Retirement Savings Plans

RBC Dominion Securities

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1 › Introduction

For most Canadians, their retirement savings plan (RSP) represents a key source of retirement income—a source that will be accumulated over many years to guarantee the attainment of their retirement objectives. Recognizing the importance of this resource, it is essential that you fully understand the rules specific to RSPs, as well as the savings strategies available. A thorough understanding, accompanied by effective management of your RSP assets, will help you accumulate the largest possible retirement nest egg.

The purpose of this publication is to review the basics of RSP investing and provide an outline of strategies available to maximize your RSP savings. If you have a locked-in RSP, ask your advisor for more information on this topic.

And remember, maximizing the growth of your RSP requires your ongoing attention and effective management. You and your advisor can work together to meet your RSP, and ultimately your retirement, objectives.

2 › Basic RSP concepts

An RSP is a tax-sheltered investment vehicle that provides individuals with an effective means of saving for retirement. Contributions to an RSP result in a tax deduction and the income earned in the plan compounds on a tax-deferred basis. Individuals with RSP contribution room in Canada may contribute to an RSP up to the end of the year in which the planholder reaches age 69.

THE BENEFITS OF RSP INVESTING

While most individuals recognize the benefits of investing in an RSP, many do not exploit its unique advantages to their fullest potential. There are three primary benefits to investing in an RSP:

1. Tax savings

Contributions to an RSP are deductible for tax purposes within certain prescribed limits. In the year a contribution is made to an RSP you can choose to deduct the contribution from your taxable income. This deduction reduces the amount of taxable income and thus the tax payable. The actual tax savings will depend on your marginal tax rate. The table below outlines the amount of tax saved and the after-tax cost of a $1,000 RSP contribution based on various marginal tax rates.

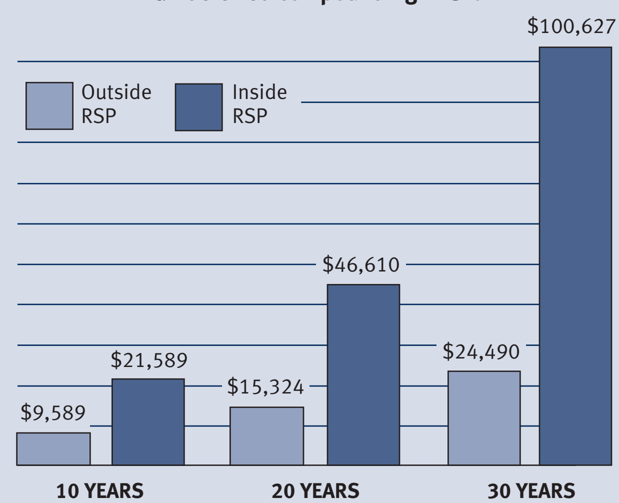
Marginal tax rate	Tax saved	After-tax cost
25%	$250	$750
40%	$400	$600
45%	$450	$550

2. Tax-deferred compounding

The most significant opportunity offered by the RSP is the tax-deferred compounding of income earned within the plan. The term “tax-deferred” refers to the fact that all income earned within the RSP accumulates tax-free until withdrawn. If you have $10,000 to invest and have the choice of making an RSP contribution or not making an RSP contribution, consider **Figure 1**, which shows the difference between investing the money inside and outside an RSP (tax-deferred versus taxed). Remember, if you invest the money in an RSP, you will save $4,000 in tax

FIGURE 1

Tax-deferred compounding — 8%



(assuming a 40% tax rate). Therefore, a $10,000 contribution to the RSP is comparable to a $6,000 investment outside the RSP, assuming the tax savings are reinvested. As you can see from **Figure 1**, you would be better off contributing to the RSP. The question is, how much better? To determine the RSP advantage we have to convert the RSP value to an after-tax value. To provide this comparison, let’s assume you will withdraw the $21,589 accumulated by the 10th year and pay tax at 40% on this income. In the unlikely event the RSP is actually collapsed in the 10th year, you would still have $3,364 more by investing in the RSP. Allowing the money to remain in the RSP after the 10th year will further enhance the benefit to you.

3. Income splitting

Utilizing income-splitting strategies between spouses can provide significant tax savings. One of the most simplistic, yet effective, methods of income splitting between spouses is achieved by contributing to a spousal RSP. The objective of this strategy is to provide both spouses with similar retirement incomes and thus similar income tax rates in retirement.

3 › Contributions to your RSP

In order to be deductible in the current taxation year, contributions to your RSP must be made either during the year or up to 60 days after December 31 of the current year. Contributions made in the first 60 days of the following year can either be deducted in the current year, or in a future year.

Contribution limits to your RSP are in part based upon a percentage of your "earned income" from the previous year.

WHAT IS EARNED INCOME?

