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Frequently asked RSP Tax Questions

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As we get closer to year-end, it's time again to start thinking about your RSP contribution. Before you know it, the RSP deadline will be just around the corner. For the 2008 tax year, the RSP contribution deadline is March 2, 2009. To help you in your decision-making, this article answers a few of the most frequently asked RSP tax questions.

Severance and retiring allowances — What are the rules for rolling these amounts over to my RSP?

DO I NEED TO HAVE RSP CONTRIBUTION ROOM?

When you receive a retiring allowance from a former employer for the loss of employment, it may be possible for you to contribute some, or all, of the amount to an RSP without requiring unused RSP deduction room. In other words, this contribution would be over and above your regular RSP contribution room limit.

The definition of a retiring allowance is broad and includes almost all payments received from your former employer for the loss of employment.

WHAT IS THE DIFFERENCE BETWEEN AN 'ELIGIBLE' AND 'NON-ELIGIBLE' RETIRING ALLOWANCE ON MY T4A?

If you expect to receive a retiring allowance, your employer will need to determine how much of your retiring allowance is considered "eligible" and, how much, "non-eligible" and report these amounts on your T4A. Eligible amounts can be rolled over to your individual RSP (not a spousal RSP) without requiring unused contribution room. Non-eligible amounts can be transferred to either your own RSP or to a spousal RSP, but only if you have unused RSP deduction room.

HOW IS MY ELIGIBLE RETIRING ALLOWANCE CALCULATED?

An eligible retiring allowance that qualifies for an RSP rollover cannot exceed the least of these amounts:

- The amount actually received as a retiring allowance; **or**
- $1,500 per year of employment, up to and including 1988, in which you did not participate in your employer’s pension plan or deferred profit sharing plan (DPSP) **plus** $2,000 per year of employment, up to and including 1995.

Note that any partial years of employment count as full years for the purpose of this calculation.

WILL MY SEVERANCE PAYMENT CREATE ADDITIONAL RSP ROOM FOR NEXT YEAR?

It is important to note that amounts received as a retiring allowance from a former employer are not considered as earned income for the purpose of calculating next year’s RSP contribution limit. This applies to the whole amount of the retiring allowance, whether or not it is actually rolled over to an RSP. Otherwise, you would get two tax-deferred benefits out of the same amount, which is clearly not something that the Canada Revenue Agency (CRA) favours.

IS THERE A DEADLINE FOR ROLLING OVER MY RETIRING ALLOWANCE TO MY RSP?

If an amount that is eligible to be rolled into an RSP as a retiring allowance is not contributed to an RSP by the regular RSP contribution deadline for the year, then you **lose the ability to make this special contribution to your RSP forever**. This means that for eligible retiring allowances received in 2008, the last day to contribute these amounts to your RSP is March 2, 2009.

Private company shares — Can I hold private company shares in my RSP? If so, what are the tax consequences?

Yes, if certain conditions are met, you can hold shares of small- or medium-sized Canadian controlled private corporations (CCPC) that carry on active business and are not listed on a prescribed stock exchange in your self-directed RSP.

Both of the following conditions must be met:

- You must deal at arm's length with the corporation and not be a connected shareholder. A connected shareholder is a person or their immediate family who owns or has options to acquire 10% or more of the issued shares of any class of the capital stock of the corporation or a related corporation; and

- Your shares must be

  - part of the capital stock of a Canadian corporation that is not controlled by non-residents where 90% of the assets of the corporation are used principally in an active business carried on primarily in Canada by the particular corporation or by a corporation related to it; **or**

  - part of a prescribed venture capital corporation; **or**

  - part of a specified cooperative corporation where share purchase is not a requirement in order to become a member.

An exception exists for a connected shareholder. As long as the shareholder deals at arm's length with the company and the total cost of the shares of that person and their immediate family is less than $25,000, the shares can be held in their RSP.

Notwithstanding the exception noted above for connected shareholders, if you, as the shareholder, and your family control the corporation, then these shares are not eligible to be put into your RSP. Control is generally defined as having more than 50% of the shares of the company.

Due to costs and complex administrative requirements, there are also internal restrictions for holding CCPC shares in your self-directed RSP. For this reason, you should consult your **tax** advisor to learn more about any specific requirements that may need further consideration.

RSP deductions — Do I have to deduct my RSP contributions in the year that I contributed them, or can I carry forward my tax deduction to a future year?

RSP DEDUCTION CARRYFORWARD RULES

There are no rules that require you to claim an RSP deduction in the year that you made a contribution to your RSP. As long as your actual RSP contribution does not exceed the deduction room available by more than $2,000, you may carry this contribution forward indefinitely (even after your 71st birthday) with no tax penalties.

Contributions you make on or before March 2, 2009, can be deducted on your 2008 tax return or carried forward to deduct in 2009 or a later year.

SHOULD I TAKE THE TAX DEDUCTION NOW OR LATER?

The choice of when to take the deduction depends on several factors including your taxable income, the marginal tax rates, your immediate cash flow needs and the comparable rates of return available for other investments.

For example, it may be beneficial for you to deduct only a portion of the current year's RSP contribution if you are in the middle tax bracket with 2008 taxable income between approximately $38,000 and $75,000. The RSP deduction in this range will result in a refund of approximately 30 to 40 cents on the dollar or 30% – 40%, depending on the province.

However, if you claim a greater deduction to bring your taxable income below approximately $38,000, the deduction will result in a refund of only approximately 21 to 35 cents on the dollar or 21% – 35%. This is a difference of approximately 10% after tax! Assuming that you do not have an immediate need for this cash flow, it may be more beneficial for you to carry forward this deduction for use in a later year at a higher rate.

