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Answering your RRSP questions

Abbreviations used in this bulletin

CCPC - Canadian Controlled Private Corporation
CCPC - Canadian Controlled Private Corporation
CCRA - Canada Customs and Revenue Agency
CDIC - Canada Deposit Insurance Corporation
DPSP - Deferred Profit Sharing Plan
GIC - Guaranteed Investment Certificate
LSVCC - Labour Sponsored Venture Capital Corporation
PA - Pension Adjustment
PAR - Pension Adjustment Reversal
RPP - Registered Pension Plan
RRIF - Registered Retirement Income Fund
RRSP - Registered Retirement Savings Plan

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RRSPs are an important component of an overall financial plan for most Canadians. As we struggle with high personal taxes and a fear that our government will not be able to provide adequate pensions for us in retirement, RRSPs offer a great opportunity to save taxes currently, and provide for our retirement needs.

This bulletin explains the rules for RRSP contributions, the types of investments an RRSP can hold and the ways in which RRSP withdrawals can be made. We have done this in a question and answer format, attempting to anticipate the questions that you might have about your RRSP.

Although we have tried to deal with as many issues as possible, you may have a question which is not covered by the material in this bulletin. Contact your BDO advisor for help with any RRSP concerns you may have.

What is an RRSP?

An RRSP is simply a contract or plan between you, the plan "annuitant," and the plan "issuer," usually a financial institution. You make contributions to the plan over a period of years; these contributions are invested and earn income, providing you with savings to live on in your retirement.

RRSPs provide three main benefits in helping you save for your retirement:

1. You get a tax deduction for the amounts contributed (up to certain limits). Therefore, you can effectively set aside a part of your income each year to save for retirement on a pre-tax basis.
2. Earnings on the assets in your RRSP accumulate tax-free. This helps the size of your RRSP grow faster - savings compound much more quickly if the return is not subject to tax.
3. RRSP funds are only taxed when withdrawn. This can mean real savings if you withdraw the funds in years when your income (and marginal tax rate) is lower, such as when you retire.

There are many different RRSP investment alternatives available to you. Through banks, trust companies, credit unions and other financial institutions, you can put your money in interest-bearing investments such as guaranteed investment certificates (GICs) and daily interest savings accounts. As well, you can invest in mutual funds through most financial institutions and mutual fund companies. If you want to hold a wider variety of investments in a plan, you can use a self-directed RRSP.

The PA is a measure of the benefits that accrued to you as a member of an employer-sponsored pension plan (see A3).

For instance, your 2002 RRSP contribution room is 18% of your 2001 earned income to a maximum of $13,500. This is reduced by your PA for 2001. Your 2003 RRSP contribution room is 18% of your 2002 earned income, to a maximum of $13,500, less your 2002 PA. RRSP limits have been frozen at $13,500 up to and including the year 2003.

Contribution limits

Year	Maximum contribution	Earned income required in preceding year for maximum contribution
2002 *to* 2003	$13,500	$75,000
2004	14,500	80,556
2005	15,500	86,111
2006	*Indexed*	*Indexed*

A2. What is "Earned Income?"

Your RRSP limit for a given year depends on your "earned income" for the previous year. Generally, this includes active income such as employment earnings and business income, but does not include most types of passive income including interest, dividends and capital gains from investments.

Specifically, earned income includes:

- salaries and wages, net of employment expenses claimed,
- research grants,
- royalties (eg. on patents),
- net income from self-employment,
- net rental income from real property,
- alimony and maintenance received, and
- supplementary unemployment benefit plan payments.

Your earned income is reduced by:

- rental losses from real property,
- losses from self-employment, and
- alimony or maintenance payments made.

A3. What is a "Pension Adjustment" (PA)?

The PA is what puts everyone on an equal footing in terms of annual RRSP contribution room. It's the value of the pension benefits that accrue to individuals who are members of employer-sponsored Registered Pension Plans (RPPs) or Deferred Profit Sharing Plans (DPSPs). PAs reduce their RRSP contribution limits since they are earning pension benefits through their employers' plans.

