from **Figure 1**, you are better off contributing to an RRSP. The question is, how much better? To determine the RRSP advantage, you have to convert the RRSP value to an after-tax value. To provide this comparison, let’s assume you will withdraw the \$21,589 accumulated by the 10th year and pay tax at 40% on this income. In the unlikely event the RRSP were to be collapsed in the 10th year, you would still have \$3,364 more by investing in the RRSP. Allowing the money to remain in the RRSP after the 10th year would further enhance the benefit to you.

#### 3. Income splitting

Utilizing income-splitting strategies between spouses can provide significant tax savings. One of the most simplistic, yet effective, methods of income splitting between spouses is achieved by contributing to a spousal RRSP. The objective of this strategy is to provide both spouses with similar retirement incomes and thus similar income tax rates in retirement.

In order to be deductible in the current taxation year, contributions to your RRSP must be made either during the year or up to 60 days after December 31 of the

## 3 › CONTRIBUTIONS TO YOUR RRSP

current year. Contributions made in the first 60 days of the following year can either be deducted in the current year or in a future year.

Contribution limits to your RRSP are in part based upon a percentage of your earned income from the previous year.

### WHAT IS EARNED INCOME?

Earned income is calculated from the following types of income:

- Salary or wages from employment. This amount is reduced by deductible employment-related expenses such as union or professional dues.
- Disability pensions paid under the Canada Pension Plan (CPP) or Quebec Pension Plan (QPP) (you must be a resident of Canada when you receive the payments) and taxable income from a disability plan. Regular CPP and QPP retirement pensions do not qualify as earned income.
- Net income from a business carried on by a self-employed individual or by an active partner of a partnership.
- Net rental income from real property.
- Payments from supplementary unemployment benefit plans (not Employment Insurance).
- Taxable alimony or maintenance payments received.
- Royalties and net research grants.

Please note that no RRSP contribution room is created from the receipt of a retiring allowance.

Earned income must be reduced by the following amounts:

- Losses from a business carried on by a self-employed individual or by an active partner of a partnership.
- Net rental losses from real property.
- Deductible alimony or maintenance payments.

### CALCULATING YOUR CONTRIBUTION LIMIT

The annual RRSP contribution limit generally depends upon two factors: your prior year's earned income

and the prior year's deemed pension benefit from your employer pension plan, if applicable.

To calculate your current RRSP contribution limit, you must follow a two-step calculation:

#### Step 1: Determine your overall limit

Calculated as the lesser of:

- 18% of your prior year's earned income
- The legislated annual maximum limit

Year	Legislated annual maximum limit	Income level
2012	\$22,900	\$127,611
2013	\$23,820	\$132,333
2014	\$24,270	\$134,834

#### Step 2: Subtract your prior year's pension adjustment (PA) factor if applicable

Once your overall limit is calculated, this amount must be reduced if you are a member of a pension plan. If you are not a member of a pension plan or a deferred profit sharing plan (DPSP), your overall limit calculated in Step 1 represents your actual limit for the year.

Members of a registered pension plan (RPP) or a DPSP must subtract the pension adjustment factor indicated on their prior year's T4 slip from the overall limit calculated in Step 1. This pension adjustment factor is intended to represent the pension benefit that the member will receive in the year. Reducing the overall contribution limit by a pension factor is intended to equate the retirement benefit provided to pension plan members with the benefit available to non-members.

Also, members of defined benefit pension plans may have a past service pension adjustment (PSPA), which will further reduce their available contribution limit. A PSPA could also result when a plan member purchases pension benefits relating to prior years of employment (after 1989).

Furthermore, employees that are terminating their interest in an RPP may receive a pension adjustment reversal (PAR). A PAR is added to your RRSP contribution room. For defined



**RRSP PLANNING TIP**

Contributions to your RRSP should be made early in the year to maximize tax-deferred compounding.



**RRSP PLANNING TIP**

Each year the Canada Revenue Agency (CRA) sends out, along with your Notice of Assessment for your tax return, a calculation of what your RRSP contribution limit is for the year. You usually receive this notice in the June to August period. Use **Figure 2** to help you calculate your contribution limit and contribute early.

benefit pension plans, a PAR is generated when the sum of all pension adjustments since 1990 is greater than the value of post-1989 pension benefits upon plan termination. For defined contribution and DPSP plans, a PAR is generated when contributions to these plans are forfeited due to early termination.

**Figure 2** is provided to assist you with calculating your RRSP contribution limit, and the following is an example for your reference.

