RSPs – Retirement Savings Plans

A Retirement Savings Plan (RSP) is a tax sheltered investment vehicle designed to encourage you to save assets that will provide you with income in your retirement years. This article provides an overview of the benefits of RSPs as well as how they work.

Benefits

Most people know that it is important to save now to ensure they have income for their retirement years when they will not be working. The government also recognizes this need and provides individuals with additional incentives to save. The additional incentives for saving through your RSP are twofold:

- a reduction in your current tax liability by making RSP contributions tax-deductible; and
- a deferral of the tax on the investment growth inside your RSP until money is actually withdrawn from the plan.

Tax Deduction

Contributions to an RSP can be made up to and including the year in which you turn 71. Contributions are tax deductible within certain limits if the contributions are made in the calendar year or within 60 days after year-end.

Your RSP deduction limit is shown on your Notice of Assessment or Notice of Reassessment for the prior year and is based on several factors namely:

- your previous year's earned income;
- your pension adjustment;
- a maximum annual contribution limit; and
- any unused contribution room carried forward from previous years.

Earned Income

"Earned Income" includes:

- Income from employment (i.e. after all employment-related deductions but before deductions for income tax, EI, CPP etc. which are withheld at source)
- Net rental income
- Net business income (if you are self-employed or if you are an active partner in a business)
- Certain spousal and child support payments received
- CPP/QPP disability pension income
- Research grants

"Earned Income" does not include:

- RSP/RIF income
- Interest income
- Dividend income
- Capital gains
- Other CPP/QPP income (i.e. not disability pension income)
- Old Age Security
- Workers' Compensation
- Retiring allowance

Pension Adjustment

If you are a member of a registered pension plan (RPP) or deferred profit sharing plan (DPSP), your RSP deduction limit is based on 18% of your prior years earned income and is reduced by your pension adjustment (PA) for the previous year as well your past service pension adjustment (PSPA) for the current year.

The rationale for this is that, being a member of an RPP (whether a defined benefit plan or defined contribution plan) or DPSP, you are already receiving the same benefits an RSP is supposed to provide (i.e. tax deferred savings and tax-free compounding of investment income and capital gains). Thus, your limit is reduced by what the government calculates your pension benefit to be in that year. This is intended to equate your retirement benefits with other individuals who do not have access to these plans. The government's intention is to provide you with incentives to save up to the prescribed maximum annual limits regardless of whether you do it through an RSP, RPP or DPSP.

Note: the calculation of your RSP deduction limit is also increased by the pension adjustment reversal (PAR), which you may be entitled to if you are a member of a company pension plan and you terminate your employment before retirement.

Dollar Limit

Your RSP deduction limit is restricted to an annual maximum amount which is as follows:

Year	Maximum RSP Contribution
2007	$19,000
2008	$20,000
2009	$21,000
2010	$22,000
2011	$22,450
2012	$22,970
2013	Indexed to increase in the Average Industrial Wage

Carry-forward

Your RSP contribution room is calculated annually. If you have not contributed your maximum allowable amount in a particular year, the unused portion can be carried forward indefinitely to be used in future years.

Tax-deferred Accumulation of Funds

Another advantage of utilizing an RSP is that income earned from investments in your RSP accumulates tax-free until withdrawn. If you were to hold these investments outside your RSP, the income and capital gains realized would be taxed annually.

It is only when the funds are withdrawn from your RSP that you will be subject to tax. Note that the entire amount withdrawn will be included in your income in the year of withdrawal and taxed as ordinary income since amounts withdrawn do not retain their original character for taxation purposes.

Withholding Tax

At the time of withdrawal, a withholding tax is retained by your financial institution which will be applied against your taxes payable when you file your annual tax return. The withholding rates depend on your residency status and the amount you withdraw.

For residents of Canada, the rates are:

Amount Withdrawn in Excess of Minimum	All Provinces Except Quebec	Quebec	Non-Residents Living in U.K. or U.S.
Up to $5,000	10%	5% federal + 16% provincial	25%
$5,001-$15,000	20%	10% federal + 16% provincial	25%
Over $15,000	30%	15% federal + 16% provincial	25%

The tax withheld is not always enough to cover the tax owing in your particular tax bracket and consequently you may owe more tax when you file your annual tax return.

Spousal RSPs: Income Splitting Opportunity

Individuals with spouses or common law partners (hereinafter collectively referred to as the "Partners") are provided an opportunity to split income to lower their household's over-all tax burden during retirement by making spousal contributions.

You can choose to contribute to a spousal RSP and claim a deduction from your own taxable income. The amount you can contribute to your spousal RSP is based on your own annual contribution room. When your

Partner withdraws the funds in retirement the income is reported on his or her tax return (subject to a three year attribution rule). Thus, income withdrawals in retirement can be evened out between the Partners, likely resulting in a smaller over-all tax bill.

Maturity

RSPs mature by the end of the year in which you turn 71, at which time you have to choose one of the following options for your RSP:

1. withdraw the funds;
2. transfer the funds to a Retirement Income Fund (RIF);
3. use the funds to purchase a life annuity or a fixed-term annuity.

If the option chosen is a full withdrawal of the funds (i.e. cashing in the RSP), the entire amount withdrawn will be included in income in the year of withdrawal. By contrast, if the RSP funds are transferred to a RIF or used to purchase an annuity, only the amounts received from the RIF or annuity will be taxed as income in the year they are received.

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