Earned income is calculated from the following types of income:

› Salary or wages from employment. This amount is reduced by deductible employment-related expenses such as union or professional dues.
› Disability pensions paid under the Canada Pension Plan (CPP) or Quebec Pension Plan (QPP) (you must be a resident of Canada when you receive the payments) and taxable income from a disability plan. Regular CPP and QPP retirement pensions do not qualify as earned income.
› Net income from a business carried on by a self-employed individual or by an active partner of a partnership.
› Net rental income from real property.
› Payments from supplementary unemployment benefit plans (not Employment Insurance).
› Taxable alimony or maintenance payments received.
› Royalties and net research grants.

Earned income must be reduced by the following amounts:

› Losses from a business carried on by a self-employed individual or by an active partner of a partnership.
› Net rental losses from real property.
› Deductible alimony or maintenance payments.

CALCULATING YOUR CONTRIBUTION LIMIT

The annual RSP contribution limit depends upon two factors: your prior year's earned income and the prior year's deemed pension benefit from your employer pension plan, if applicable.

To calculate your current RSP contribution limit you must follow a two-step calculation:

Step 1: Determine your overall limit
Calculated as the lesser of:

a) 18% of your prior year's earned income
b) The legislated annual maximum limit

Year	Legislated annual maximum limit
2005	$16,500
2006	$18,000
2007	$19,000
2008	$20,000
2009	$21,000

Step 2: Subtract your prior year's pension adjustment factor (PA), if applicable
Once your overall limit is calculated, this amount must be reduced if you are a member of a pension plan. If you are not a member of a pension plan or a deferred profit sharing plan (DPSP), your overall limit calculated in Step 1 represents your actual limit for the year.

Members of a registered pension plan (RPP) or a DPSP must subtract the pension adjustment factor indicated on their prior year's T4 slip from the overall limit calculated in Step 1. This pension adjustment factor is intended to represent the pension benefit that the member will receive in the year. Reducing the overall contribution limit by a pension factor is intended to equate the retirement benefit provided to pension plan members with the benefit available to non-members.

Also, members of defined benefit pension plans may have a past service pension adjustment (PSPA), which will further reduce their available contribution limit. A PSPA could also result when a plan member purchases pension benefits relating to prior years of employment (after 1989).

Furthermore, employees that are terminating their interest in an RPP, may receive a pension adjustment

RSP PLANNING TIP

Contributions to your RSP should be made early in the year to maximize tax-deferred compounding.

reversal (PAR). A PAR is added to one's RSP contribution room. For defined benefit pension plans, a PAR is generated when the sum of all pension adjustments since 1990 is greater than the value of post-1989 pension benefits upon plan termination. For defined contribution and DPSP plans, a PAR is generated when contributions to these plans are forfeited due to early termination.

Figure 2 is provided to assist you with calculating your RSP contribution limit and the following is an example for your reference.

Example: Throughout 2005, Susan was employed by a company which sponsors a pension plan for its employees. Her employer reported a 2005 PA of $6,000 on her 2005 T4. Susan's employment income in 2005 was $50,000. She has always made her maximum RSP contribution each year. Susan's 2006 deductible RSP contribution is calculated as follows:

Unused contribution from prior years	**NIL (a)**
Plus: *The lesser of:*	
18% of earned income from prior year: ($50,000 x 18% = $9,000)	
OR *maximum annual 2006 contribution: $18,000*	**$9,000 (b)**
Less: Pension adjustment from prior year	**$6,000 (c)**
Total: [(a + b) – c]	**$3,000 (d)**
Less: Past service pension adjustment (PSPA)	**NIL (e)**
Plus: Pension adjustment reversal (PAR)	**NIL (f)**
Allowable deductible contribution [d – e + f]:	**$3,000 (g)**

RSP PLANNING TIP

Each year the Canada Revenue Agency sends out, along with your Notice of Assessment for your tax return, a calculation of what your RSP contribution limit is for the year. You usually receive this notice in the June to August period. Use **Figure 2** to help you calculate your contribution limit and contribute early.

FIGURE 2

Unused contribution from prior years	________	(a)
PLUS: The lesser of:		
18% of earned income from prior year ________		
OR maximum annual contribution ________	________	(b)
LESS: Pension adjustment from prior year	________	(c)
TOTAL [(a + b) – c]	________	(d)
LESS: Past service pension adjustment (PSPA)	________	(e)
PLUS: Pension adjustment reversal (PAR)	________	(f)
Allowable deductible contribution [d – e + f]	________	(g)

THE CARRY-FORWARD RULE

As of 1991, individuals that do not contribute their maximum annual contribution to their RSP can carry forward the "unused portion" and make the contribution in a future year. This unused portion can be carried forward indefinitely.

Be aware, however, that waiting until a future year to "catch up" on deductible contribution room will, in most cases, result in a smaller RSP due to the loss of tax-deferred growth.

RSP PLANNING TIP

Although you must make your annual contribution during the outlined 14-month period to qualify as a current year tax deduction, you can choose to delay claiming this deduction. Making a contribution today will allow you to put your money to work immediately, while it may be more beneficial to claim the tax deduction in a later year.