If you're not a member of an RPP or a DPSP at work, you can ignore PAs. Your RRSP limit is calculated as explained earlier. However, if you do belong to an RPP or DPSP, your employer must calculate your PA and report it to the Canada Customs and Revenue Agency (CCRA) on your T4 each year. The CCRA then takes 18% of your earned income for the year (up to the maximum limit) and reduces it by your PA, to determine your RRSP contribution limit for the following year.

How are PAs calculated? If you're a member of a money purchase RPP or DPSP, your PA is the total of your contributions to the plan and those of your employer. If your RPP is a defined benefit plan, your PA is determined by a formula designed to reflect the pension benefit entitlement you earned in the year.

	2002 Contribution	2003 Contribution
Based on:	18% of 2001 earned income (max. $13,500) less 2001 PA	18% of 2002 earned income (max. $13,500) less 2002 PA
Arises:	January 1, 2002	January 1, 2003
Contribution deductible in year if made by:	March 1, 2003	February 29, 2004

A4. I've just left a job where I was a member of a defined benefit RPP. The pension benefits I am entitled to are far less than the total PAs which have reduced my RRSP contribution room over the years. Is there any way to correct this problem?

In many cases, the accumulated PA that has reduced your RRSP contribution room has not been fair. If you leave an employer where you were a member of a defined benefit RPP, the accumulated PAs are often greater than the pension benefits to which you are entitled. This is usually the case for younger individuals; your former employer's contributions to the plan on your behalf are very low because they would not have had to provide you with pension benefits for many years.

The Pension Adjustment Reversal (PAR) is intended to address this inequity. The PAR is the amount that the PA exceeds the actual amount of contributions that you will realize if you quit. In other words, this is the amount of lost RRSP contribution room that you should get back. Your PAR will be calculated by your pension plan administrator and added to your RRSP contribution room in the year you leave. This means that it could be used to top up your RRSP contribution to defer tax on any severance package you may be getting.

A5. Do I have to calculate my RRSP limit each year?

No. The CCRA calculates your contribution limit for the upcoming year and reports this limit to you on the Notice Of Assessment that you receive from the Agency after you file your income tax return. The CCRA will also include any amounts you can contribute because of undercontributions in prior years (see A11).

A6. When does my contribution room for a given year become available?

Your contribution room for a given year generally arises on the first day of the year. This is because the amount is based on information from the prior year, and can be determined on January 1st. For instance, your contribution room for 2003 arises on January 1, 2003. From that point on, you are entitled to contribute this amount to your RRSP without penalty. Once the contribution is made, you can deduct it in the current year or any future year. As discussed in A4, an exception to this general rule does apply for PARs, which are added to contribution room during the year, as they arise.

As a practical matter, however, you may not know your RRSP limit until a few months into 2003. Remember, it's based on your PA and earned income for 2002. Your PA will only be available when you get your T4, which is normally in late February, 2003. Also, you'll generally only calculate your earned income for 2002 when you prepare your income tax return, which is due April 30th, 2003 (June 15th, if you have business income). If you rely on the CCRA to advise you of your RRSP limit, you'll have to wait until your tax return for 2002 has been assessed, which could be several weeks or months after you file.

However, if you know your earned income for 2002 is high enough and you're not a member of an employer-sponsored RPP or DPSP, your RRSP limit for 2003 would be the maximum amount of $13,500. You could contribute this amount on January 1, 2003.

A7. When should I make my RRSP contribution?

RRSP contributions can be made at any time. However, to take full advantage of the tax-deferred compounding of income in your RRSP, your contribution for a particular year should be made as early as possible in the calendar year. If you make your contribution for the year in early January instead of at the end of February of the following year, you will benefit from more than an extra year's compounding of income for each contribution which could make a significant difference in the value of your RRSP when you retire.

