Tax & Estate

Registered retirement savings plans (RRSPs)

RRSPs allow taxpayers to minimize their tax burden by making tax-deductible contributions toward their retirement while they are in their higher-taxed, income-producing years. They can defer the tax on the growth while they build their nest egg inside the plan and withdraw the funds when they reach retirement at a time when they may be in a lower tax bracket.

Earned income includes the following:

- Income from employment
- Royalties
- Net rental income
- Net business income
- Net research grants
- Certain support payments received
- Canada Pension Plan/Quebec Pension Plan disability payments

Earned income does not include the following:

- RRSP/RRIF income
- Interest income
- Capital gains
- Dividends
- CPP/QPP (other than disability)
- Old Age Security
- Workers' compensation
- Retiring allowance

Contributions

Contributions to an RRSP are generally allowed up to and including the year an individual turns age 71, subject to the individual's RRSP deduction limit.

An individual's RRSP deduction limit is based on 18% of his or her previous year's earned income less the individual's pension adjustment, plus carryforward of any unused RRSP deduction room. The annual limit is currently set at $25,370 for 2016, with the government indexing the limit annually.

Unused contribution room may be carried forward indefinitely. Contributions made in the current year or in the first 60 days of the following year can be deducted against the current year's income. However, all contributions made after the first 60 days of the current year, up to the first 60 days of the following year, must be reported on the current year's tax return even if they are not claimed until a year later. The taxpayer can choose to carry forward all or part of the contributions indefinitely to be deducted against income in a future year. Schedule 7 ("RRSP Unused Contributions, Transfers, and HBP or LLP Activities") of the federal government's *Personal Income Tax and Benefit Return* tracks undeducted contributions.

Maturity of an RRSP

An RRSP matures at the end of the year in which the annuitant turns 71. At that time, the annuitant has three options:

- Convert the RRSP to a registered retirement income fund (RRIF)
- Purchase an annuity
- Cash in the RRSP

For more information on these options, please refer to our *Tax & Estate InfoPage* titled "Registered retirement income funds (RRIFs)."

Spousal or common-law partner RRSPs

Contributions can also be made to an RRSP belonging to one's spouse or common-law partner (a common-law partner includes both opposite-sex and same-sex partners), as this can provide an opportunity for income splitting upon retirement. The contributions are deductible by the contributor based on his or her contribution room. The annuitant is the owner of the spousal or common-law partner RRSP assets and has full control over the plan.

When income is withdrawn from a spousal or common-law partner RRSP, it is generally taxable to the annuitant; however, it may attribute back to the contributing spouse or common-law partner. Attribution applies on withdrawals up to the amount of the contributions made to all spousal or common-law partner RRSPs in the same calendar year as the withdrawal and the previous two calendar years.

Example

In March 2016, John contributed $5,000 to a spousal RRSP for his wife Lisa. Therefore, any RRSP withdrawals by Lisa to a total of $5,000 out of any spousal plan in 2016, 2017 and/or 2018 will be attributed to John and taxed in his hands. However, assuming no further contributions are made, Lisa can withdraw the funds in 2019, and the withdrawal will be taxable to her.

If the spouses or common-law partners are living apart because of a breakdown of their marriage or common-law relationship, then the annuitant will be responsible for the tax on any withdrawals from the spousal or common-law partner RRSP. A spousal or common-law partner RRSP must remain a spousal or common-law partner plan until the death of the contributing spouse or common-law partner, or on the breakdown of a marriage or common-law relationship (subject to certain conditions).

An individual over 71 who continues to generate earned income (and therefore RRSP contribution room or has unused carryforward RRSP deduction room) can make contributions to a spousal or common-law partner RRSP under which his or her spouse or common-law partner is the annuitant until the end of the year the spouse or common-law partner turns 71.

Overcontributions

An individual over age 18 can exceed his or her contribution limit by $2,000 at any time without penalty. There is a penalty tax of 1% per month of the contributions in excess of the $2,000 overcontribution limit that begins as of the end of the first month when this limit is exceeded. Persons under the age of 19 do not have this $2,000 overcontribution cushion and will be subject to the penalty tax on any amounts above their limit. Canada Revenue Agency (CRA) Form T1-OVP, *Individual Tax Return for RRSP Excess Contributions*, is used to calculate and remit the overcontribution penalty to the CRA. This penalty needs to be paid within 90 days of the calendar year following the overcontribution.