But, how do you determine if you should take the extra deduction now at a lower rate or wait until next year to claim a deduction at a higher rate? If there is an investment where it is possible to earn an after-tax return of approximately 10%, it may be beneficial to actually take the deduction today and invest the extra savings.

If I am over 71 years of age, can i make a spousal RSP contribution for my spouse who is 71 years of age or younger?

You are required to choose an RSP maturity option (such as a RIF or an annuity) or deregister your RSPs by the end of the year in which you turn 71 years of age. However, this requirement does not prevent you from making an RSP contribution to a spousal RSP as long as your spouse is turning 71 years old or younger in the year of the contribution, even though you, yourself, can no longer hold an RSP in your own name.

As long as you have RSP contribution room, either through carryforwards or from the income you earned last year, you can still make a contribution to a spousal RSP. As well, even though you are over 71 years of age, you will also receive a tax deduction for this contribution.

Can I swap securities into my RSP in exchange for cash? If so, what are the tax implications?

Yes, it is possible to transfer securities from a non-registered account to your RSP in exchange for cash. The tax implications are as follows:

SECURITIES IN A GAIN POSITION

If you have appreciated securities with an unrealized capital gain in a cash account and you transfer those securities to an RSP in exchange for an amount of cash or investments from your RSP, the following rules apply:

- The securities must be transferred to the RSP at their fair market value (FMV) on the date of the transfer.
- An amount of cash equal to the FMV of the securities must be transferred out of the RSP back into your cash account to replace the securities.
- You must recognize the unrealized capital gain on the securities by including it as a taxable capital gain on your tax return in the year in which the swap occurs. In other words, there will be an immediate tax consequence when you make a swap.

SECURITIES IN A LOSS POSITION

If the securities you transfer to the RSP are in a loss position, the loss will be denied and lost forever.

SWAPPING BONDS OR OTHER INTEREST-BEARING SECURITIES

If you transfer bonds or other interest-bearing securities to your RSP, any accrued interest and any capital gains on the bonds have to be recognized on your tax return in the year of the swap.

SWAPPING SECURITIES OUT OF MY RSP IN EXCHANGE FOR CASH

If you take securities out of your RSP and replace them with cash, the result is quite different. As all of the growth (or losses) of the assets were tax-sheltered while in the RSP, the securities will be transferred to your cash account at their fair market value (FMV) with no current tax consequence. However, you will not be able to use any losses that may have occurred within your RSP to offset gains outside of your RSP.

I heard about the 'forgotten RSP contribution'. So, what is it?

ARE YOU TURNING 71 THIS YEAR? DO YOU HAVE QUALIFYING RSP EARNED INCOME IN 2008?

If you have to mature your RSP because this is the year that you turn age 71, you can still make an extra RSP contribution — called the "forgotten RSP contribution" — if you have regular RSP contribution room.

In the year that you turn age 71, there is a December 31 deadline to convert your RSP into a RIF or choose another RSP maturity option. Once this deadline passes, it will not be possible for you to make any further contributions to your individual RSP.

If you earned income in 2008, for example, and you also turned (or will turn) age 71 in 2008, you will be prevented from contributing to your individual RSP next year. By not being able to contribute to your RSP in 2009, you will be denied a possible tax refund (based on the RSP deduction) as well as the benefit of tax-deferred compound growth on a contribution of up to $20,000 (the maximum 2008 RSP deduction) to your RSP.

HOW DOES THE FORGOTTEN RSP CONTRIBUTION WORK?

The forgotten RSP contribution involves making your RSP contribution just prior to the end of the year in which you turn age 71. This means making an RSP contribution in December 2008 based on earned income from 2008. If you already made your maximum RSP contribution for 2008, the CRA will consider this December contribution as an extra contribution that is subject to the over-contribution penalty of 1% of the extra amount per month.

Assuming that you still have room in your RSP for an allowed $2,000 over-contribution and you can make the maximum 2008 RSP contribution of $20,000, your penalty will be relatively small, only $180 [($20,000 – $2,000) x 1%]. If you have already used up your $2,000 over-contribution, your penalty will be only $200.

Once January 2009 rolls around, the extra forgotten RSP contribution will no longer be considered an over-contribution because on January 1, 2009, you will realize new contribution room (the room based on the 2008 earned income discussed above). This means that the penalty will apply for only one month, but you will now have an RSP tax deduction for the 2009 taxation year thanks to your 2008 RSP over-contribution (your forgotten RSP contribution).

IF MY SPOUSE IS YOUNGER THAN 71, DO I STILL NEED TO CONSIDER THIS STRATEGY?

The forgotten RSP contribution may not be necessary if you are turning age 71 in 2008, but still have a spouse who is younger. If this is your situation, you can continue to make contributions to a spousal RSP owned by your spouse as long as your spouse is young enough to have an RSP. Your age, as the contributor, is irrelevant in this case, even if you are over age 71. But you may wish to consider using the forgotten RSP contribution in the year that your younger spouse turns age 71!

SUMMARY OF THE FORGOTTEN RSP CONTRIBUTION

In summary, if you are turning 71 in 2008, you are going to have to choose an RSP maturity option by December 31, 2008. As long as you have qualifying RSP earned income in 2008, you can make the forgotten RSP contribution in December 2008, pay only a small penalty tax for over-contributing and claim the RSP deduction on your 2009 income tax return.