EXCESS CONTRIBUTIONS

The ability to make a contribution in excess of the available contribution limit was first introduced in 1991. This excess contribution limit was intended as a buffer to allow pension plan members to estimate their contribution limit early in the year and to make a contribution without the risk of incurring a penalty tax if they accidentally exceeded their actual limit.

Beginning January 1, 1996, the excess contribution limit was reduced to $2,000. Therefore, if you do not exceed your available contribution limit by more than $2,000 on a cumulative basis, a penalty tax of 1% per month on the excess amount will not be assessed.

If a contribution exceeds the $2,000 excess contribution limit, it must be removed to avoid the penalty tax. The removal of this excess amount from the RSP may result in the inclusion of the excess amount as taxable income unless it is withdrawn in either the year that it is contributed, the year the CRA Notice of Assessment is received, or the following year.

Note: The $2,000 excess contribution limit is only available to individuals who have attained the age of 18 in a prior year.

Before January 1, 1996 individuals were allowed to make an excess contribution of up to $8,000. Individuals that made an excess contribution of more than the new $2,000 limit prior to February 27, 1995, are required to reduce this excess balance as soon as possible.

This is achieved by claiming the excess contribution amount as a deductible RSP contribution starting with the 1996 tax year. Additional contributions will not be allowed until the excess contribution has been reduced to the $2,000 level. While this excess contribution limit was intended as a buffer against accidental excess contributions, it does present an opportunity to add additional capital to your RSP and benefit from its tax-deferred compounding.

CONTRIBUTIONS MADE BY SECURITIES

If you don't have the cash to make your RSP contribution, you can contribute eligible investments from outside your RSP at their fair market value. For tax purposes, investments transferred into the RSP (i.e. an in-kind contribution) are treated as if the investment was actually sold. Therefore, this transfer can trigger a taxable capital gain.

Unfortunately, if the fair market value of the transferred investment is less than its original cost, the resultant capital loss cannot be claimed. Also, any accrued interest up to the transfer date must be reported as income (i.e. interest that has been earned but not paid).

For example, on the transfer of two securities to an RSP—one with a gain of $1,500 and the other with a loss of $500—the gain of $1,500 is included in income, but the loss cannot be used to reduce the gain to $1,000.

The previously outlined rules for in-kind contributions also apply where investments are "swapped" or substituted between a taxable portfolio and an RSP.

RSP PLANNING TIP

Contributions can be made by those individuals who have no earned income in the current year, but who did have earned income in the prior year (e.g. retirees) due to the ability to carry forward the RSP contribution limit.

4 › Transfers into an RSP

Certain amounts may be transferred into your RSP in addition to your allowable RSP contribution limit. These lump-sum transfers are allowed between registered plans on a tax-deferred basis.

RETIRING ALLOWANCE

Often, when an employee is offered a retirement or severance package, the employer will include a lump-sum payment classified as a "retiring allowance" (i.e. reported as income due to loss of office). It is often possible to transfer or "roll over" at least a portion of this payment to the RSP. This transfer provision is referred to as a retiring allowance rollover and is based upon the number of years of employment. The maximum amount that can be transferred to an RSP is calculated as the lesser of the retiring allowance received or the amount determined by the following formula:

› $2,000 per year of service up to and including 1995 (note that any part year is counted as a full year for purposes of this calculation)

plus

› $1,500 for each year, up to and including 1988, in which the employee was not a member of a pension plan, a DPSP, or in which the employer pension contributions were not vested

The rollover can either be transferred directly to your RSP or it can be paid to you. If received by you, it can only be contributed to the RSP in the year of receipt or in the first 60 days of the following year. A retiring allowance rollover can only be contributed to the RSP of the individual receiving the payment. It cannot be contributed to a spousal RSP.

It may be advantageous to have your employer pay the retiring allowance directly to your RSP, since tax will not be withheld. Your employer will be required to withhold tax on the payment if it is paid to you. If you receive the payment and then contribute it to the RSP you may have to "top up" the rollover amount due to the tax that has been withheld.

For example, Mr. Smith retired on July 1, 2005, as part of his employer's early retirement program.

His retirement package included a retiring allowance of $35,000. Mr. Smith began his employment on December 29, 1982 but did not join the pension plan until 1985. Mr. Smith can roll over the following amount to his RSP:

1982 to 1995 = 14 years @ $2,000 per year	=	$28,000
1982 to 1984 = 3 years @ $1,500 per year	=	$4,500
Maximum rollover	=	$32,500

Although Mr. Smith was employed for over 22 years, his final years from 1996 to 2005 are not included in this calculation as a result of the elimination of the rollover provision for all years after 1995.

Generally, it is advisable to make your maximum retiring allowance rollover. If you do not make the rollover within the allowed time period, you cannot carry it forward to a future year.

If you are unsure whether you will require the retiring allowance to support your current lifestyle, it may still be advantageous to make the rollover while you can and then deregister RSP funds, as necessary.

The benefits of this strategy are the deferral of tax until withdrawn and the tax-free growth of these funds while in the RSP.

For additional details on issues surrounding early retirement, ask your advisor.

