RRSP Myths and Misconceptions

We thought it would be prudent to review some of the misunderstandings, myths and otherwise wrong assumptions surrounding registered retirement savings plans.

Myth #1
I've Worked, Therefore I Can Contribute

While it is true that one's ability to contribute to an RRSP is based on that individual having earned income, some individuals loose sight of the fact that the income must have been earned in a previous year. This becomes particularly confusing during the first 60 days of the year as individuals have the ability to make a contribution related to two tax years. For example, during the first 60 days of 2006, contributions can be for either the 2006 or 2005 tax year. Individuals making their 2006 contribution will do so based on their 2005 earned income, even though the contribution is being made in 2006.

Myth # 2
A Spousal Contribution Gives Me Twice the Deduction

Although this is incorrect, it is surprising to find out how many people believe this to be true. The simplest way of remembering who can take the deduction is to remember that an individual has only one deduction limit based on him/her having earned income (or carryforwards) from a pervious year. In the case where spouse A wants to contribute to spouse B's RRSP, the contribution must be made based on spouse A's RRSP limit. For example, Jane has a limit (lets say it's $16,500) and can choose to contribute to her own RRSP or to John's RRSP. Even if John also has a limit of $16,500, the most Jane can contribute is still $16,500 based on her own limits. Jane cannot use John's contribution room, although Jane could fund John's contribution but John will get the tax deduction.

Myth # 3
Once I Contribute, I Can't Carryforward

Wrong again. The confusion here though is excusable. There are actually two types of carryforwards. The first kind of carryforward relates to someone not making use of their ability to contribute to their RRSP. Starting with the 1991 tax year, if you were allowed to contribute to your RRSP but didn't, you can carryforward this ability until such time as you have the funds to make the contribution. Unfortunately, many people loose sight of the fact that once the contribution is made the deduction does not have to be claimed and can be carried forward to a future tax year. This can be a good strategy when an individual wants to take advantage of tax-deferred growth now, but knows they will be in a higher tax bracket in the future and will therefore get a better deduction.

ScotiaMcLeod™

Myth # 4
Once I Turn 69, I Can No Longer Contribute to an RRSP

Nothing could be further from the truth. No piece of legislation exists that states that there are any age restrictions on making an RRSP contribution. Whether young or old, individuals can make a contribution as long as they have earned income in a previous year or at least have a carryforward amount from a previous year. What this means of course is that someone who is over the age of 69 who has had to collapse their RRSP can still make a spousal contribution. This of course assumes that (1) the spouse still has an RRSP i.e. is 69 or younger and (2) the contributor is able to contribute because he/she either had earned income the previous year or still has carryforwards that were never used.

Myth # 5
I Can't Contribute in the Year I Convert My RRSP to a RRIF

We're not sure where this one came from but quite simply, it is incorrect. Given that an RRSP must be collapsed by December 31st of the year you turn 69, an individual is able to make an RRSP contribution right up to and including the day the RRSP is converted.

Myth # 6
I Can Use My Spouse's Age to Determine My Minimum RRIF Payment

This is in fact not a myth, but is the absolute truth. This rule however does seem to go unnoticed. An annuitant will of course want to do this where their spouse is younger (in age, not spirit!!), so as to ensure that a lower minimum payment will be received and less tax will have to be paid.

Myth # 7
It Is Possible To Get My Money Out Of an RRSP/RRIF Tax Free

Given that this is impossible, it is surprising how often this gets asked. It is in fact no more possible to get money out of an RRSP tax free, than it is to receive employment income tax free. Those claiming to be able to do so, are in actual fact creating a leveraged asset strategy where the interest on the loan used to invest in a portfolio is used to offset the income from the RRIF. A risky venture to say the least, for those individuals who are retired.

Myth # 8
I Have to Use Cash to Make My RRSP Contribution

You don't have to use cash. You can in fact also use stocks and bonds and make what is known as a "contribution-in-kind". The thing to remember is that the contribution of the asset is considered a disposition for tax purposes and as a result, tax would have to be paid on the capital gain. It is also vital to remember that if a capital loss should result from the transfer, this loss **cannot** be used for tax purposes.

ScotiaMcLeod™

Myth # 9
The Last Day to Contribute Is February 28th

The Canada Customs and Revenue Agency allows an RRSP contribution to take place in the year or within 60 days after the end of the year. Since February has 28 days, the last day to contribute is normally March 1st.

Myth #10
I Can Sell For a Loss and Then Buy Back Within My RRSP

This is actually not a myth. Contrary to popular belief, this is a recognized and acceptable tax planning strategy. You must sell the security first (outside the RRSP) and then reacquire it with cash in the RRSP. If instead, a direct transfer or swap was to take place (and a loss was incurred) the loss would be denied.

Note: The above article is for information purposes only and should not be construed as offering tax advice. Individuals should consult with their personal tax advisors before taking any action based upon the information in this article.

ScotiaMcLeod™