Assume that you contribute $10,000 to your RRSP annually and that you will earn an 8% return on these funds. If you contribute the $10,000 at the start of each year, your RRSP will be worth about $494,000 at the end of the 20th year. However, if you wait until the end of each year to contribute, you will only have about $458,000 in your RRSP at the end of the 20th year. By contributing at the start of the year, your RRSP will be larger by $36,000.

You might find it difficult to come up with a lump-sum RRSP contribution all at once. You can pre-arrange monthly contributions with most RRSP issuers. You can also reduce the money you need to make your contributions by getting the benefit of your tax deduction when you make the contribution. If you write to the CCRA and provide them with evidence of your contributions, such as receipts, they will write a letter to you which you can give to your employer authorizing them to reduce the income tax withholdings from your salary. If you contribute to a group RRSP at work, your employer can automatically reduce your income tax withholdings, taking your contributions into account. In addition, if your employer will agree to pay part of your salary or an amount, such as a bonus, directly to your RRSP, they will not have to withhold tax on this payment provided that the amount contributed does not exceed your RRSP deduction limit (as reported to you by the CCRA each year on your Notice of Assessment).

A8. When can I deduct my contribution?

To be deductible for a particular taxation year, a contribution must be made on or before the 60th day of the following year. Therefore, the last day an RRSP contribution can be made to be deductible for 2002 is March 1, 2003.

A9. Can I make an RRSP contribution now and deduct it in a future year?

RRSP contributions do not have to be deducted in the year in which they are made. The contributions can be deducted in that year or in any future year. You should consider deferring the deduction of your contribution if you don't have much taxable income in the current year. By deferring the deduction to a year when your marginal tax rate is higher, you will save more in taxes. Remember, however, that delaying the deduction has a cost in prepaid tax as you will not be getting the benefit of the deduction until the future. Therefore, you also have to consider the time value of money when making the decision to defer the deduction of your RRSP contributions.

A10. Should I borrow to make my RRSP contribution?

Interest on money borrowed to make your RRSP contribution is not deductible for tax purposes. Therefore, whenever possible, you should use cash to make your RRSP contribution and borrow to make other investments.

In some cases, however, it can make sense to borrow to contribute to your RRSP. Remember that the income earned on an RRSP investment accumulates on a tax deferred basis. If you can pay off your loan quickly, particularly if you are getting a tax refund, the non-deductible interest expense can be minimized.

For example, let's assume that you want to make a $10,000 RRSP contribution for 2002 by the deadline of March 1, 2003. Assuming a top marginal rate of 45%, this will generate a tax refund of

about $4,500 for you. If you borrow the $10,000 to make the contribution, you will be able to pay back 45% of the loan as soon as you get your refund.

A11. Can I carry forward my unused RRSP contribution room to a future year?

If you don't make an RRSP contribution this year or you contribute less than your maximum limit, the unused amount is carried forward and can be used in any future year. The carryforward rules began with the 1991 contribution limit. The RRSP contribution room that the CCRA shows on your Notice of Assessment includes all your unused room that carries forward from prior years.

A12. How many RRSPs can I have?

There is no limit on the number of RRSPs you can have. The limits are on the total amount you can deduct. However, most people find it simpler to have only one or two plans, making it easier to keep track of their RRSP investments.

If you are investing in assets which are insured by the Canada Deposit Insurance Corporation (CDIC), it may make sense to have more than one RRSP with different RRSP issuers. The CDIC only insures up to a specified limit of assets with each member financial institution. Therefore, by having RRSPs with more than one institution, you can increase the amount of your investments that are covered by the CDIC. Assets covered usually include bank or trust company deposits and GICs, but not mutual funds.

A13. Can I contribute to my spouse's RRSP?