Example: Throughout 2013, Susan was employed by a company which sponsors a pension plan for its employees. Her employer reported a 2013 PA of \$6,000 on her 2013 T4. Susan’s employment income in 2013 was \$50,000. She has always made her maximum RRSP contribution each year. Susan’s 2014 deductible RRSP contribution would be calculated as follows:

Unused contribution from prior years	NIL (a)
Plus the lesser of	
<i>18% of earned income from prior year</i>	}
(\$50,000 x 18% = \$9,000)	
<b>OR</b>	
<i>the maximum annual 2014 contribution (\$24,270)</i>	}
	<b>\$9,000 (b)</b>
Less pension adjustment from prior year	<u>\$6,000 (c)</u>
Total: (a + b) – c	<u><u>\$3,000 (d)</u></u>
Less past service pension adjustment (PSPA)	NIL (e)
Plus pension adjustment reversal (PAR)	<u>NIL (f)</u>
Allowable deductible contribution: d – e + f	<u><u>\$3,000 (g)</u></u>

**FIGURE 2**

Unused contribution from prior years	_____ (a)
<b>PLUS the lesser of</b>	
18% of earned income from prior year	}
_____	
<b>OR</b> maximum annual contribution	}
	_____ (b)
<b>LESS</b> pension adjustment from prior year	_____ (c)
<b>TOTAL:</b> (a + b) – c	<u>_____ (d)</u>
<b>LESS</b> past service pension adjustment (PSPA)	_____ (e)
<b>PLUS</b> pension adjustment reversal (PAR)	_____ (f)
Allowable deductible contribution: d – e + f	<u>_____ (g)</u>

**THE CARRY-FORWARD RULE**

As of 1991, individuals that do not contribute their maximum annual contribution to their RRSP can carry forward the unused portion and make the contribution in a future year. This unused portion can be carried forward indefinitely.

Be aware, however, that waiting until a future year to catch up on deductible contribution room will, in most cases, result in a smaller RRSP due to the loss of tax-deferred growth.

**RRSP PLANNING TIP**

Although you must make your annual contribution during the outlined 14-month period to qualify as a current year tax deduction, you can choose to delay claiming this deduction. Making a contribution today will allow you to put your money to work immediately, while it may be more beneficial to claim the tax deduction in a later year.

**EXCESS CONTRIBUTIONS**

The ability to make a contribution in excess of the available contribution limit was first introduced in 1991. This excess contribution limit was intended as a buffer to allow pension plan members to estimate their contribution limit early in the year and to make a contribution without the risk of incurring a penalty tax if they accidentally exceeded their actual limit.

Beginning January 1, 1996, the excess contribution limit was reduced to \$2,000. Therefore, if you do exceed your available contribution limit by more than \$2,000 on a cumulative basis, a penalty tax of 1% per month on the excess amount will be assessed.

If a contribution exceeds the \$2,000 excess contribution limit, it must be removed to avoid the penalty tax. The removal of this excess amount from the RRSP may result in the inclusion of the excess amount as taxable income, unless it is withdrawn in either the year it is contributed, the year the CRA Notice of Assessment is received or the following year.

*Note: The \$2,000 excess contribution limit is only available to individuals who have attained the age of 18 in a prior year.*

Before January 1, 1996, individuals were allowed to make an excess contribution of up to \$8,000. Individuals that made an excess contribution of more than the new \$2,000 limit prior to February 27, 1995, are required to reduce this excess balance as soon as possible.

This is achieved by claiming the excess contribution amount as a deductible RRSP contribution starting with

the 1996 tax year. Additional contributions will not be allowed until the excess contribution has been reduced to the \$2,000 level. While this excess contribution limit was intended as a buffer against accidental excess contributions, it does present an opportunity to add additional capital to your RRSP and benefit from its tax-deferred compounding.

**CONTRIBUTIONS MADE BY SECURITIES**

If you don't have the cash to make your RRSP contribution, you can contribute eligible investments from outside your RRSP at their fair market value. For tax purposes, investments transferred to the RRSP (i.e. in-kind contributions) are treated as if they are actually sold. Therefore, this transfer can trigger a taxable capital gain.

Unfortunately, if the fair market value of the transferred investment is less than its original cost, the resultant capital loss cannot be claimed. Also, any accrued interest up to the transfer date must be reported as income (i.e. interest that has been earned but not paid).

For example, on the transfer of two securities to an RRSP—one with a gain of \$1,500 and the other with a loss of \$500—the gain of \$1,500 is included in income, but the loss cannot be used to reduce the gain to \$1,000.

**RRSP PLANNING TIP**

Contributions can be made by those individuals who have no earned income in the current year, but who did have earned income in the prior year (e.g. retirees) due to the fact that RRSP room is based on the prior year's earned income and the ability to carry forward the RRSP contribution limit.