LUMP-SUM TRANSFERS FROM A PENSION PLAN

It is possible in certain circumstances to transfer the accumulated benefit from your employer's RPP to your RSP.

Generally, this option is only allowed upon the termination of employment, or upon revisions or "wind up" of a pension plan. The amount that may be transferred is commonly referred to as the commuted pension value, which represents the lump-sum value of your future pension in today's dollars.

5 › RSP INVESTMENT STRATEGY

Generally, all of the commuted pension value must be transferred to a locked-in RSP or locked in retirement account (LIRA). A locked-in RSP and LIRA are essentially the same type of account. The variation in account name is due to differences in provincial pension legislation.

A locked-in RSP or LIRA is very similar to a regular RSP except that funds can only be withdrawn by converting to a life annuity, a life income fund (LIF), a locked-in retirement income fund (LRIF) (currently only available in Alberta, Manitoba, Ontario and Newfoundland and Labrador), or a prescribed retirement income fund (PRIF) (currently only available in Saskatchewan and Manitoba).

For more details on your locked-in RSP/LIRA options, ask your advisor.

TRANSFERS FROM ANOTHER RSP

RSP assets (i.e. cash and securities) can be transferred tax-free between RSP accounts.

A common reason for transfers between RSPs is to consolidate your RSPs into a self-directed plan. Consolidating all your RSP investments will make it easier to maintain a proper asset mix and to evaluate performance, simplify administration and reduce expenses.

A CRA requirement is that the original book value of the transferred RSP assets must flow from one RSP to the other RSP account of the same person. This rule also applies for RSP-to-RIF and RIF-to-RIF transfers.

The investment direction chosen for your RSP should complement investments held outside your RSP and match the level of risk with which you are comfortable.

Most investors take a conservative approach to investing their RSP since it is generally intended to provide income and financial security in retirement. Individual strategies should vary depending upon an individual's circumstances. Those with large portfolios outside their RSP or those who wish to have only the most secure investments will tend to have a greater allocation of fixed-income investments in their RSP. On the other hand, growth-oriented investors—typically those with a number of years to retirement—should allocate a greater proportion of their RSP to equity investments. Note that capital investments that produce gains and dividends from Canadian corporations are taxed more favourably if held outside an RSP. Therefore, from a tax perspective, some investors will hold a greater equity position outside the RSP and fixed income inside the RSP.

Regardless of circumstances, it is important that equity investments not be ignored as they represent a potential hedge against the impact of inflation. One of the most common mistakes made by retirees is to convert all of their RSP to fixed-income investments. By adopting this strategy, retirees are ignoring the potential impact inflation will have on their retirement lifestyle.

INVESTMENT OPTIONS FOR YOUR RSP

The investment options for your RSP are wide ranging, but there are specific restrictions regarding the types of investments that qualify. Your investment options will also vary depending on the type of RSP account used. A self-directed RSP will provide the widest range of eligible investment options. The following provide an outline of qualifying Canadian investments.

Liquid investments

- Cash or deposits
- Treasury bills
- Money market instruments
- Canada Savings Bonds and Provincial Savings Bonds
- Bankers' acceptances, commercial paper

Fixed income

- Federal, provincial and municipal bonds and coupons
- GICs
- Bonds issued by publicly-traded corporations listed on a Canadian stock exchange
- Mortgage-backed securities and mortgage investment receipts
- World Bank bonds denominated in a foreign currency
- Indexed-linked notes
- Debt issued by a limited partnership whose units are listed on a Canadian stock exchange

Equity

- Common and preferred shares listed on a Canadian stock exchange
- Covered call options, warrants and rights issued by companies listed on a Canadian stock exchange
- Listed put options
- Canadian resource property royalty units and limited partnership units listed on a Canadian stock exchange

Mutual funds

Canadian mutual funds qualify to be held in an RSP. This would include money market, bond, mortgage, equity and balanced mutual funds. Class A shares of a labour sponsored venture capital corporation are also eligible.

Mortgages

Arm's-length mortgages, secured by real property in Canada, are qualified investments for an RSP. Non arm's-length mortgages may qualify if the mortgage is insured and administered by an approved lender under the National Housing Act.

Venture capital corporations

- Registered under specific provincial acts

Private company shares

- Shares of a small business corporation can be held in an RSP if specific requirements are met

Gold or silver

- Gold or silver legal tender bullion coins, bullion bars, ingots or wafers may qualify if certain conditions are met
- Gold or silver certificates may qualify if certain conditions are met

FOREIGN CONTENT

Most people would agree that the old saying "don't keep all your eggs in one basket" also applies to their RSP investments. Dividing your RSP between cash, bonds and equities will help to minimize fluctuations in RSP growth. An additional level of diversification is also available through your foreign content.

Qualified foreign investments

Qualifying foreign investments that may be held include:

- Common shares listed on exchanges in the United Kingdom, the United States or several other stock exchanges in the world
- American depository receipts
- Canadian mutual funds investing outside of Canada
- Certain companies listed in Canada, but based outside of Canada
- Debt issued by foreign corporations, if the corporation's shares trade on one of the qualifying foreign exchanges
- Foreign government debt, if it has an investment-grade rating with a bond-rating agency at the time of purchase

Enhancing growth through foreign diversification

By diversifying your RSP investments outside of Canada, you may help improve your overall return and create a currency hedge against the value of the Canadian dollar.