If you have available RRSP contribution room, you can make a contribution to your RRSP or to an RRSP for your spouse (often referred to as a spousal RRSP). A contribution to a spousal RRSP will qualify as a tax deduction for you as long as your total contributions to your plan and a spousal plan do not exceed your contribution limit for the year. For 2001 and subsequent taxation years, a spouse includes a same-sex partner. In certain circumstances, a joint election may be made so that this new rule will apply to 1998, 1999 or 2000.

A14. Is it better to contribute to my spouse's RRSP?

The main benefit of a spousal RRSP is that it will allow income splitting in the future, at retirement, since withdrawals will usually be taxable in the hands of your spouse.

When deciding whether to contribute to either your RRSP or to a spousal RRSP, you should attempt to estimate both your and your spouse's income from all sources in retirement. Your goal should be to equalize these incomes at that time - by doing so you will achieve income splitting which will minimize your taxes in your retirement years.

A15. What happens if my spouse makes an RRSP withdrawal?

If you have made a contribution to your spouse's plan in the current year or in either of the two preceding years, a withdrawal by your spouse from a spousal RRSP is taxable to you to the extent of the contributions made during the three-year period.

Note that this rule does not apply to all RRSPs held by your spouse. The attribution of RRSP withdrawals to you will not apply if you contribute to a spousal plan and your spouse withdraws funds from an RRSP that they contributed to (i.e. not a spousal RRSP). For this reason, it is usually a good idea to set up a new plan for spousal contributions.

This attribution rule also does not apply if, at the time of withdrawal, and as a result of the breakdown of your marriage, you and your spouse are living separate and apart pursuant to a court order or written separation agreement. In addition, the rules do not apply where your spouse receives funds from the RRSP in the form of a regular annuity which cannot be commuted.

If your spouse is planning to make an RRSP withdrawal from a spousal plan, you should not make a

contribution to a spousal RRSP. This may be the case if your spouse will have low taxable income in the near future (for example, a maternity or paternity leave). However, if you're sure the attribution rule will not be a concern, you may want to use only one RRSP for your spouse (to which you and your spouse can contribute) to reduce RRSP fees that you have to pay (see B2).

A16. What happens if I overcontribute to my RRSP?

If you contribute more than your contribution limit, you will be subject to a 1% penalty tax per month to the extent that the overcontribution amount exceeds $2,000. This penalty tax is expensive, ensuring that it is not worthwhile to make overcontributions above this limit.

A17. Should I make a $2,000 overcontribution to my RRSP?

You can make an extra one-time $2,000 overcontribution to your RRSP without being subject to the 1% per month penalty tax on overcontributions. This will enable you to shelter the income on the $2,000 from tax.

The $2,000 cushion is intended as a protection from inadvertent overcontributions. Therefore, if you use up the cushion, you have absolutely no margin for error left. This would usually only be a concern for members of pension plans, but could also cause problems for other individuals.

Also note that if you decide to take the $2,000 out of your RRSP, the withdrawal will be taxable without you ever having received the benefit of a tax deduction for the contribution. Although it is possible to remove inadvertent overcontributions from an RRSP without tax (an offsetting deduction is provided), this remedy is not available where the overcontribution was made intentionally.

There is a solution to this problem. You can deduct any contribution made in a prior year to the extent it was not previously deducted, provided you have unused contribution room. Therefore, the $2,000 could be deducted in a subsequent year by treating it as part of that year's contribution limit. In fact, you could even deduct it after you reach 69 (which is the year in which you must collapse your RRSPâ??see A18) if you still had earned income in the prior year. Of course, if the $2,000 stays in your RRSP long enough, the advantage of tax-free compounding of income will outweigh even the disadvantage of having the undeducted amount taxed on withdrawal.

A18. How long can I continue to contribute?

At the end of the year in which you reach age 69, your RRSP matures and the funds in your plan must be removed. We discuss the options you have under "Making withdrawals from your RRSP."

However, if you still have unused RRSP contribution room, or will continue to generate earned income, you can make RRSP contributions to a spousal RRSP after the year in which you turn 69. Remember that your spouse must be under 70 for this to be possible - at the end of the year in which your spouse turns 69, his or her RRSP will mature as well.