## 4 > TRANSFERS INTO AN RRSP

Certain amounts may be transferred into your RRSP in addition to your allowable RRSP contribution limit. These lump-sum transfers are allowed between registered plans on a tax-deferred basis.

### RETIRING ALLOWANCE

Often, when an employee is offered a retirement or severance package, the employer will include a lump-sum payment classified as a “retiring allowance” (reported as income due to loss of office). It may be possible to transfer or “roll over” at least a portion of this payment to an RRSP. This transfer provision is referred to as a “retiring allowance rollover” and the amount that can be rolled over is based upon the number of years of employment. The maximum amount that can be transferred to an RRSP is calculated as the lesser of the retiring allowance received or the amount determined by the following formula:

- \$2,000 per year of service up to and including 1995 (note that any part year is counted as a full year for purposes of this calculation)

#### plus

- \$1,500 per year of service, up to and including 1988, in which the employee was not a member of a pension plan, a DPSP, or in which the employer pension contributions were not vested

The rollover amount can either be transferred directly to your RRSP or it can be paid to you. If received by you, it can only be contributed to the RRSP in the year of receipt or in the first 60 days of the following year. A retiring allowance rollover can only be contributed to the RRSP of the individual receiving the payment. It cannot be contributed to a spousal RRSP.

It may be advantageous to have your employer pay the retiring allowance directly to your RRSP since tax will not be withheld. Your employer will be required to withhold tax on the payment if it is paid to you. If you receive the payment and then contribute it to the RRSP, you may have to top up the rollover amount due to the tax that has been withheld.

For example, Mr. Smith retired on July 1, 2013, as part of his employer’s early retirement program.

His retirement package included a retiring allowance of \$35,000. Mr. Smith began his employment on December 29, 1982, but did not join the pension plan until 1985. Mr. Smith can roll over the following amount to his RRSP:

1982 to 1995 = 14 years @ \$2,000 per year	=	\$28,000
1982 to 1984 = 3 years @ \$1,500 per year	=	\$4,500
Maximum rollover	=	<u>\$32,500</u>

Although Mr. Smith was employed for over 30 years, his final years from 1996 to 2013 are not included in this calculation as a result of the elimination of the rollover provision for all years after 1995.

Generally, it is advisable to make your maximum retiring allowance rollover. If you do not make the rollover in the year of receipt or in the first 60 days of the following year, you cannot carry it forward to a future year.

If you are unsure whether you will require the retiring allowance to support your current lifestyle, it may still be advantageous to make the rollover while you can and then deregister RRSP funds as necessary.

The benefits of this strategy include the deferral of tax until withdrawn and the tax-free growth of these funds while in the RRSP.

For additional details on issues surrounding early retirement, ask your advisor at RBC.

### LUMP-SUM TRANSFERS FROM A PENSION PLAN

It is possible in certain circumstances to transfer the accumulated benefit from your employer’s RPP to your RRSP.

Generally, this option is only allowed upon the termination of employment, or upon revisions or windup of a pension plan. The amount that may be transferred is commonly referred to as the “commuted pension value”, which represents the lump-sum value of your future pension in today’s dollars.

Generally, the commuted pension value subject to a maximum limit must be transferred to a locked-in RRSP or locked in retirement account (LIRA). A locked-in RRSP and LIRA are essentially the same type of account. The variation in account name is due to differences in provincial pension legislation.

A locked-in RRSP or LIRA is very similar to a regular RRSP except that funds can generally only be withdrawn by converting to a life annuity, a life income fund (LIF) (not available in Saskatchewan), a locked-in retirement income fund (LRIF) (currently only available in Newfoundland and Labrador) or a prescribed registered retirement income fund (Prescribed RRIF) (currently only available in Saskatchewan and Manitoba).

For more details on your locked-in RRSP/LIRA options, ask your advisor.

### TRANSFERS FROM ANOTHER RRSP

RRSP assets (i.e. cash and securities) can be transferred tax-free between RRSP accounts.

A common reason for transfers between RRSPs is to consolidate your RRSPs into a self-directed plan. Consolidating all your RRSP investments will make it easier for you to maintain a proper asset mix, evaluate performance, simplify administration and reduce expenses.

Most investors take a conservative approach to investing their RRSP since it is generally intended to provide income and financial security in retirement. Individual strategies should vary depending upon an individual's circumstances. Those with large portfolios outside their RRSP or those who wish to have only the most secure investments will tend to have a greater allocation of fixed-income investments in their RRSP. On the other hand, growth-oriented investors—typically those with a number of years to retirement—may want to allocate a greater proportion of their RRSP to equity investments. Note that capital investments that produce gains and dividends from Canadian corporations are taxed more favourably than interest income when held outside of an RRSP. Therefore, from a tax perspective, some investors will hold a greater equity position outside the RRSP and fixed income inside the RRSP.