If the overcontributions are withdrawn in the year they are made, in the following year, in the year (or following year) that a Notice of Assessment or Notice of Reassessment was sent from the CRA, they can generally be removed without any net tax implications. Withholding tax at source can be avoided by using CRA Form T3012A, *Tax Deduction Waiver on the Refund of Your Unused RRSP, PRPP, or SPP Contributions*. If Form T3012A is not used, CRA Form T746, *Calculating Your Deduction for Refund of Unused RRSP Contributions*, can be used to offset the income inclusion. Once that time limit has passed, the overcontributions will be taxable when withdrawn, even if no deduction is ever taken for the contributions. The contributor can continue to carry the contributions forward as an undeducted contribution and deduct it in the future if contribution room is generated.

Making a final RRSP (over)contribution

An individual can also overcontribute to his or her RRSP before the end of the year in which he or she turns 71 and before transferring the RRSP to a RRIF. Provided the individual has earned income in the year in which he or she turns 71, RRSP contribution room will be generated for the following year. As a result, in the new year, overcontribution penalties will cease and the contributor will be able to deduct the contribution.

Example

In 2015, Hank has $150,000 of earned income, which generates $25,370 of RRSP contribution room for 2016. He turns 71 in 2015. However, in December, prior to converting his RRSP to a RRIF, he overcontributes $25,370 to his RRSP. His overcontribution penalty for the month of December is 1% of the amount of the overcontribution in excess of the $2,000 lifetime overcontribution limit, or ($25,370 – $2,000) x 1% = $253.70.

In January 2016, the new RRSP contribution room will become available, and Hank will no longer be considered to have overcontributed and be subject to the penalty tax. He will be able to deduct the contribution in 2016 or in a future year. Assuming a tax rate of 45%, the deduction will result in a tax savings of $11,416.50. After considering the overcontribution penalty, Hank is still ahead by $11,162.80 ($11,416.50 – $253.70).

Withdrawals

Amounts withdrawn from an RRSP are taxable as income when they are received. Tax is withheld by the RRSP administrator and will be applied toward the annuitant's taxes when he or she files his or her annual tax return. Taxes are withheld based on the following schedule:

Amount of withdrawal	All provinces except Quebec	Quebec
Up to $5,000	10%	21%
$5,000.01 to $15,000	20%	26%
$15,000.01 and above	30%	31%

As of January 28, 2009, a first-time homebuyer has been able to withdraw up to $25,000 of RRSP funds to purchase a qualifying home under the federal Home Buyers' Plan (HBP). Up to $20,000 can also be withdrawn to fund the annuitant's or the annuitant's spouse's or common-law partner's post-secondary education under the federal Lifelong Learning Plan (LLP). In both cases, there is no withholding tax on the redemption, and the withdrawal is not taxable when withdrawn. The client has the choice of repaying the withdrawal or taking it into income over a number of years.

For more information, please refer to our *Tax & Estate InfoPages* titled "Home Buyers' Plans (HBPs)" and "Lifelong Learning Plans (LLPs)."

Transfers

Full transfers from one RRSP or RRIF to another RRSP or RRIF for the same annuitant can be done without withholding tax.

Transfers from investment ("open") accounts into RRSPs are dispositions and occur at fair market value, possibly resulting in a capital gain at the time of transfer. Any capital loss resulting from the transfer would be denied. A contribution receipt will generally be issued for the fair market value of the property transferred into the RRSP.

While certain pension plan and retiring allowance transfers result in RRSP contribution receipts, they may or may not use up RRSP contribution room. For more information, please refer to our *Tax & Estate InfoPage* titled "Retiring allowances."