A19. Should I pay down my mortgage before making RRSP contributions?

This is not an easy question. You will probably want to discuss your situation with your BDO advisor.

Mathematically, you can calculate which alternative is better, given assumptions about mortgage rates and the rate of return in your RRSP. Most analyses conclude that it is better to pay off your mortgage first, assuming that the rate of return of the investments in your RRSP does not exceed your mortgage rate. However, there are many other factors that you should consider as well. Will you be able to "catch-up" on your RRSP contributions once you have paid off your mortgage? Will you need the funds in your RRSP for emergencies? Do you want to diversify your investments rather than placing all your available cash in your home? These are all questions that should be asked when making this decision.

Keep in mind, however, that having the discipline to save money, either by paying down your mortgage or putting money in your RRSP, will mean that you will increase your net worth in the long run. Paying off your mortgage and saving for your retirement are important components of any good

financial plan.

A20. Can I transfer pension income or retiring allowances to my RRSP?

Prior to 1995, it was possible to transfer up to $6,000 of pension income annually to your spouse's RRSP. However, this transfer is no longer available.

A retiring allowance, which is an amount received by you on retirement or as compensation for the loss of employment, can be transferred to an RRSP. The eligible amount that can be put into your RRSP is equal to $2,000 for each year of employment before 1996 (due to changes announced in the 1995 budget, no amounts can be transferred for years of service after 1995). An additional $1,500 can be transferred for each year before 1989 where your employer's contribution to an RPP or DPSP had not vested at the time of your retirement or termination. This transfer can be made directly by your employer to your RRSP, eliminating the requirement that tax be withheld at source. You can also transfer amounts you actually received during the year. Any eligible amount must be contributed to your RRSP in the year or within 60 days of the end of the year.

In addition to this special rollover, you may want your employer to contribute more of your retiring allowance to your RRSP, if you have unused RRSP contribution room. You no longer have to get a waiver to reduce tax on these amounts, provided that the employer contribution to your RRSP does not exceed your RRSP deduction limit. When the two rules are combined, no income tax has to be withheld if the amount your employer transfers directly to your RRSP does not exceed the total of your special rollover and your RRSP deduction limit.

Investing and managing your RRSP

B1. How do I set up an RRSP?

Setting up an RRSP is easy. Most banks, trust companies, credit unions and other financial institutions can act as a plan issuer.

There are different types of RRSPs you can have. The plan you choose should suit your investment needs.

Depository RRSPs are the most basic; your RRSP funds will be on deposit with your RRSP issuer and you will be able to invest in any type of eligible product they sell. For example, you can have a depository RRSP with your bank and invest your money in the bank's GICs. These investments are usually insured by the CDIC up to specified limits.

You can also have a trusteed RRSP. Your RRSP issuer will appoint a trustee who will hold your RRSP assets "in trust" for you. With these types of RRSPs, you have more flexibility in the types of investments you can make. With certain trusteed plans, you are limited to the investment products and mutual funds that your RRSP issuer offers. Under fully self-directed RRSPs, you can invest in any eligible RRSP investment; these types of RRSPs are generally held with securities brokers who can sell you any qualifying security or investment product. Investments held in trusteed RRSPs, such as mutual funds or specific securities, are usually not insured by the CDIC.

B2. What kind of fees apply to RRSPs?

There can be several types of fees associated with RRSPs. These fees are usually higher for trusteed plans.

Fees are usually charged if you make withdrawals from your plan, or your plan is wound up or transferred to another RRSP issuer. These fees usually range from $25 to $100.

In addition to these fees, there are annual administration fees associated with trusteed RRSPs. For self-directed plans, these fees usually range from $100 to $200 annually. These fees are not deductible for tax purposes. If they are paid with RRSP funds, this will simply reduce the amount available for future withdrawal.

