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***RRSP*STRATEGY**

Tapped out, but still want to add to your RRSP? Here's how to...

Comb for contributions

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The start of a new year signals a time for renewal, for looking ahead and making plans. And for many of us, it also triggers a mad scramble to reduce our 2012 tax bills by contributing to an RRSP.

Not surprisingly, banks are in full swing, selling us on borrowing so we can catch up on our contributions.

But if you're not keen on a loan (and I will get into the pros and cons of this later), and have already combed your couch for spare change, you may want to consider other financial resources to add to your RRSP.

Contributions in kind

If you own qualifying investments, it's possible to transfer them to an RRSP and obtain a deduction based on their market value. Some contribution candidates include shares that trade on qualifying stock exchanges and Canada Savings Bonds.

To implement this strategy, you'll need to set up a self-directed RRSP. This will allow you to pick and choose your own RRSP investments. These accounts are available from most brokerages on a low-fee basis. Alternatively, it's possible to do a swap for an RRSP's cash or other assets of an equivalent value. In this case, though, a tax deduction will not be received.

Either way, there will be a "deemed sale" based on the current market value of the transferred assets. And if the value is different than the cost, CanRev may challenge the transaction in two different ways:

☞ If the investment has gone up in value, there will be capital gains tax to pay. There is also a chance, however, that you may have offsetting capital losses if you sell off other investments that have gone down in value.

Even if you don't, the contribution itself will shelter at least double the capital gains tax. These contributions may not be a bad idea, especially if you would not otherwise have the resources to make a contribution.

☞ If your investments have gone down since you originally invested, another set of tax rules known as "stop-loss rules" may deny the loss. These rules apply when you sell and you (or an "affiliated person" i.e., a spouse or minor child) reacquire the investment within 30 days. One potential alternative to avoid the stop-loss rules is to sell your shares on the market and have the RRSP reacquire the same investment.

Be warned, though: some CanRev Technical Interpretations suggest that the General Anti-Avoidance Rule might apply in these cases. Whether CanRev would succeed on this basis (especially in light of certain Supreme Court decisions on GAAR), or even bother to make a federal case about your tax file to begin with, is another matter.

Retiring Allowances: A large severance payment may present a great opportunity for a catch-up contribution. Adding the payment to your RRSP may shelter tax that you would otherwise pay on the severance itself.

For longer-standing employ-

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ees, there's another opportunity to add to your RRSP contributions as a result of a severance payment.

This type of payment usually qualifies as a so-called "retiring allowance" if you were in the job during 1995 or previously.

The amount per year that you can contribute to your RRSP – over and above your normal RRSP limits – is $2,000 for each year that you were employed between 1989 and 1995. (For years of service prior to 1989, the extra RRSP contribution room can be hiked from $2,000 to $3,500, except for years where employer contributions to a pension or deferred profit-sharing plan have since been "vested.")

If your employer transfers the retiring allowance directly to an RRSP, withholding on the payment can be avoided.

Otherwise, you must make the retiring allowance contribution by the normal RRSP deadline for the year in which it (the allowance) is received. By the way, you can't contribute a retiring allowance to a spousal RRSP.

Should I borrow to make an RRSP contribution?

Borrowing funds for an RRSP doesn't sit well with many people. When you think about it, however, making an RRSP contribution instead of paying down your mortgage is, in effect, similar to borrowing for the purpose of an RRSP contribution (i.e., by leaving your mortgage outstanding).

So, borrowing may make sense if you think you can earn a better return on your RRSP than the interest you pay. This holds especially true for those who expect their tax bracket to drop when they retire, and includes borrowing to make a catch-up contribution.

Figure out whether your tax bracket will drop after retirement, and watch out for hidden taxes e.g., Old Age Security and other items that are subject to "clawbacks" as income increases.

Although there is something to be said for this strategy, it is not necessarily at the top of my list. Yet the advertisements put out by some banks would lead you to believe that it's a no-brainer.

But much of this advertising focuses on your short term position and leaves out the tail-end tax effects of the RRSP-loan gambit – thus conveniently omitting the biggest downside of the strategy.

Bottom line: while this may not be a bad idea if you can pay down your loan in the not-too-distant future, longer-term loans do not make sense unless you are confident you can earn more on your investments than the interest charged.

This pretty well rules out any interest-bearing investments, which means you're leaving yourself open to more risk by investing in the stock market.

An RRSP mortgage: Another option is to have your RRSP make you a loan secured by the mortgage on your home. This can be permissible if the mortgage loan from your RRSP is insured and you pay your RRSP interest at the market rates in effect at the time the RRSP loan is made.

By the way, this strategy can be used for other things besides making a catch-up contribution; for example, simply paying down an existing mortgage.

Slash your source deductions: One rather unlikely place to find cash could be the source deductions withheld on your paycheque. Many people regularly get tax refunds because of deductions such as support payments and carrying charges on investments.

This may give you a good feeling when you file your tax return, but the truth is that you are really lending the government money – your money – on a largely interest-free basis. In fact, by the time you get your refund, CanRev could have had the use of your money for up to a year and a half – money that could come in handy at this time of year to pay for holiday spending or winter vacations.

If you're in this situation, simply fill out Form T1213, which can be found on the CRA website (*www.cra-arc.gc.ca*), and file it with the Client Services Division of your local CRA Tax Services Office.

If CRA approves your request, they will notify you in writing within four to eight weeks. Note that the CRA will most likely not approve your request if you owe tax or have a tax return which is overdue for filing.

Once you receive written notification from the CRA, present it to your employer, who should then reduce withholding accordingly.

You usually have to file this request each year. However, if you have deductible support payments that are the same or greater for more than one year, you can make this request for two years.

Most tax offices are quite cooperative when it comes to this procedure. According to CanRev, there is no specific minimum amount below which they will not consider an application.

Note that occasionally the personal exemptions on which your source deductions are partly based may change. If so, you should fill out form TD1 with the revised exemptions and give it to your employer who will adjust your source deductions in accordance with the revised information. In this case, Can-Rev approval is not required.

One item that may get you a source-deduction slash is an early RRSP contribution for 2013. Contributing early in the year also means your earnings will compound on a tax-sheltered basis sooner rather than later.

One word of caution: if your refund is based on something you don't want the feds looking at, you may want to think twice before you apply for a source-deduction slash; it is possible that your application could result in scrutiny of the items on which your claim is based. So if you are making aggressive claims, it may be best to leave well enough alone.

Inheritance advances: If you receive an advance on an inheritance as a gift rather than a loan, and you are married when this happens, the advance should be documented so that the gift (and subsequent income earned on it) is not subject to a spousal claim in the event of marital difficulties. ❐