Regardless of circumstances, it is important that equity investments not be ignored as they represent a potential hedge against the impact of inflation. One of the most common mistakes made by retirees is to convert all of their RRSP to fixed-income investments. By adopting this strategy, retirees are ignoring the potential impact that inflation will have on their retirement lifestyle.

### INVESTMENT OPTIONS FOR YOUR RRSP

The investment options for your RRSP are wide ranging, but there are specific restrictions regarding the types of investments that qualify. Your investment options will also vary depending on the type of RRSP account you have. A self-directed RRSP will provide the widest range of possible investment options.

The following provides an outline of qualifying Canadian investments:

#### Liquid investments

- Cash or deposits
- Treasury bills
- Money market instruments
- Canada Savings Bonds and provincial savings bonds
- Bankers' acceptances, commercial paper

#### Fixed income

- Federal, provincial and municipal bonds and coupons
- GICs
- Bonds issued by publicly traded corporations listed on a Canadian stock exchange
- Mortgage-backed securities and mortgage investment receipts
- World Bank bonds denominated in a foreign currency
- Index-linked notes
- Debt issued by a limited partnership whose units are listed on a Canadian stock exchange
- Debt obligation that has an investment-grade rating and that is part of a minimum \$25 million issuance

#### Equity

- Any security (other than a futures contract) such as common and preferred shares listed on a Canadian stock exchange
- Covered call options, warrants and rights issued by companies listed on a Canadian stock exchange
- Listed put options
- Canadian resource property royalty units and limited partnership units listed on a Canadian stock exchange

#### Mutual funds

- Canadian mutual funds qualify to be held in an RRSP. This includes money market, bond, mortgage, equity and balanced mutual funds. Class A shares of a labour-sponsored venture capital corporation are also eligible.

#### Mortgages

- Arm's-length mortgages, secured by real property in Canada, are qualified investments for an RRSP. Non arm's-length mortgages may qualify if the mortgage is insured and administered by an approved lender under the National Housing Act.

#### Venture capital corporations

- Registered under specific provincial acts

#### Private company shares

- Shares of a small business corporation can be held in an RRSP if specific requirements are met.

#### Gold or silver

- Gold or silver legal tender bullion coins, bullion bars, ingots or wafers may qualify if certain conditions are met.
- Gold or silver certificates may qualify if certain conditions are met.

#### FOREIGN CONTENT

Most people would agree that the old saying “don't keep all your eggs in one basket” also applies to their RRSP investments. Dividing your RRSP between cash, bonds and equities will help to minimize fluctuations in RRSP growth. An additional level of diversification is also available through investing in foreign content.

#### Qualified foreign investments

Qualifying foreign investments that may be held include:

- Any security (other than a futures contract) such as common shares listed on exchanges in the United Kingdom, the United States or several other stock exchanges in the world (prescribed stock exchanges)
- American depository receipts
- Canadian mutual funds investing outside of Canada
- Certain companies listed in Canada, but based outside of Canada
- Debt issued by foreign corporations if the corporation's shares trade on one of the qualifying foreign exchanges
- Foreign government debt if it has an investment-grade rating with a bond-rating agency at the time of purchase

#### Enhancing growth through foreign diversification

By diversifying your RRSP investments outside of Canada, you may help improve your overall return and create a currency hedge against the value of the Canadian dollar.

There are many reasons for including non-Canadian assets in your RRSP. Perhaps the most persuasive reason is the fact that historically, for a given level of risk, the investment returns achieved are greater for a diversified portfolio that includes international securities than for a portfolio invested only in Canadian domestic securities.

## 6 > STRATEGIES TO MAXIMIZE YOUR RRSP

As we indicated at the beginning of this publication, the contribution to your RRSP and its resultant tax savings is only the first step toward maximizing RRSP growth. This section of the guide is dedicated to strategies intended to maximize your retirement savings.

### SPOUSAL RRSPs

Utilizing income-splitting strategies between spouses can provide significant tax savings. One of the most simplistic, yet effective, methods of income splitting between spouses is achieved by contributing to a spousal RRSP. The objective of this strategy is to provide both spouses with similar incomes and thus similar income tax rates in retirement. Before setting up a spousal RRSP, a couple should estimate their expected retirement incomes. If one spouse is likely to have a significantly lower retirement income, then spousal RRSP contributions should be considered.

When a spousal RRSP contribution is made, the spouse making the contribution (i.e. the contributor) will claim the contribution on their tax return, while the contribution will be deposited in the other spouse's (i.e. annuitant's) RRSP. Note that you can choose to split your contribution limit between a spousal RRSP and your own plan.