There are many reasons for including non-Canadian assets in your RSP. Perhaps the most persuasive reason is the fact that historically, for a given level of risk, the investment returns achieved are greater for a diversified portfolio that includes international securities than for a portfolio invested only in Canadian domestic securities.

6 › Strategies to maximize your RSP

As we indicated at the beginning of this publication, the contribution to your RSP and its resultant tax savings is only the first step toward maximizing RSP growth. This section of the guide is dedicated to strategies intended to maximize your retirement nest egg.

SPOUSAL RSPs

Utilizing income-splitting strategies between spouses can provide significant tax savings. One of the most simplistic, yet effective, methods of income splitting between spouses is achieved by contributing to a spousal RSP. The objective of this strategy is to provide both spouses with similar incomes and thus similar income tax rates in retirement. Before setting up a spousal RSP, a couple should estimate their expected retirement incomes. If one spouse is likely to have a significantly lower retirement income, then spousal RSP contributions should be considered.

When a spousal RSP contribution is made, the spouse making the contribution (i.e. the contributor) will claim the contribution on their tax return, while the contribution will be deposited in the other spouse's (i.e. annuitant's) RSP. Note that you can choose to split your contribution limit between a spousal RSP and your own plan.

A limitation of this strategy is that withdrawals from a spousal RSP can result in the triggering of the income attribution rules. This triggering will occur if funds are withdrawn from any spousal RSP in the year any spousal contribution is made or in either of the following two calendar years. A withdrawal from any spousal RSP within this three-year period will result in the income being taxed in the hands of (i.e. attributed to) the spouse that made the contribution. The attribution of income is limited to the total spousal contributions made during the attribution period.

The following example illustrates the impact of the attribution rules on spousal RSP withdrawals. Let's assume that both you and your spouse make the following contributions to a spousal RSP of which your spouse is the annuitant.

Year	Spousal contributions by you	Contributions by your spouse
1	$2,000	$2,000
2	nil	$4,000
3	$2,000	nil

If during the third year, your spouse withdrew $6,000 from the spousal RSP, the first $4,000 would be included in your income. The remaining $2,000 would be taxed in your spouse's hands. If your spouse had contributed his or her total contribution of $6,000 to a spousal RSP and you made a contribution to your own regular RSP, then any withdrawals from the spousal RSP would be taxed in your spouse's hands and not attributed back to you.

To avoid triggering the attribution rules during the three-year period since the last spousal RSP contribution, you can convert the RSP to a retirement income fund (RIF). Minimum RIF payments will not be attributed to the contributing spouse. Any funds withdrawn from the RIF in excess of the minimum payment could be attributed to the contributing spouse. It is important to note that there is no minimum payment requirement in the year of conversion to a RIF, thus RIF payments received in the year of conversion could be subject to attribution.

RSP PLANNING TIP

- Make contributions to a spousal plan to allow for future income splitting. Contribute to your spouse's plan until his or her expected retirement income equals yours.
- If you are 69 or older and you have earned income, you can still contribute to a spousal RSP if your spouse is age 69 or under.

RSP PLANNING TIP

If you are turning age 69 this year and have maximized your RSP contributions, but you have earned income in the year, you may consider contributing to an RSP in December—just before the RSP must mature—and deduct the contributions in the following year. Note, however, a penalty of 1% would be payable for the excess contribution in December.

THE IMPORTANCE OF CONTRIBUTING EARLY

The vast majority of Canadians make their contributions at the end of the tax year. By making your RSP contribution either at the beginning of the year—early 2006 for the 2006 tax year, instead of early 2007—or by making regular monthly contributions, you will build yourself a significantly larger RSP. Why, you ask? It's because of the additional years of compound growth that result from making your contribution sooner rather than later.

Consider 35-year-old Tim, who contributes $5,000 at the end of each tax year. Assuming Tim continues to contribute until age 65, and assuming an 8% growth rate, his RSP will be worth $566,000 upon retirement. Now consider 35-year-old Denise, who contributes the same amount each year, but pays it in monthly instalments. Based on the same rate of return, her RSP at age 65 would be worth $587,000. If she made her contributions in a lump sum at the beginning of each year, it would be worth $611,000. In other words, Denise's retirement fund would be $21,000—$45,000 larger than Tim's, simply because she gave some thought to her RSP earlier in the year.

BORROWING TO MAKE AN RSP CONTRIBUTION

While borrowing to invest outside your RSP may provide you with a tax-deductible interest expense, borrowing to make an RSP contribution will not. Deciding whether or not to borrow is complicated by the fact that you can carry forward your unused contribution limit to a future year when cash may be available. While carrying forward your contribution will avoid borrowing costs, tax-deferred growth must be forfeited. In general, if you expect to be able to repay an RSP loan within one year, this strategy should prove advantageous. Use your tax savings from the contribution to help repay your RSP loan.

