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RSP over-contributions

Removing the excess amount from your RSP

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Since 1996, you have been permitted to make a $2,000 over-contribution to your RSP without being subject to penalty tax. If you have an RSP over-contribution in excess of the $2,000 limit (hereinafter referred to as "excess") at the end of each month, you will be liable for an over-contribution penalty equal to 1% per month on the excess. This article discusses ways you could withdraw the excess amount in order to stop the 1% penalty.

Penalty on over-contribution

If you realize that you made an excess contribution, then the best way to stop the over-contribution "penalty tax clock" is by withdrawing the excess from your RSP. The withdrawal of the excess only stops future penalties from being incurred; it does not eliminate the penalties that are incurred before the excess is withdrawn.

In order to calculate the amount of penalty payable on the excess, you have to complete Form T1OVP with the assistance of your accountant.

Withdrawing the excess

Normally, any withdrawals from your RSP are subject to income tax at your marginal tax rates. However, excess contributions can be withdrawn from your RSP and the RSP income inclusion may be offset by a deduction (so that no income tax is payable) if the withdrawal is made in any of the following years:

- The year in which the excess over-contribution is made or the following year; or
- The year in which you are sent a Notice of Assessment or Notice of Reassessment for the year in which the excess over-contribution was made or the following year.

In addition to meeting the above criteria, to have no income tax payable on the withdrawal, you must also have reasonably expected to deduct the excess as a regular RSP contribution for the year of contribution or the previous year.
If all of these criteria are met, then you can complete Form T746 when you file your income tax return to claim the withdrawal as a tax deduction and offset the income inclusion on your tax return resulting from the withdrawal.

Two options for withdrawing excess contributions

If the criteria mentioned are met, then you have two options for withdrawing the excess from your RSP:

- **You can simply withdraw the excess from your RSP and complete Form T746 when you file your tax return.** When you withdraw the excess, withholding tax will be applied to your RSP withdrawal. The withdrawal must be reported as income on your tax return in the year of withdrawal. However, since all the necessary criteria are met, you can complete Form T746 when you file your income tax return to claim the withdrawal as a tax deduction so that no income tax is payable, and you will get the withholding tax refunded, or you can use it to reduce your taxes owing at the time of filing.

- **Before you withdraw the excess from your RSP, you can complete Form T3012A and send it to the Canada Revenue Agency (CRA).** If the CRA certifies the completed Form T3012A, the excess can be withdrawn with no withholding tax applied. Please note that the over-contribution penalty continues to accrue until the funds are withdrawn from the RSP. Any delays in getting the form certified will result in the penalty continuing to be applied to the over-contributed amount.

Regardless of the withholding tax exemption, the withdrawal is still considered income that must be reported for tax purposes. However, as previously mentioned, Form T746 can be completed when the tax return is filed to claim an offsetting deduction so no tax is paid. This alternative simply avoids the withholding tax at source if the CRA certifies Form T3012A; otherwise, if taxes are withheld, they are recoverable (as explained under the previous option).

Alternative to withdrawing funds

Instead of withdrawing the excess from the RSP, you can wait until January 1 of the following year if you expect new RSP deduction room to be created. This strategy basically uses the excess in the current year as an RSP contribution for the following year.

The disadvantage of this strategy is that if the excess was made early in the year, the 1% penalty tax will continue to accrue on the excess at the end of every month remaining in the year.

If you have any questions or require clarification of any of the issues discussed in this document, do not hesitate to discuss these with your advisor.