A limitation of this strategy is that withdrawals from a spousal RRSP can result in the triggering of the income attribution rules. This triggering will occur if funds are withdrawn from any spousal RRSP in the year any spousal contribution is made or in either of the following two calendar years. A withdrawal from any spousal RRSP within this three-year period will result in the income being taxed in the hands of (i.e. attributed to) the spouse that made the contribution. The attribution of income is limited to the total spousal contributions made during the attribution period.

The following example illustrates the impact of the attribution rules on spousal RRSP withdrawals. Let's assume that both you and your spouse make the following contributions to a spousal RRSP of which your spouse is the annuitant.

Year	Spousal contributions by you	Contributions by your spouse
1	\$2,000	\$2,000
2	nil	\$4,000
3	\$2,000	nil

If during the third year (after you made your spousal RRSP contribution), your spouse withdrew \$6,000 from the spousal RRSP, the first \$4,000 would be included in your income. The remaining \$2,000 would be taxed in your spouse's hands. If your spouse had contributed all of the \$6,000 to a spousal RRSP that your spouse is the annuitant of and you made a contribution to your own regular RRSP, then any withdrawals from the spousal RRSP would be taxed in your spouse's hands and not be attributed back to you.

To avoid triggering the attribution rules during the three-year period since the last spousal RRSP contribution, you can convert the RRSP to a registered retirement income fund (RRIF). Minimum RRIF payments will not be attributed to the contributing spouse. Any funds withdrawn from the RRIF in excess of the minimum payment could be attributed to the contributing spouse. It is important to note that there is no minimum payment requirement in the year of conversion to a RRIF; thus RRIF payments received in the year of conversion could be subject to attribution.



#### RRSP PLANNING TIP

- > Make contributions to a spousal plan to allow for future income splitting. Contribute to your spouse's plan until their expected retirement income equals yours.
- > If you are 71 or older and you have earned income, you can still contribute to a spousal RRSP if your spouse is age 71 or under.

Effective from the year 2007, it is possible to split certain types of income with a lower income spouse during retirement. Income subject to the income-splitting rules must qualify for the pension tax credit. Such income includes pension income from an employer's pension plan or RRIF income for those

over the age of 65. Up to 50% of the qualifying income may be transferred and taxed in the hands of the lower income spouse, even if the lower income spouse is not 65. Although these new rules allow for income splitting during retirement, they do not eliminate the benefit of having a spousal RRSP. For example, 100% of income from a spousal RRSP may be taxed in the hands of the lower income spouse (if attribution rules don't apply), and there is no restriction on age and requirement that the higher income spouse must receive a portion of the income in order to allow for income splitting. Therefore, a spousal RRSP should be considered as one of the most flexible strategies that provide for income splitting during retirement.



#### RRSP PLANNING TIP

If you are turning age 71 this year and have maximized your RRSP contributions, but you have earned income in the year, you may consider contributing to an RRSP in December—just before the RRSP must mature—and deduct the contributions in the following year. Note, however, a penalty of 1% would be payable for the excess contribution in December.

#### THE IMPORTANCE OF CONTRIBUTING EARLY

The vast majority of Canadians make their contributions at the end of the tax year. By making your RRSP contribution either at the beginning of the year—early 2013 for the 2013 tax year, instead of early 2014—or by making regular monthly contributions, you will build yourself a significantly larger RRSP. Why, you ask? It's because of the additional months of compound growth that result from making your contribution sooner rather than later.

Consider 35-year-old Tim, who contributes \$5,000 at the end of each tax year. Assuming Tim continues to contribute until age 65, and assuming an 8% growth rate, his RRSP will be worth \$566,000 upon retirement. Now consider 35-year-old Denise, who contributes the same amount each year, but pays it in monthly instalments. Based on the same rate of return, her RRSP at age 65 would be worth \$587,000. If she made her contributions in a

lump sum at the beginning of each year, it would be worth \$611,000. In other words, Denise's retirement fund would be \$21,000–\$45,000 larger than Tim's, simply because she gave some thought to her RRSP earlier in the year.

#### BORROWING TO MAKE AN RRSP CONTRIBUTION

While borrowing to invest outside your RRSP may provide you with a tax-deductible interest expense, borrowing to make an RRSP contribution will not. Deciding whether or not to borrow is complicated by the fact that you can carry forward your unused contribution limit to a future year when cash may be available. While carrying forward your contribution will avoid borrowing costs, tax-deferred growth will be forfeited. In general, if you expect to be able to repay an RRSP loan within one year, this strategy should prove advantageous. Use your tax savings from the contribution to help repay your RRSP loan.

