The trappings of tapping into your RRSP

Tax Talk

Scott Taylor

With the holidays behind us, we'll be entering the next Big Season in Canada: the RRSP push.

Monday, March 2 is the deadline to make registered retirement savings plan contributions that can be deducted on your 2008 income tax return. This year you can contribute up to 18% of your earned income to a maximum of $20,000, plus any unused contribution room from previous years. (Earned income includes salary or wages, but not dividends or investment income). To see your RRSP contribution limit, call Canada Revenue Agency's automated TIPS service at 800-267-6999, or check your Notice of Assessment statement.

Whether you're a sole proprietor, incorporated owner/operator, or company driver, an RRSP is probably the best vehicle you have to reduce your tax obligation. The amount you contribute can be deducted from your earned income, and any income from investments in your RRSP will compound tax-free.

Still, few Canadians take advantage of it. According to Statistics Canada, less than one-third of taxpayers who were eligible to contribute to an RRSP for the 2007 tax year actually did so. The $34.1 billion in total RRSP contributions for that year is equal to just 6% of Canadians' total available contribution room. Nationally, the median RRSP contribution was $2,780.

I doubt these stats will be any better for 2008, a year that had a lot of people thinking about pulling money out of their RRSP to pay off debt or other expenses. But think twice before you call your RRSP administrator about an early withdrawal.

An RRSP is a long-term savings plan. The idea is that by the time you retire you'll probably be in a lower tax bracket than you are now, when you're working and earning income. Funds withdrawn at that time will be taxed at a lower rate.

Generally, you must close out your RRSP by the last day of the year in which you turn 71. But if you take out funds from your RRSP for anything other than retirement, post-secondary education expenses for you or your spouse, or to buy your first home, three things will happen:

1. You'll pay an immediate withholding tax of 10% on withdrawals up to $5,000; 20% on withdrawals of $5,001 to $15,000; and 30% when the amount exceeds $15,000 (in Quebec, the tax is 21%, 26%, and 31%, respectively).

2. The amount you take out will be added to your taxable income. So you'll not only pay more tax, the withdrawal amount may bump you into a higher income tax bracket.

3. The withdrawal amount is not added back to your unused contribution room. Once you take money out of the RRSP, you can't put that sum back in.

If someone says you can take out money tax-free, watch out. An increasing number of RRSP and Registered Retirement Income Fund (RRIF) products are promising tax-free withdrawals, typically involving offshore debit or credit cards, offshore bank accounts, or loan-back arrangements.

Investing in such schemes may result in a reassessment of your tax returns.

Worse, the promoters – who sound slick and professional – may simply disappear along with all of your retirement savings.

If you need to take money out of your RRSP before you retire, talk to an experienced accountant about whether it's the right move for you (it may be).

Better still, that advisor can help you plan for times when cash is tight without having to deal with the consequences of tapping into your RRSP.

Log into CRA's 'My Business Account'

If you bank online – and more than 67% of Canadians do, tops in the world, according to the comScore research firm – you'll quickly catch on to CRA's My Business Account service.

The Internet-based service is a secure and convenient way to transmit corporate tax returns and manage your income, payroll, excise, GST/HST, and other tax accounts.

Your account balances, return status, and statements are accessible online 21 hours a day, seven days a week using a single user ID and password.

You can also transfer payments or credits from one account to another, like when you'd log on to your bank's site to check your balances and pay your credit card bill.

If you like the idea of self-service but would rather have an employee or accountant do the job for you, CRA lets you authorize access to an employee or third-party. For information, visit www.cra-arc.gc.ca.

For security reasons, registration takes time and patience – you may not have access to all of your information until CRA mails you a special code. But the benefits are worth the wait. □

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