Advantage tax, prohibited investment and non-qualified investment rules

In an effort to curb illegitimate uses of the tax-deferred plan, the government introduced several anti-avoidance rules aimed at curtailing tax-planning schemes involving the RRSP through the introduction of similar rules applicable to tax-free savings accounts (TFSAs). Namely, the government enacted the advantage rules, the prohibited investment rules and an amendment to the existing non-qualified investment rules. The rules impose a special penalty tax equal to 100% of the fair market value of the advantage obtained through the use of the RRSP and a 50% special tax on the fair market value of any non-qualified or prohibited investments acquired. Any income generated on a prohibited investment will be treated as an advantage, whereas any income generated on a non-qualified investment will remain taxable to the RRSP. Generally, the effective date of these provisions applies after March 22, 2011; however, there are several exemptions to the effective date, particularly to the application of the prohibited and non-qualified investment provisions. For a thorough discussion of these provisions and related rules, a tax accountant may be consulted.

Death

The fair market value of an RRSP is normally included in a deceased's income in the year of death. If the value changes between death and final distribution, a decrease may be carried back to offset year-of-death income inclusion, and an increase is generally included in the income of the beneficiary(ies). However, if the annuitant's spouse, common-law partner or financially dependent child or grandchild is named as a beneficiary of the RRSP (either directly or indirectly via the deceased's Will), then the amount received by that beneficiary may qualify as a refund of premiums, which is eligible for special tax treatment.

If the deceased's spouse or common-law partner is named as the beneficiary, then the value of the RRSP can be taxed in the hands of the beneficiary, rather than to the deceased. The spouse or common-law partner generally has the option of transferring the refund of premiums to his or her own RRSP, RRIF, specified pension plan (SPP), pooled registered pension plan (PRPP) or to an issuer to purchase an eligible annuity, which will generally offset the income inclusion from the deceased's RRSP.

The value of an RRSP that is included in the deceased's income at death can be reduced if it is being transferred as a refund of premiums to a beneficiary who is a financially dependent child or grandchild. A (grand)child is presumed not to be financially dependent if the income of the (grand)child in the year prior to the year of the annuitant's death exceeds the basic personal exemption amount. For a death in 2016, the (grand)child's income cannot exceed the 2015 basic personal amount of $11,327. A (grand)child who is infirm will be presumed not to be financially dependent if his or her income is greater than $19,226 for 2015. If the beneficiary is a financially dependent minor, the refund of premiums can be used to purchase an annuity for the (grand)child to age 18. If the beneficiary is financially dependent and infirm, then he or she can transfer the refund of premiums into his or her own RRSP, RRIF, SPP, PRPP or to an issuer to purchase an eligible annuity.

If the estate is named as the RRSP beneficiary, and the spouse, common-law partner or financially dependent child or grandchild receives the RRSP property as a beneficiary of the estate, the legal representative of the estate and the beneficiary can jointly elect to treat the amount as if it had been transferred directly to the beneficiary. This will preserve the refund of premiums treatment.

Where the estate is named as the RRSP beneficiary (or no beneficiary designation is made on the RRSP), the RRSP assets may be subject to probate taxes, where applicable. By designating someone other than the estate as beneficiary of the RRSP, it is possible to save probate taxes (in provinces where applicable). The assets will transfer directly to the beneficiary designated on the plan. The charitable donation tax credit is also available to the deceased on donations made when charities are named directly as beneficiaries on RRSPs.

Contributions cannot be made to an RRSP on which the annuitant is deceased. However, if the deceased taxpayer has a surviving spouse or common-law partner age 71 or younger, contributions can be made by the estate to the surviving spouse's or common-law partner's spousal or common-law partner RRSP based on the deceased's remaining RRSP contribution limit in the year of death or within the first 60 days after the end of the year. The deduction can be taken on the deceased's terminal tax return.

For more information please see our *Tax & Estate InfoPages* titled "Death and taxes" and "Probate planning to minimize estate costs."

Note: Invesco currently does not accept beneficiary designations on RRSPs/RRIFs if the annuitant is a resident of Quebec.

Post-death decrease in value of RRSP

It is possible to have the post-death decrease in value of a deceased annuitant's RRSP carried back and deducted on the deceased annuitant's terminal return. To be eligible for a deduction, the RRSP cannot hold a non-qualified investment after death and the RRSP must be wound up or settled within the exempt period. A prescribed form is also required. The exempt period extends from the date of death and ends in December of the year following the year of death. In the event the conditions are not met, the CRA (at its discretion) may allow for a portion or all of the post-decline amounts as a deduction on the deceased's terminal return upon written request by the deceased's legal representative.