PAYING DOWN YOUR MORTGAGE VERSUS CONTRIBUTING TO YOUR RSP

A perplexing question that many individuals ask themselves each year is, "Should I pay down the mortgage or make my RSP contribution?" The answer to this question depends on your tax bracket, your mortgage rate and the assumed growth rate of your RSP. In general, the solution is to compromise—contribute to your RSP each year and use the tax savings to reduce your mortgage balance.

TIMING YOUR RSP DEDUCTION

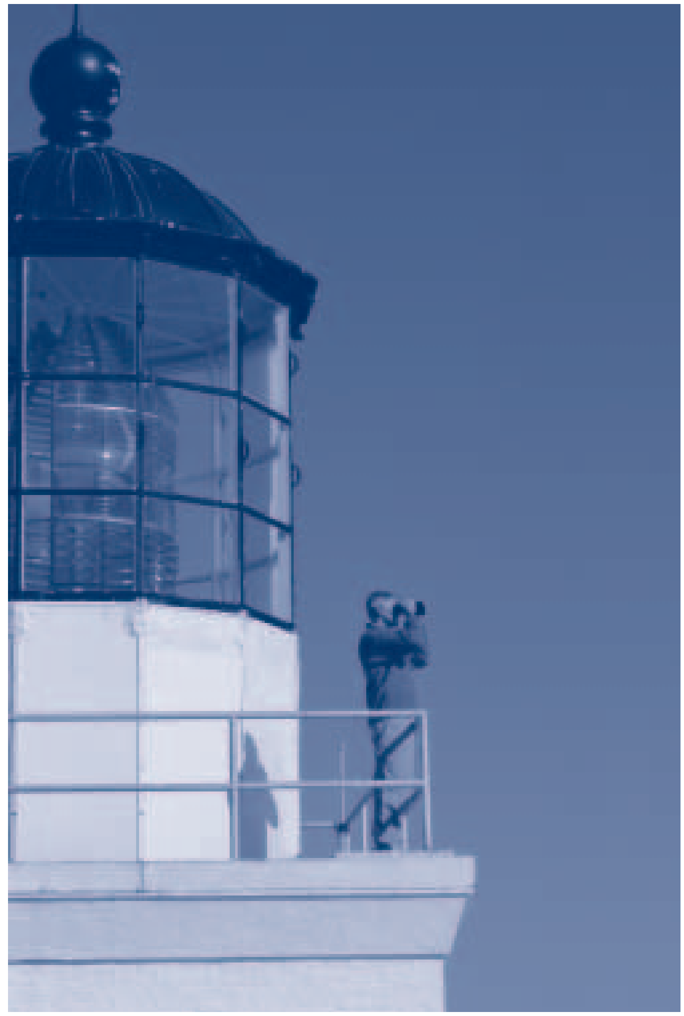
While it is advisable to make your RSP contribution each year, you can choose to delay claiming the tax deduction until a future tax year. If your income tends to fluctuate from year to year it may be advantageous to defer the tax deduction to a future year when your income, and thus your tax rate, will be significantly higher. While this strategy delays the tax savings, your contribution is growing tax-deferred.

To illustrate the benefit of this strategy, let's assume that your current marginal tax rate is 25% but you expect your income will rise next year, increasing your tax rate to 40%. If you made a $10,000 contribution this year and claimed the deduction, you will save $2,500 in tax, while waiting until next year would yield a $4,000 tax saving.

SETTING A TARGET

If you are like many Canadians, you endeavour to save as much as possible within your RSP each year. The question that must be asked is, "Will it be enough?" Before you can answer this question, you must determine your desired retirement lifestyle. Determining this objective will allow you to set a savings target for your RSP. Setting this target is the only way you can gauge your progress and determine when enough is truly enough.

As a rule of thumb, for every $10,000 in before-tax retirement income, you must accumulate $150,000 in RSP assets by the year of retirement. This assumes that your life expectancy once retired is 25 years, that your income increases at a rate of 3% per year to keep pace with inflation, and that there is an 8% growth rate on your investments.



ARE YOU ON TRACK?

Attempting to put all the pieces of your retirement puzzle together to answer this question can be difficult. But your advisor can help. Services available through your advisor can help you determine if you're on track with your retirement plans. If your current situation doesn't match your goals, your advisor can provide the direction necessary to put you back on course. Ask your advisor for more information on financial plans.

