Wealth
Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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RRSP strategies at age 71

Even though you must wind up your RRSP in the year you turn 71, this does not necessarily mean that you can no longer benefit from RRSP deductions. The following strategies can be used, even after age 71, as long as you still have RRSP contribution room or continue to earn room.

The forgotten RRSP contribution

An RRSP must mature by December 31 of the year in which you turn 71. On maturity, the funds must be withdrawn, transferred to a RRIF or used to purchase an annuity. You will not be able to make any further contributions to your individual RRSP after this date.

RRSP contribution room is based on your previous year's income. This creates an unusual situation in the year you turn 71. If you are still working in the year you turn 71, you will have earned income which will generate additional RRSP contribution room next year but you can no longer contribute to your individual RRSP at that time.

The forgotten RRSP contribution strategy may help you defer some tax in this unusual situation. This strategy involves over contributing to your RRSP in the year you turn 71. By over contributing to your RRSP before you convert it to a RRIF, you will have to pay a small penalty but potentially benefit from a large RRSP deduction and tax-deferral.

You can consider the following if you're turning 71 or have turned 71 this year and would like to use the forgotten RRSP contribution room:

1. Just before the end of the year, estimate your earned income for the year and using this amount, estimate the RRSP room that you will receive on January 1 of next year. RRSP room is calculated as 18% of the previous year's earned income up to a maximum threshold.
2. Make your RRSP contribution before the end of the year. This contribution is considered an over-contribution and is subject to a penalty of 1% of the amount per month. You may want to minimize the penalty by contributing in the last month of the year. You will need to file a T1-OVP to report the over-contribution and remit the penalty to the Canada Revenue Agency (CRA) within 90 days of the following year.

For example, if your RRSP contribution limit for the next calendar year is $20,000 based on this year's earned income, in December you may want to contribute that amount to your RRSP in advance. You will have a one-time penalty of $180 ([$20,000 – $2,000] x 1%). This assumes you aren't currently in an over contribution position.

3. Deduct the additional RRSP contribution on your next year's tax return or carry it forward to deduct on any future year's tax return.

On January 1 of next year, the RRSP over-contribution you make in December will no longer be considered an over-contribution because you will receive new contribution. This means that the penalty will only apply for one month. It's likely that the taxes saved by deducting the contribution on your tax return and the benefit of tax deferral and compounded growth will outweigh the one-month penalty.

You're 71 or older but have a younger spouse

Even though you can no longer hold an RRSP in your own name after the year you turn 71, you can still make an RRSP contribution to a spousal RRSP as long as your spouse is 71 or younger at year-end and you have RRSP contribution room. You can be 71 or older and still generate new RRSP contribution room as long as you have earned income. You can claim a deduction for the spousal RRSP contribution when you file your tax return.

Using up your existing RRSP room

If you have accumulated unused RRSP room and have not contributed to your RRSP, consider if it makes sense to use up your RRSP room by making a contribution in the year you turn 71. Remember, you don't have an additional 60 days after the end of the year to make a contribution, as you can no longer have an RRSP after December 31.

Generally, if you're going to be in a higher bracket in the year you turn 71 compared to a future year, you can realize a tax savings and deferral of tax by contributing and deducting that contribution.

Alternatively, you can make the contribution up to your limit and spread out the deduction over future years when your income may be higher because of receiving RRIF, pension or annuity payments. This strategy can help lower your income and keep your income under the OAS clawback threshold.

On January 1 of next year, the RRSP over-contribution you make in December will no longer be considered an over-contribution because you will receive new contribution. This means that the penalty will only apply for one month.

Deducting your $2,000 over-contribution when you're 71

If you've currently over-contributed to your RRSP by $2,000 or less, you don't need to pay the 1% penalty on excess RRSP contributions. However, you may want to consider deducting this over-contribution from your income now if you have RRSP contribution room.

For example, if your RRSP contribution room is $15,000 in the year you turn 71 and you over-contributed $2,000 to your RRSP in a prior year, then you could contribute $13,000 to your RRSP and deduct $15,000. This strategy ensures you deduct the $2,000.

If you don't deduct the $2,000 from your income, then that amount is subject to double taxation; once as you never deducted it when it was contributed to the RRSP (you would have generally paid tax on this amount when it was earned) and a second time when you withdraw it from your RRSP or RRIF.

Conclusion

To summarize, if you turn 71 or have turned 71 this year, you must choose an RRSP maturity option by December 31 of this year. There are tax saving opportunities if your spouse is under 71, if you have unused RRSP contribution room, or if you have earned income this year. You should consult with your tax advisor before implementing any strategy discussed in this article to ensure it's right for you.

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