

THE INs AND OUTs OF RRSP's

Registered retirement savings plans (RRSPs) were introduced in 1957 to provide an income tax incentive to save money for retirement. Taxpayers who contribute to an RRSP can deduct, within certain limits, their contributions from their income when filing their income tax returns.

Life insurance companies, trust companies, banks, credit unions and certain types of investment companies (including mutual funds companies) are authorized to issue RRSPs.

Basic concept

The RRSP provides certain tax advantages designed to encourage individuals to save for their retirement. They are:

- deferral of income taxes on the portion of income that is contributed to an RRSP
- deferral of income taxes on the investment income earned in the plan

The payment of income taxes is deferred until the money is withdrawn, generally during retirement from an annuity or registered retirement income fund (RRIF). At that time, the taxpayer's income tends to be lower than during the earning years and consequently the deferred income may be subject to a lower rate of tax. Amounts withdrawn prior to retirement are taxable at the individual's (highest) applicable tax rate.

Points to consider

Before contributing to an RRSP, individuals should ensure they:

- are willing to put aside money for spending during, not before, retirement
- have other assets available for emergencies
- are interested in deferring taxes
- qualify for the income tax deduction
- have sufficient income to justify RRSP's... otherwise, use other saving tools such as TFSA's

Annual deduction limit

If you look at your annual Notice Of Assessment (NOA) for the previous year, you will see a line that states how much RRSP contribution room you have.

Taxpayers who cannot locate their assessment notice may obtain the amount of their limit by calling the automated Tax Information Phone Service (T.I.P.S.) of the Canada Revenue Agency (CRA), formerly Canada Customs and Revenue Agency, at 1-800-267-6999. For members of a registered pension plan (RPP) this limit will be reduced by any net past service pension adjustment (net PSPA) reported by their employer.

The annual deduction limit available will be increased by any pension adjustment reversal (PAR) reported to an individual who forfeited benefits upon leaving an RPP or deferred profit sharing plan (DPSP) during that year. The amount of the PAR adjustment must also be reported to the CRA who will then issue Form T1028 showing the revised RRSP deduction limit.

RRSP contributions for the previous taxation year may only be made until normally the last day of February or sometimes the first day of March.

Annual deduction limit

In order to maximize the deferral of income taxes on the investment income earned in the plan, many taxpayers start their RRSP contributions as early as possible. For the 2004 taxation year, this can be done at any time after Jan. 1 of that year. The maximum amount that can be claimed is the **lesser** of two amounts:

1. 18 per cent of "earned income" for the previous taxation year (see below), or
2. The prescribed limit set forth by CRA

The deduction limit is increased by any unused RRSP deduction room carried forward from the previous year. You can carry forward amounts earned since 1991.

What is earned income*?

In general, earned income consists of salary and wages, commissions, taxable benefits (e.g., group life insurance premiums paid by the employer), taxable family support income, net business income and net income from the rental of property. Earned income also includes research grants, Canada Pension Plan/Quebec Pension Plan disability payments, employee profit sharing plan allocations, supplementary unemployment benefits and certain royalties.

In calculating earned income, any employment expenses (such as union or professional dues, or salesperson's expenses) claimed by the taxpayer must be deducted. Earned income is also reduced by losses from business operations and the rental of property, and by deductible family support payments.

NOTE: Dividends, interest, annuities and pensions **do not** qualify as earned income.

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