7 › Withdrawals from an RSP

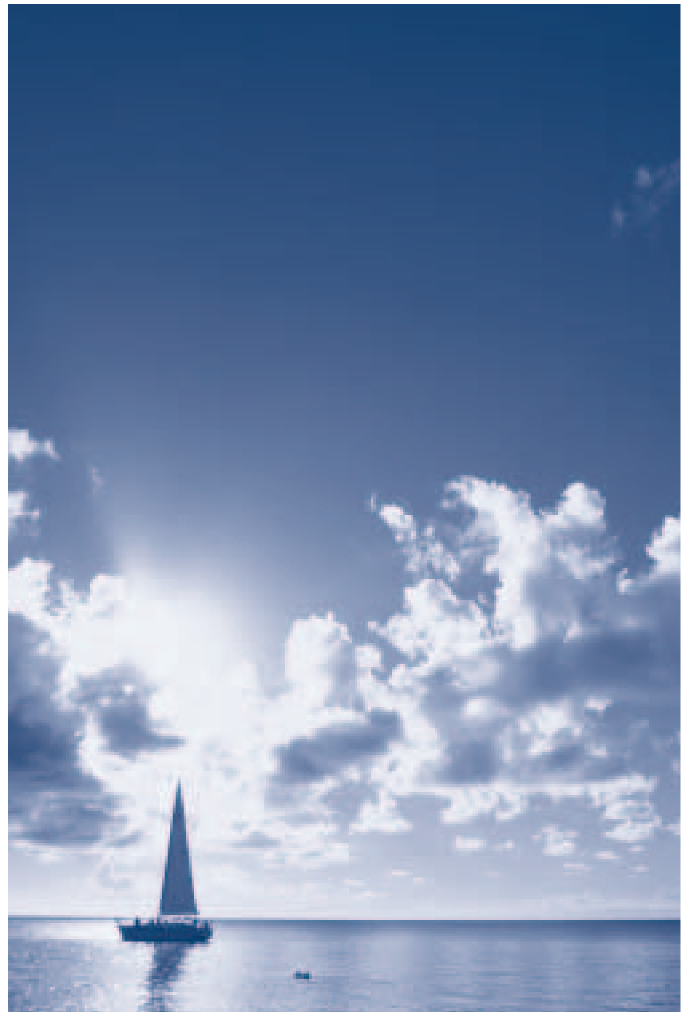
Although you should plan to leave your RSP untouched until retirement, there may be occasions when a withdrawal is necessary. It is possible to withdraw or deregister funds from your RSP at any time, unless held in a locked-in RSP or LIRA. The amount withdrawn must be included in your taxable income in the year of withdrawal.

Amounts withdrawn do not retain their original tax treatment. Thus, whether the withdrawal represents interest, capital gains, dividends earned, or previously made contributions, all amounts are treated as regular taxable income.

When deregistering funds from an RSP, the federal government requires a withholding tax be deducted from the amount withdrawn. The withholding tax rate applied will depend upon the amount withdrawn. The withholding tax is similar to the tax withheld on your salary and is used as a credit to reduce your taxes payable when you file your tax return. **Figure 3** outlines the withholding tax rates applied to withdrawals from an RSP or to RIF withdrawals in excess of the minimum.

FIGURE 3

Amount withdrawn	Quebec	Other provinces
$5,000 or less	21%	10%
$5,001-$15,000	26%	20%
Over $15,000	31%	30%



WITHDRAWALS BY NON-RESIDENTS

Lump-sum withdrawals from an RSP by a non-resident are subject to withholding tax based on the applicable tax treaty. For most countries, including the United States, the applicable rate is 25%.

Limited amounts withdrawn from a RIF (i.e. the greater of twice the minimum amount or 10% of the RIF balance on January 1) and payments from annuities purchased with registered funds may receive reduced withholding tax treatment (i.e. 10% or 15%) for residents of countries with which Canada has an income tax treaty. Note that RIF withdrawals in excess of this special minimum amount are generally taxed in Canada based on the 25% withholding tax rate, as no treaty-based deduction applies to these excess amounts.

8 › RSP MATURITY OPTIONS

There are several maturity options available to allow you access to your RSP assets, each with specific advantages and disadvantages. You can convert all or a portion of your RSP assets to any of the following options. This conversion can occur at any time, but you must convert all RSP assets by December 31 of the year in which you turn age 69.

Option 1: Deregister your RSP and receive a lump-sum cash payment

Option 2: Convert to a RIF

Option 3: Purchase either a life annuity or term certain annuity to age 90

The option(s) that should be chosen depend(s) upon a number of criteria, but simply stated, your decision relates to whether or not you want income now or later, or if you want to maximize your estate for your heirs. Some of the criteria to consider include:

- Personal and family income needs
- Estate objectives
- Required income flexibility versus income guarantee
- Desire to minimize income tax
- Need to protect against inflation

The tax implications of your decision will vary depending upon the option that you choose. A RIF or annuity will continue to provide a degree of tax-deferral since income will be received over a number of years. Lump-sum payments of cash will attract the most adverse tax consequences. Lump-sum payments are generally inappropriate except when the RSP is relatively small.

At maturity, most individuals choose either a RIF or an annuity. The conversion from an RSP to a RIF or annuity occurs on a tax-deferred basis. Also, if converting to a RIF, the investments held in your RSP can be transferred directly into the RIF account. Investments in your RSP do not have to mature or be liquidated prior to transfer to the RIF.

