THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

A mix of RRSP tips and traps

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I think you're only as old as you feel, and I'm feeling pretty young still. When I think about what life will be like in 40 years, one thought keeps coming to mind: There are going to be millions of elderly folks walking around with tattoos. That'll be a sight. The good news? I won't be one of them. But I also think about my retirement lifestyle and that of my friends. RRSPs should help with this. Today, I want to share some tips and traps to keep in mind as you plan RRSP contributions by the March 1, 2022, deadline.

1. Over-contributions to an RRSP. You should always know your RRSP contribution limit, which can be found at the bottom of your Notice of Assessment each year, or you can find it online if you login to CRA's My Account portal. You're allowed to over-contribute to your RRSP to the tune of $2,000 (although you can't claim a deduction for this over-contribution), but any amount over that will attract a penalty at the rate of 1 per cent per month of the excess amount.

Now, CRA has the power to waive the penalty tax if you made the excess contributions because of a reasonable error. A recent court decision, however, established that misunderstanding or not knowing the rules about RRSP contributions doesn't constitute a reasonable error. If you've over-contributed, contact your financial institution to withdraw the excess, and then you're required to file Form T1-OVP with the taxman to self-assess the penalty tax, if any.

2. Claiming your RRSP deduction. If you're going to contribute to your RRSP by the deadline, you'll be entitled to claim a deduction for that contribution on your 2021 tax return assuming you haven't over-contributed to your RRSP. But you're entitled to defer that deduction to any future year if you want. It could make sense to do this if you expect your marginal tax rate (MTR) to be higher in 2022.

Suppose, for example, that you contribute $10,000 to your RRSP by the deadline. Let's also assume that your income in 2021 was $60,000 and that you live in Ontario so that your MTR for 2021 is 29.7 per cent. A $10,000 contribution will save you $2,970 if you claim it in 2021. Now suppose that your income for 2022 is going to be higher at, say, $100,000, giving rise to an MTR of 43.4%. Claiming your RRSP deduction in 2022 will save you $4,340 in taxes – 46 per cent more than claiming the deduction in 2021. You can find your MTR by checking a variety of online resources such as www.taxtips.ca, or the tax calculators at www.ey.ca.

3. Business owners and RRSPs. If you're a business owner and have earned income in your corporation, you have a decision to make about what to do with those earnings. If you want to save for retirement, you could pay the earnings out to yourself as salary or dividends and then contribute the amount to an RRSP, or leave the funds in the corporation to accumulate over the years.

The general rule is that paying salary to yourself and then contributing the amount to your RRSP typically makes the most sense if you're going to hold a balanced portfolio. You're likely to accumulate more over the years using the RRSP. In addition, you'll reduce the amount of passive investment income earned in your corporation, which can help to preserve the small business deduction (SBD). The SBD ensures a low rate of tax on the first $500,000 of active business income in your corporation each year, but the SBD can be reduced or eliminated as the corporation's investment income climbs above $50,000 annually.

4. Spousal RRSP contributions. In a perfect world, you and your spouse – if you have one – will have equal incomes in retirement since this will result in the lowest combined tax bill for the two of you. One way to help accomplish this is to have the higher-income spouse contribute to a spousal RRSP. The contributing spouse gets the tax deduction while the other – the spouse receiving the funds – is generally taxed on the withdrawals. Keep in mind that the contributing spouse can only use his or her own RRSP contribution room to make contributions to an RRSP for themselves, or their spouse. You can't use your spouse's contribution room for a spousal RRSP.

Be careful if you contribute to a spousal RRSP at a time when you also owe money to the taxman. Your spouse could become liable for your tax debts to the extent of the contribution. A court decision in Wannan v. The Queen (2003 FCA 423) established that Section 160 of our tax law (which can cause one person to be liable for another's tax debts) can apply in this situation.

More about RRSPs next time.

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