Wealth Management

RBC Wealth Management Services

Create RRSP contribution room for a minor

Help your minor child start a savings plan

Filing a tax return for your child that has earned income will allow them to generate RRSP contribution room and open an RRSP. By being able to open and contribute to an RRSP, your child may learn the benefits of saving and may reduce their taxes in the process.

This article outlines several strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax advisor before acting on any of the information in this article.

Please contact us for more information about the topics discussed in this article.

File a tax return

Many teens start working part-time after school or on weekends to earn pocket money. It gives them some freedom, a sense of purpose and duty, and an appreciation for the value of money.

If your child earns an annual income below the basic personal exemption ($11,474 for 2016), they may not need to file a tax return. However, it may be worthwhile for them to do so. The reason is that it may allow them to build RRSP contribution room. RRSP contribution room can only accumulate by having "earned income" documented with the Canada Revenue Agency (CRA).

Earned income commonly includes:

- Salary or wages from employment;
- Net business income carried on by a self-employed individual;
- Net rental income from real property;
- Royalties; and
- Net research grants.

By filing a return, your minor child will start to accumulate RRSP contribution room at the rate of 18% of earned income (up to a maximum of $25,370 for 2016).

Example of contributing to an RRSP and earning room at an early age

Assume two schoolmates, Bob and

If you own a business, consider hiring your children and paying them a salary. There is no attribution on employment income earned by your child from your business. Keep in mind that the salary you pay them must be "reasonable" for the services they provide.

Joe, each get summer jobs at age 13. Bob and Joe live in Ontario. They continue working and each earn $4,000 every summer. At age 22, they both get full-time jobs after graduating from university.

Bob's parents file a tax return each year on Bob's behalf while Joe's parents do not. This extra effort made by Bob's parents generates $6,480 [($4,000 x 18%) x 9 years = $6,480] of RRSP contribution room for Bob by the time he graduates from university. The tax rules allow for an indefinite carry forward of unused RRSP contribution room, so this RRSP contribution room accumulates for Bob from age 13.

Let's assume that Bob's marginal tax rate is 31.5%* when he starts working full time. Bob will be able to reduce his tax liability by approximately $2,041 ($6,480 x 31.5%) if he contributes the full amount of his carry forward room to his RRSP in his first year of employment. If Bob leaves the funds in his RRSP, by age 60, that extra $6,480 in Bob's RRSP will grow to nearly $60,000 (assuming a growth rate of 6% per year).

Just by filing a tax return when younger, Bob will be able to save sooner and allow the savings to compound on a tax-deferred basis for a longer period of time, and potentially provide a larger nest egg at retirement.

The withdrawals Bob makes from the RRSP will eventually be taxable at his marginal tax rate at the time he makes the withdrawal. It may be possible for Bob to time his withdrawals so that the RRSP income he draws is taxed at a lower rate, like at retirement when he is earning less income and he is in a lower marginal tax bracket.

* The 31.5% tax rate is an estimate of the marginal tax rate for those with taxable income of approximately $70,000 in Ontario. The exact rate of tax savings will depend on the individual's actual income for the year and their province of residence.

Other benefits

- **Educational:** If you involve your children in preparing their tax returns, they can begin to understand Canada's tax system and may help them learn good financial management habits.
- **Income splitting:** If you own a business, consider hiring your children and paying them a salary. There is no attribution on employment income earned by your child from your business. Keep in mind that the salary you pay them must be "reasonable" for the services they provide. Generally, if you are trying to determine what is considered reasonable, you should ask yourself what you would pay an unrelated individual to do the same work.
- **Tax-deferred compounding:** Going back to the example above, to take advantage of additional years of tax-deferred compounding, Bob could make the contributions to his RRSP annually ($4,000 x 18% = $720 per year) so that the funds are invested as soon as possible in his RRSP. He can also choose to claim the deduction when his income increases and he is subject to tax at higher rates in order to maximize the value of the RRSP deduction. The tax rules allow your undeducted RRSP contributions to be carried forward indefinitely. Please note that if you have over-contributed to your RRSP, you may be subject to penalties.
- **Home Buyers Plan:** If your children build up their RRSP's early, they could use the funds in the RRSP to take advantage of the Home Buyers Plan (HBP). The HBP allows your child to use up to $25,000 of their RRSP to purchase their first home.

Other considerations:

- **Additional costs:** You may incur additional tax advisor fees or have to dedicate additional time and

If your minor child or children have earned income, consider helping them file a tax return, even if they do not have to pay any taxes and are not required to file a tax return. This will allow them to create RRSP contribution room and is also a great way to help them get into the habit of saving and learning about the benefits of compound growth.

resources in order to file a tax return for your child. Keep this cost in mind when determining whether it makes sense to use this strategy.

- **Ability to work:** Refer to federal and provincial laws for information on the type of part-time employment available to minors. This particularly relates to industrial settings. You should keep this in mind if you plan to employ your minor child in your business.
- **Ability to open account:** Although the tax rules allow minors to open and contribute to their RRSP as long as they have the contribution room, not all institutions can accommodate opening RRSPs for minors. Speak with your financial institution to ensure that they can open an RRSP for your minor child.
- **$2,000 over-contribution:** Generally an individual can over-contribute a cumulative lifetime total of $2,000 to their RRSP without incurring a penalty. Minors do not qualify for the lifetime over-contribution. The additional $2,000 over-contribution amount is available to them when they are 19 years old or older.
- **Social Insurance Number (SIN):** Your minor child must have a SIN to file their tax return and open an RRSP account. You may apply for their SIN at any time after birth.

Summary

If your minor child or children have earned income, consider helping them file a tax return, even if they do not have to pay any taxes and are not required to file a tax return. This will allow them to create RRSP contribution room and is also a great way to help them get into the habit of saving and learning about the benefits of compound growth.

Please contact us for more information about the topics discussed in this article.