#### PAYING DOWN YOUR MORTGAGE VERSUS CONTRIBUTING TO YOUR RRSP

A perplexing question that many individuals ask themselves each year is, "Should I pay down the mortgage or make my RRSP contribution?" The answer to this question depends on your tax bracket, your mortgage rate and the assumed growth rate of your RRSP. In general, the solution is to compromise—contribute to your RRSP each year and use the tax savings to reduce your mortgage balance.

#### TIMING YOUR RRSP DEDUCTION

While it is advisable to make your RRSP contribution each year, you can choose to delay claiming the tax deduction until a future tax year. If your income tends to fluctuate from year to year, it may be advantageous to defer the tax deduction to a future year when your income, and thus your tax rate, will be significantly higher. While this strategy delays the tax savings, your contribution is growing tax-deferred.

To illustrate the benefit of this strategy, let's assume that your current marginal tax rate is 25% but you expect your income will rise next year, increasing your tax rate to 40%. If you made a \$10,000 contribution this year and claimed the deduction, you would save \$2,500 in tax; while waiting until next year would yield a \$4,000 tax saving.

### TAX-FREE SAVINGS ACCOUNT (TFSA) AND RRSP

Starting in 2009, you are able to use a TFSA to save for your short-term or long-term goals. TFSAs and RRSPs are similar in many ways but there are some key differences. Similarities include the following:

- Both accounts are registered accounts that allow your funds to grow on a tax-free basis;
- The same investment restrictions apply for both types of accounts;
- Overcontribution penalty tax of 1% applies to both accounts.

Differences include the following:

- The annual contribution limit for TFSAs is \$5,500 per year (\$5,000 for the years 2009 – 2012) and is not dependent on your income while the annual contribution limit for RRSP purposes is based on your earned income;
- Contributions to a TFSA are not deductible for tax purposes and withdrawals are made tax-free. As for RRSPs, contributions to the plan are tax deductible and withdrawals are taxable;
- Withdrawals made from a TFSA are added to your contribution room and may be re-contributed to the TFSA at the beginning of the following calendar year. Withdrawals from the RRSP may not be contributed back unless you are using the Home Buyer's Plan, the Lifelong Learning Plan or you use up new RRSP contribution room;
- Withdrawals from the TFSA do not impact income tested government benefits such as Old Age Security or the GST/HST credit. Withdrawals from the RRSP are added to your taxable income and may impact government benefits.
- RRSPs are creditor protected under federal legislation from seizure in the event of bankruptcy and in some provinces, broader legislation protects them even if bankruptcy does not occur. TFSAs do not enjoy this protection.

Given these similarities and differences, you may be wondering whether you should invest in a TFSA or RRSP. The answer depends on a number of factors including your tax bracket, your investment time horizon, your asset mix and your need for liquidity. For short-term goals the TFSA provides greater flexibility. For long-term goals, such as your retirement, the RRSP can provide you with a deduction when your tax rate is high and a taxable amount when your income is lower during retirement. If you contribute to your RRSP, any tax refund generated may be used to contribute to your TFSA. A combination of the RRSP and TFSA would be the best solution as you would have maximized your retirement assets and your tax-free savings which may be used for any purpose.

### SETTING A TARGET

If you are like many Canadians, you endeavour to save as much as possible within your RRSP each year. The question that must be asked is, "Will it be enough?" Before you can answer this question, you must determine your desired retirement lifestyle. Determining this objective will allow you to set a savings target for your RRSP. Setting this target is the only way you can gauge your progress and determine when enough is truly enough.

As a rule of thumb, for every \$10,000 in before-tax retirement income, you must accumulate \$150,000 in RRSP assets by the year of retirement. This assumes that your life expectancy once retired is 25 years, that your income increases at a rate of 3% per year to keep pace with inflation, and that there is an 8% growth rate on your investments.

### ARE YOU ON TRACK?

Attempting to put all the pieces of your retirement puzzle together to answer this question can be difficult. But your advisor can help. Services available through your advisor can help you determine if you're on track with your retirement plans. If your current situation doesn't match your goals, your advisor can provide the direction necessary to put you back on course. Ask your advisor at RBC for more information on financial plans.