You should always be clear as to what fees will apply to your RRSP before you invest, in order that

you will know the annual costs and the cost of winding up your plan.

B3. What investments can I hold in my RRSP?

Your RRSP can hold any type of investment. However, you should restrict your RRSP holdings to qualified investments only, in order to avoid adverse tax consequences. Fortunately, a wide range of investments qualify for your RRSP:

- cash and bank, trust company or credit union deposits, including GICs.
- cash and bank, trust company or credit union deposits, including GICs.
- shares listed on most foreign stock exchanges.
- shares or units of Canadian-based mutual funds which meet prescribed guidelines (mutual funds are certified as RRSP eligible by the CCRA).
- shares of Canadian public corporations which are not listed on the stock exchanges above.
- options on the purchase of eligible investments.
- most government debt and debt of corporations listed on the Canadian stock exchanges described above.

If a non-qualifying investment is acquired by your RRSP, the value of this investment will be included in your taxable income. Any income you earn on this investment will also be taxable. You will get a tax deduction when your RRSP disposes of the non-qualifying asset.

B4. Should tax considerations affect my RRSP investment strategy?

Normally, you will want to choose RRSP investments that maximize your return and stay within your risk tolerance. While equities hold out the promise of higher returns, they are more volatile than bonds or GICs. Most people prefer to hold a larger percentage of equities in their RRSP when they are younger and are willing to take more risks and then gradually convert to more stable, income producing investments as they near retirement.

Tax can, however, play a part in your investment decisions if you have investments inside and outside of your RRSP. Remember that income earned and capital gains realized in your RRSP are not taxed until they are withdrawn from your plan, usually after you retire. Therefore, from a tax point of view, there is a bias to hold income producing investments such as GICs inside your RRSP as the interest income will be fully taxed if they are held outside of your RRSP. Similarly, it makes sense to hold investments that produce capital gains outside of your RRSP, as tax only has to be paid on 50% of the gain, effective for gains realized after October 17, 2000 (prior to October 18, 2000, higher capital gains inclusion rates applied).

You can break down your investment decisions from a tax perspective even further. Capital gains are only taxed when they are realized (that is, when you sell your investment). If you invest in stocks that you expect to sell in the short-term outside of your RRSP, capital gains will be realized that will be taxable, reducing the funds you have to invest. However, if you invest in stocks that you expect to hold for several years, any capital gains that accrue will not be subject to tax until you sell. Therefore, from a tax perspective, it makes sense to hold stocks that are short-term holds in your RRSP, where the tax on capital gains will be deferred, and to hold stocks that are long-term holds outside of your RRSP.

Keep in mind that tax advantages can sometimes conflict with other objectives for your RRSP investments. Although it makes sense to invest in stocks that are short-term holds in your RRSP, these investments usually are more risky and may conflict with your objective to have stable investments in your RRSP. In addition, if you incur losses on investments held in your RRSP, the losses will not be tax deductible - they will reduce the size of your RRSP that will be available to you in your retirement.

Your primary concern in choosing investments for your RRSP should be to maximize your return while staying within your risk tolerance. However, tax can play a part in making these investment decisions. Contact your BDO advisor if you have any questions about the type of investments that you should be making in your RRSP.

B5. How much of my RRSP can be invested in foreign property?

Foreign property generally includes foreign currency, shares and debt obligations of companies listed on most foreign stock exchanges, including mutual funds that invest in these assets, and debt obligations of certain foreign governments. These assets are qualifying RRSP investments; however, there are restrictions on the amount of your RRSP that can be invested in this type of property. Only 30% of the total cost of all the assets in your RRSP can be invested in foreign property, effective for taxation years after 2000 (prior to 2001, lower limits applied). If you exceed the foreign content limit, you will be charged a 1% penalty tax per month on your excess foreign investments. This penalty tax makes it worthwhile to stay within the threshold.