RETIREMENT INCOME FUND (RIF)

A RIF is basically an extension of an RSP except that it is intended to provide an ongoing flow of income. Choosing this option will allow you all the same flexibility provided by the RSP, such as allowable investment types and access to funds. Unlike an RSP, a RIF does require the receipt of at least a minimum annual payment. The RIF option provides the maximum amount of flexibility of the available maturity options, giving you control over the management of your assets, flexibility of annual income and potential tax minimization. The minimum payments from a RIF are shown in **Figure 4**.

When receiving payments from a RIF prior to age 71 or for a RIF established prior to 1993 (for ages under 79), the minimum withdrawal is calculated using the following formula:

$$\text{Market value of the RIF at Dec. 31 of previous year} \times \frac{1}{\text{(90 minus your age* on December 31 of prior year)}}$$

*If spouse is younger, then the younger spouse's age at the end of the prior year can be used to minimize the payment.

Minimum payment percentages for RIFs set up after 1992 are outlined in **Figure 4**. To determine the annual minimum payment, the market value of the plan at the end of the previous year is multiplied by the minimum payment percentage corresponding to the individual's age at the end of the previous year.

FIGURE 4

Required minimum payment as a percent of RIF assets

Age on December 31 of previous year	Minimum payment (%)
69	4.76
70	5.00
71	7.38
72	7.48
73	7.59
74	7.71
75	7.85
76	7.99
77	8.15
78	8.33
79	8.53
80	8.75
81	8.99
82	9.27
83	9.58
84	9.93
85	10.33
86	10.79
87	11.33
88	11.96
89	12.71
90	13.62
91	14.73
92	16.12
93	17.92
94+	20.00

RSP PLANNING TIP

When setting up a RIF, use the younger spouse's age if you want to minimize annual RIF payments.

ANNUITIES

An annuity is essentially a contract between an individual (i.e. the annuitant) and an insurance company, to provide a guaranteed income stream for the individual's life or for a fixed term. When purchasing an annuity, the individual must decide whether all or a portion of their RSP will be used to purchase an annuity. They must also determine the type of annuity that should be purchased based on their retirement and estate objectives. This decision can be complicated since there are many options to choose from. The amount of annuity income received will depend on the annuity option chosen and factors such as life expectancy, current age, sex, health, amount invested and interest rates at the time of purchase. By purchasing an annuity, the annuitant is locking in current interest rates on the investment for the annuity's duration.

Annuities may be purchased from a life-licensed advisor who may obtain the best rate currently available.

Various types of annuities can be purchased with RSP funds including:

- A life annuity, with or without a guarantee
- A joint life annuity, with or without a guarantee
- A term certain annuity to age 90

For more detailed information on the maturity options for an RSP, ask your advisor.

9 › Death of an RSP holder

The treatment of an RSP upon the death of the planholder will depend upon who is the beneficiary of the plan. If the assets of an unmatured plan (called a refund of premiums) are left to a surviving spouse (including a common-law partner regardless of sex), or to a financially dependent child or grandchild, they can be transferred on a tax-deferred basis.

The surviving spouse will receive a T4 RSP information slip and has until December 31 of the year following the year of death to contribute the refund of premiums to one of the following:

- An RSP in the name of the surviving spouse (except where the surviving spouse is over the age of 69)
- A life annuity or a term certain annuity to age 90
- A RIF

The surviving spouse would then deduct the transfer of the "refund of premiums" amount from their taxable income, as they would any other normal RSP contribution, thus avoiding any immediate tax liability.

If the RSP is transferred tax-deferred to a financially dependent child or grandchild that is under age 18, the RSP funds can be used to purchase a term certain annuity with a term not exceeding the child's 18th year. Also, if there is a financially dependent child or grandchild that is mentally or physically infirm, the RSP funds can be transferred on a tax-deferred basis to the child's or grandchild's own RSP. Subsequent income from RSP assets transferred to a financially dependent child or grandchild will be taxed in the hands of the financially dependent child or grandchild.

If someone other than a surviving spouse or qualifying dependent child or grandchild is the beneficiary of the RSP, the RSP must be collapsed and the balance paid to the named beneficiary or to the deceased's estate. The value of the collapsed RSP will be included in the deceased's income on their terminal tax return.

Note that the transfer options that exist for an RSP upon the death of the planholder also exist for a planholder that owns a RIF upon death.

RSP PLANNING TIP

- Where a planholder has died without making his or her RSP contribution for the year, the estate representatives may elect to have a spousal RSP contribution made on behalf of the deceased and claim the deduction (to reduce taxable income) on the last tax return of the deceased. Such a contribution must be made within 60 days after the year end of the year of death.
- On the death of an individual with a locked-in RSP, the locked-in RSP may be rolled over to the spouse's RSP or RIF on a tax-deferred basis. However, some provinces require the funds to remain locked in even for the surviving spouse.
- If you intend to leave your RSP to your spouse, consider naming your spouse as the beneficiary on the account in order to minimize probate taxes. Also ensure that the beneficiary election on your RSP account is consistent with the terms of distribution indicated in your Will.

For more information, speak with an Investment Advisor
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