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TAX MATTERS

Seniors can take advantage of RRSPs even after age 71

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My grandfather used to joke about getting older. Old age didn't bother him one bit. In fact, he'd tell me that you get better as you age – unless you're a banana. And getting older can come with some tax perks. Today, I want to share a clever tax idea for those seniors who turned 71 this year or will reach that age in the next year or two.

The scenario

Plenty of seniors continue to work beyond age 65. Some people feel that they need to work for financial reasons, while others want to keep active and full- or part-time work can be a meaningful way to do that. If you're a senior who expects to have earned income after age 71, the idea I'm going to share can save you potentially significant tax dollars.

This idea involves using your registered retirement savings plan while you still have one. Now, you can't keep your RRSP around forever. You're allowed to have one until the end of the year in which you reach age 71, at which time your RRSP matures, so you'll need to wind up your plan by the end of that year. Most people will convert their RRSPs to a registered retirement income fund (RRIF) – but that's a conversation for another day.

Wouldn't it be great if you could continue to claim RRSP deductions even after you reach age 71? You can do this in two possible ways. First, you can continue to contribute to a spousal RRSP if your spouse is still young enough to have an RRSP. You'll get the deduction for this contribution provided you have RRSP contribution room to use up. The other option is the strategy I want to share today, called an "advance contribution" to your RRSP.

The strategy

You'll be able to claim RRSP deductions even after age 71 – beyond the age at which you still have an RRSP – if you make excess contributions to your RRSP before you wind up your plan by the end of the year in which you reach 71, and you still have earned income. So, if you turned 71 this year, you have until Dec. 31 to take advantage of this idea. You'll pay a penalty for any excess contributions you make, but the penalty will pale in comparison to the taxes you'll save. Consider Wendy's example.

Wendy turned 71 this year and will need to wind up her RRSP by Dec. 31. Wendy has continued to work this year and has earned income of $171,000 in 2022. This will provide her with RRSP contribution room for next year of $30,780 ($171,000 times 18 per cent), which is the maximum in RRSP contribution room possible for 2023 (your earned income in one year provides RRSP contribution room for the following year). Now, even if your earned income is not as high as Wendy's, this idea still works. I'm simply showing an example with maximum RRSP contribution room so that you can understand the potential tax savings.

Here's the problem: Even though Wendy has created RRSP contribution room for 2023, she won't have an RRSP around any longer since she turned 71 this year, and has to wind up her plan by the end of the year. But Wendy can still take advantage of her 2023 RRSP contribution room. How? By making her 2023 RRSP contribution in 2022 while she still has an RRSP.

Assuming Wendy has already maximized her RRSP contributions for 2022, making an additional contribution for 2023 before the end of this year will cause an overcontribution to her RRSP and will give rise to a penalty. But the penalty will be just $288. You see, taxpayers are allowed an overcontribution of $2,000 without a penalty, so she'll face a penalty on an overcontribution of $28,780 ($30,780 less $2,000). The penalty is 1 per cent a month, so she'll face a penalty of $288 ($28,780 times 1 per cent) for the month of December.

Here's the best part: On Jan. 1, 2023, Wendy's overcontribution problem will disappear because she'll be entitled to $30,780 of RRSP contribution room on that date thanks to her earned income from 2022. Wendy will be allowed to claim an RRSP deduction in 2023 for the $30,780 RRSP contribution that she will have not yet deducted. This deduction will save Wendy $14,209 in taxes in 2023.

A couple of last points: Wendy will have to file Form T1-OVP to report her overcontribution and pay the penalty. The deadline for this form is 90 days after the end of the year. Finally, if Wendy expects to have more earned income in 2023, she could make an advance contribution to her RRSP before the end of this year for 2024 as well. She'll face penalties for more months in this case, but the tax savings will still make this worthwhile.

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