Rollover of RRSP proceeds into a registered disability savings plan (RDSP)

If an RRSP annuitant died after March 3, 2010, it is possible to extend a transfer of the refund of premiums to an RDSP of a financially dependent infirm child or grandchild, provided the RDSP beneficiary meets requirements for RDSP contributions. The RDSP beneficiary must be financially dependent to the deceased RRSP annuitant by reason of physical or mental infirmity. Where the transfer takes place, it will reduce the amount of RDSP contribution room available. Also note that any withdrawals relating to a rollover of RRSP proceeds will be taxable when withdrawn from the RDSP, since the amounts have yet to be subject to tax. Additionally, transferred amounts will not attract the Canadian Disability Savings Grant.

For more information, please refer to our *Tax & Estate InfoPage* titled "Registered disability savings plans (RDSPs)."

Locked-in plans

Locked-in RRSPs (LRSPs) and locked-in retirement accounts (LIRAs) are RRSPs that are "locked-in" under federal or provincial pension legislation. They can only receive funds by way of transfer from a pension plan. The funds are generally locked into the plan until the annuitant reaches an age determined by the governing pension legislation or originating pension plan, often age 55. At any time between that point and maturity (age 71), the funds can be transferred to a locked-in retirement income fund (LRIF), a life income fund (LIF) or a prescribed retirement income fund (PRIF), depending on the legislation. LRIFs, LIFs and PRIFs require the annuitant to withdraw retirement income, up to an annual maximum determined by pension legislation (PRIFs do not impose a maximum). In some cases, due to financial hardship or shortened life expectancy, for example, the annuitant may be able to access the locked-in funds.

Minors

Minors are permitted to have RRSPs. Even if a child does not have to pay taxes, filing a tax return will create RRSP contribution room in respect of any earned income.

As discussed earlier, persons under the age of 19 do not have the $2,000 overcontribution cushion before penalty tax applies. For example, contributions that are made into a child's RRSP in respect of earned income but are not immediately deducted because the child does not need the deduction in the year of contribution in order to receive a full tax refund, may be carried forward indefinitely and deducted in a future year to reduce taxable income.

LLP and HBP

Where LLP and HBP balances are left outstanding upon the death of an RRSP annuitant, these balances (less any RRSP contributions made prior to death designated as LLP/HBP repayments) are to be included as income on the deceased's terminal return. Alternatively, the surviving Canadian resident spouse or common-law partner of the deceased annuitant may jointly elect, with the legal representative, to undertake the LLP/HBP repayments on behalf of the deceased. The election is made via a signed letter that is to be included with the deceased's terminal return. In these instances, the spouse or common-law partner of the deceased annuitant is deemed to have participated in the LLP/HBP program and would be responsible for repaying the deceased's outstanding balance. Repayments would be facilitated through the spouse's or common-law partner's own individual RRSP.

Non-residents

There is nothing in the *Income Tax Act* (Canada) that prevents a non-resident individual from being the annuitant on an RRSP even if the individual has never been a resident of Canada. However, an individual would only have RRSP contribution room provided he or she has met the "earned income" requirement discussed earlier. Additionally, no RRSP deductions would be possible unless the non-resident is filing a Canadian income tax return and has earned income that qualifies for a deduction. As a practical matter, RRSP administrators would also likely require a Canadian taxpayer identification number to establish an RRSP.

Upon emigrating from Canada and becoming a non-resident, there is a deemed disposition and reacquisition at the fair market value of most capital properties the individual owns. The rule is often referred to as the Canadian "departure tax" and may result in a large tax liability. Certain properties are exempted from the departure tax, including property held within RRSP or RRIF plans. Future withdrawals from an RRSP will be subject to a Canadian non-resident withholding tax levied at a rate of 25% as per the *Income Tax Act* (Canada). The withholding tax is taken at source and remitted to the CRA on behalf of the non-resident annuitant. A treaty with Canada and the foreign jurisdiction in which the non-resident resides may reduce the withholding tax rate.

The last word

As is usual in tax matters, the rules covering RRSPs are complex, and specific cases need to be addressed individually. Professional legal and tax advice should be sought when necessary.

For more information about this topic, contact your advisor, call us at 1.800.874.6275 or visit our website at invesco.ca.