## 7 > CREDITOR PROTECTION FOR RRSPs

Effective July 7, 2008, RRSPs held by banks, brokerages or mutual funds, or in self-directed RRSP accounts are protected from seizure in the event of bankruptcy. Prior to this date you may have invested in insurance contracts, such as segregated funds, to achieve creditor protection. As a result of amendments to the federal Bankruptcy and Insolvency Act, all registered investments will enjoy the same creditor protection as segregated funds in the event of bankruptcy. It is important to stress that there must be a bankruptcy in order for RRSPs to be protected under the federal Bankruptcy and Insolvency Act. To prevent abuse of the exemption, contributions made to a registered plan in the 12 months prior to a bankruptcy may not be subject to protection. Note that the provinces of Newfoundland and Labrador, Prince Edward Island, Saskatchewan, British Columbia, Alberta and Manitoba have much broader legislation in place that exempts RRSPs from seizure by creditors including cases of bankruptcy.

At the time of writing, Ontario has introduced legislation which has not yet been passed into law that will protect RRSPs from similar enforcement actions.



## 8 > WITHDRAWALS FROM AN RRSP

Although you should plan to leave your RRSP untouched until retirement, there may be occasions when a withdrawal is necessary. It is possible to withdraw or deregister funds from your RRSP at any time, unless held in a locked-in RRSP or LIRA. The amount withdrawn must be included in your taxable income in the year of withdrawal.

Amounts withdrawn do not retain their original tax treatment. Thus, whether the withdrawal represents interest, capital gains, dividends earned or previously made contributions, all amounts are treated as regular taxable income.

When deregistering funds from an RRSP, the federal government requires a withholding tax be deducted from the amount withdrawn. The withholding tax rate applied will depend upon the amount withdrawn. The withholding tax is similar to the tax withheld on your salary and is used as a credit to reduce your taxes payable when you file your tax return. **Figure 3** outlines the withholding tax rates applied to withdrawals from an RRSP or to RRIF withdrawals in excess of the minimum.

These rates are based on your cumulative withdrawals in the calendar year.

FIGURE 3

Amount withdrawn	Quebec	Other provinces
\$5,000 or less	21%	10%
\$5,001–\$15,000	26%	20%
Over \$15,000	31%	30%

### WITHDRAWALS BY NON-RESIDENTS

Lump-sum withdrawals from an RRSP by a non-resident are subject to withholding tax based on the applicable tax treaty. For most countries, including the United States, the applicable rate is 25%.

Limited amounts withdrawn from a RRIF (i.e. the greater of twice the minimum amount or 10% of the RRIF balance on January 1) and payments from annuities purchased with registered funds may receive reduced withholding tax treatment (i.e. 10% or 15%) for residents of countries with which Canada has an income tax treaty. Note that RRIF withdrawals in excess of this special minimum amount are generally taxed in Canada based on the 25% withholding tax rate, as no treaty-based deduction applies to these excess amounts.

## 9 › RRSP MATURITY OPTIONS

There are several maturity options available to allow you access to your RRSP assets, each with specific advantages and disadvantages. You can convert all or a portion of your RRSP assets to any of the following options. This conversion can occur at any time, but you must convert all RRSP assets by December 31 of the year in which you turn age 71.

**Option 1:** Deregister your RRSP and receive a lump-sum cash payment

**Option 2:** Convert to a RRIF

**Option 3:** Purchase either a life annuity or term certain annuity to age 90

The option(s) you choose should depend upon a number of criteria, but simply stated, your decision depends on whether you want income now or later, or if you want to maximize your estate for your heirs. Some of the criteria to consider include:

- Your personal income needs
- Your family's income needs
- Your estate objectives
- The current rate of return and inflation
- Flexibility versus guarantees of each option
- Your wish to minimize income taxes

The tax implications of your decision will vary depending upon the option that you choose. A RRIF or annuity will continue to provide a degree of tax-deferral since income will be received over a number of years. Lump-sum payments of cash will attract the most adverse tax consequences. Lump-sum payments are generally inappropriate except when the RRSP is relatively small.

At maturity, most individuals choose either a RRIF or an annuity. The conversion from an RRSP to a RRIF or annuity occurs on a tax-deferred basis. Also, if converting to a RRIF, the investments held in your RRSP can be transferred directly into the RRIF account. Investments in your RRSP do not have to mature or be liquidated prior to transferring them to the RRIF.

### REGISTERED RETIREMENT INCOME FUND (RRIF)

A RRIF is basically an extension of an RRSP except that it is intended to provide an ongoing flow of income. Choosing this option will allow you all the same flexibility provided by the RRSP, such as a variety of eligible investments and access to funds. Unlike an RRSP, a RRIF does require the receipt of at least a minimum annual payment. The RRIF option provides the maximum amount of flexibility of the available maturity options, giving you control over the management of your assets, flexibility of annual income and potential tax minimization.

