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*RRSP*PLANNING

Advice for last minute contributors

RRSP Tips

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By the time you read these actual words, the deadline for RRSP contributions for 2009 may only be a week or two away.

March 1 is fast approaching, so before you start panicking, take a deep breath and read on as I run you through some key last-minute RRSP tips before the clock strikes midnight.

Tip #1 - Take full advantage of spousal RRSPs

A spousal RRSP is simply an RRSP in which you make the contributions, but the plan is in your spouse's name - i.e., owned by your spouse. It's a relatively straightforward way to split income.

When you contribute to an RRSP in your spouse's name, you receive a personal tax deduction. But since the RRSP belongs to your spouse, amounts received from the plan generally will be taxable to your spouse, not you.

The purpose of a spousal RRSP is to allocate taxable income as evenly as possible between you and your spouse, so that you will both be in a fairly modest tax bracket.

If your spouse will be in a lower tax bracket than you when the RRSP is paid out, a spousal RRSP makes sense because withdrawals eventually will be taxed in his or her hands.

Another advantage is that the maturity deadline of a spousal RRSP is based on the age of the spouse. So if you're too old to contribute to your own RRSP, it may be possible to continue to contribute to a younger spouse's RRSP.

Of course, you must have what's known as "earned income." This can include employment or business income, alimony received and rental income, to name a few. Some sources don't apply, like investment income.

A spousal plan may also be a good idea if the spouse contributing is concerned about potential creditor problems.

There are rules relating to "quick withdrawals." Amounts withdrawn from a spousal RRSP must be included in the income of the spouse contributing to the extent of tax deductible contributions either in the year of withdrawal or in the previous two years.

This includes "lump sum" RRSP withdrawals made after the plan has matured.

Note – to the extent that you are pension splitting (i.e. where up to half of eligible pension income, including RRSPs, is allocated to a lower-income spouse or partner), the spousal RRSP may not give you any additional benefit.

Tip #2 - Make "Catch-up" Contributions.

If you haven't "maxed out" your RRSP contributions in the past (going back to 1991), you're entitled to make an additional contribution over and above your normal limit for the year.

That's because, (since 1991 onwards), your "unused" RRSP contribution limit can be carried forward indefinitely to future years.

Of course, one of the biggest barriers between you and your write-off could be finding the means to make a catch-up contribution.

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Possible sources for your catch-up contribution could include inheritances, contributions in kind, an RRSP mortgage or borrowing.

Note: If you make a very large RRSP contribution, you could be subject to the so-called "Alternative Minimum Tax."

But even so, the extra tax you pay can be applied to reduce your future regular taxes. In the meantime, your RRSP nest egg will be earning income on a tax-sheltered basis.

Another thing to bear in mind is that, the higher your tax bracket, the more effective your RRSP contribution will be.

So a low-income year may not be a good time to make a catch-up contribution.

If your annual income is such that you're not "too far into" a particular tax bracket, you may want to make a series of RRSP contributions which take you down to the "bottom of the bracket."

Another alternative could be to make a lump-sum contribution but defer the actual deduction until a year when you're in a higher bracket.

Tip #3 - Put the high tax stuff in your RRSP.

As I wrote in the January issue of *The TaxLetter*, you should hold high-tax investments in your RRSP and low-tax investments outside your plan. But which investments are high-tax?

Traditionally, these have been interest-bearing investments like bonds and GICs. Stocks and equity funds, on the other hand, may qualify for capital gains treatment (50 per cent of a capital gain is tax-free), as well as the dividend tax credit if the investment is Canadian.

These benefits are lost if you hold them in your RRSP, since retirement and other amounts you receive from your plan are fully taxable.

So if you have investment capital both inside and outside your RRSP and you wish to invest in both equities and fixed-income investments, it is generally better to hold the former outside your RRSP and the latter inside your plan.

Tip #4 - Building in Contribution Room for your family.

Another great tax tip involves paying your children a salary if you have a business. This would not only create contribution room for your kids but also result in a deduction to your company (note – make sure the salary is not unreasonably large).

Every person (including children) can receive up to $10,382 for the year 2010 without paying tax by claiming the basic personal tax credit.

Moreover, the salary your child receives should qualify as "earned income," so that he or she will be entitled to make an RRSP contribution based on 18 per cent of the salary, and this can be carried forward over the years.

For example, if you had two children and paid each child $10,000 a year for ten years, and this was their only income, no tax would be paid.

However, each child would then be eligible for a tax write-off of $18,000 over the ten years because of the RRSP carry forwards, which could be used to reduce their taxes when they have higher incomes.

So your two kids, together over the ten years, could be in a position to claim write-offs of $36,000 – and your business would have enjoyed lucrative write-offs in the meantime.

Strategy #5 - Don't wait to contribute.

Okay, this tip is pretty obvious, especially if you haven't yet contributed and we're now in the home stretch. But you'd be surprised how many people wait until the end of the business day on February 28.

But, if you happen to have already made your contributions for the year, this tip is still worthwhile since there's no time like the present to start contributing to your 2010 RRSPs.

If you have the cash available now, don't wait until next February to contribute to your 2010 RRSP.

Why pay tax on your interest income while it is sitting in your bank account, when you could be sheltering it from taxes in your RRSP? ❑