When receiving payments from a RRIF prior to age 71 or a RRIF established prior to 1993 (for ages under 79), the minimum withdrawal is calculated using the following formula:

$$\text{Market value of the RRIF at Dec. 31 of previous year} \times \frac{1}{(90 \text{ minus your age}^* \text{ on December 31 of prior year})}$$

\* If spouse is younger, then the younger spouse's age at the end of the prior year can be used to minimize the payment.

Minimum payment percentages for RRIFs set up after 1992 are outlined in **Figure 4**. To determine the annual minimum payment, the market value of the plan at the end of the previous year is multiplied by the minimum payment percentage corresponding to the individual's age at the end of the previous year.



FIGURE 4

**Required minimum payment  
as a percent of RRIF assets**

<b>Age on December 31 of previous year</b>	<b>Minimum payment (%)</b>
71	7.38
72	7.48
73	7.59
74	7.71
75	7.85
76	7.99
77	8.15
78	8.33
79	8.53
80	8.75
81	8.99
82	9.27
83	9.58
84	9.93
85	10.33
86	10.79
87	11.33
88	11.96
89	12.71
90	13.62
91	14.73
92	16.12
93	17.92
94+	20.00

**ANNUITIES**

An annuity is essentially a contract between an individual (i.e. the annuitant) and an insurance company to provide a guaranteed income stream for the individual's life or for a fixed term. When purchasing an annuity, the individual must decide whether all or a portion of their RRSP will be used to purchase an annuity. They must also determine the type of annuity that should be purchased based on their retirement and estate objectives. This decision can be complicated since there are many options to choose from. The amount of annuity income received will depend on the annuity option chosen and factors such as life expectancy, current age, sex, health, amount invested and interest rates at the time of purchase. By purchasing an annuity, the annuitant is locking in current interest rates on the investment for the annuity's duration. Note that funds used to purchase the annuity are no longer accessible by the annuitant other than through the income stream provided by the annuity.

Various types of annuities can be purchased with RRSP funds including:

- A life annuity, with or without a guarantee
- A joint life annuity, with or without a guarantee
- A term certain annuity to age 90

For more detailed information on the maturity options for an RRSP, speak with your advisor at RBC.

**RRSP PLANNING TIP**

When setting up a RRIF, use the younger spouse's age if you want to minimize annual RRIF payments.

## 10 › DEATH OF AN RRSP HOLDER

The treatment of an RRSP upon the death of the planholder will depend upon who is the beneficiary of the plan. If the assets of an unmatured plan (called a refund of premiums) are left to a surviving spouse (including a common-law partner regardless of sex) or to a qualifying financially dependent child or grandchild, they can be transferred on a tax-deferred basis.

The surviving spouse will receive a T4 RRSP information slip and have until December 31 of the year following the year of death to contribute the refund of premiums to one of the following:

- An RRSP in the name of the surviving spouse (except where the surviving spouse is over the age of 71)
- A life annuity or a term certain annuity to age 90
- A RRIF

The surviving spouse would then deduct the transfer of the refund of premiums amount from their taxable income, as they would any other normal RRSP contribution, thus avoiding any immediate tax liability.

If the RRSP is transferred tax-deferred to a financially dependent child or grandchild that is under age 18, the RRSP funds can be used to purchase a term certain annuity with a term not exceeding the child's 18th year. Also, if there is a financially dependent child or grandchild that is mentally or physically infirm, it may be possible to transfer the RRSP funds on a tax-deferred basis to the child's or grandchild's own RRSP or RDSP. Subsequent income from RRSP assets transferred to a financially dependent child or grandchild will be taxed in the hands of the financially dependent child or grandchild.

If someone other than a surviving spouse or qualifying dependent child or grandchild is the beneficiary of the RRSP, the RRSP must be collapsed and the balance must be paid to the named beneficiary or to the deceased's estate. The value of the collapsed RRSP will be included as income on the deceased's terminal tax return.

Note that the transfer options that exist for an RRSP upon the death of the planholder also exist for a planholder that owns a RRIF upon death.



### RRSP PLANNING TIP

- Where a planholder has died without making their RRSP contribution for the year, the estate representatives may elect to have a spousal RRSP contribution made on behalf of the deceased and claim the deduction (to reduce taxable income) on the final tax return of the deceased. Such a contribution must be made within 60 days after the year end of the year of death.
- On the death of an individual with a locked-in RRSP or LIRA, the locked-in RRSP or LIRA may be rolled over to the spouse's RRSP or RRIF on a tax-deferred basis. However, some provinces require the funds to remain locked in even for the surviving spouse.
- If you intend to leave your RRSP to your spouse, consider naming your spouse as the beneficiary on the account in order to minimize probate taxes. Also ensure that the beneficiary election on your RRSP account is consistent with the terms of distribution indicated in your Will.

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