The foreign content limit is based on the cost of the assets in your RRSP. Let's assume that your RRSP has assets that cost $100,000 when they were purchased. This means that the cost of the foreign property in your RRSP cannot exceed $30,000 in 2002. Even if the total assets are worth $150,000 in 2002, the cost of your foreign property is still limited to $30,000.

This means that you have to carefully monitor the foreign content limit if you invest in foreign property in your RRSP. Every time your RRSP sells an asset or you make an RRSP contribution, your foreign content limit will change because the cost of the assets in your RRSP will change. For example, if you sell a Canadian asset which has declined in value and purchase another Canadian asset, the total cost of plan assets has decreased which may put your plan over the foreign content limit.

B6. How can I maximize the foreign content of my RRSP?

There are several methods of increasing foreign content while still remaining within the foreign content limit. These include:

Invest in Options.

If you buy call options on foreign securities rather than the securities themselves, you can still participate in the appreciation of the underlying security. As the cost of an option is usually only a fraction of the cost of the actual security, this will allow a greater investment in other foreign securities.

Invest in Mutual Funds.

You can increase your foreign content by holding certain mutual funds. Mutual funds can hold foreign content up to the limits discussed above and still be qualified investments for RRSPs. For example, in 2002 you could hold (on a cost basis) 30% of your RRSP directly in foreign property and the balance in mutual funds which have an additional 30% of their assets in foreign property. This would give you an effective foreign investment in your RRSP of 51% (your 30%, plus 70% of the 30% held by the fund). Mutual fund issuers have recognized this potential and have structured funds to take advantage of this. Some hold options on foreign property to further increase foreign participation.

Sell assets with accrued gains.

You can increase your foreign property by selling Canadian investments with an accrued gain and repurchasing them or purchasing other Canadian properties. This will increase the cost of Canadian properties, which will allow you to increase your investment in foreign properties.

Invest in multinational Canadian corporations.

Many companies trading on Canadian stock exchanges are multinational companies with businesses all over the globe. The shares of these companies are not usually considered to be foreign property (note that in some cases shares listed on a Canadian stock exchange can be considered to be foreign property). By investing in these companies in your RRSP, you will effectively be increasing the foreign content of your RRSP.

Consolidate RRSPs.

The foreign content limit applies on a plan-by-plan basis. If you hold an RRSP where the limit has not been fully utilized, you can't invest additional funds in foreign property in another RRSP.

Consequently, maximizing your overall RRSP foreign content is made easier if you consolidate your RRSPs.

Invest in a Labour-Sponsored Venture Capital Corporation (LSVCC) or a CCPC (see B9 and B10).

If you invest in an LSVCC or have a qualifying investment in a CCPC, you will increase your foreign content limit by an amount of up to three times the cost of your LSVCC or qualifying CCPC investment to a maximum of 50% of the cost of all investments in your RRSP in 2001 and subsequent taxation years.

Foreign currencies can be held in your RRSP as foreign property. Note that it is possible to hold investments which qualify as Canadian property but which are denominated in foreign currencies; for example, the Canadian government issues bonds which are denominated in US dollars. Be careful when this type of investment matures, however, as it will become foreign property at that time, which may put your RRSP offside the foreign content limits. Fortunately, the CCRA has recognized this problem and will not apply the penalty provisions on an administrative basis, as long as the foreign currency is reinvested in a qualifying investment within a reasonable period of time.

B7. Can my RRSP hold real estate?

Your RRSP cannot have a direct investment in real estate. However, it is possible to invest indirectly in real estate by buying shares of publicly traded companies which invest in real property or units in a publicly traded Real Estate Investment Trust (REIT).

B8. Can my RRSP hold a mortgage on my home?

It is possible to invest RRSP funds in a mortgage on your own home. While this offers a feeling of comfort knowing that you, in effect, owe the funds to yourself (and it may be easier to obtain funds from your RRSP than from a commercial lender), there may not be any significant advantage to be gained by doing this. The mortgage must provide for commercial interest and repayment terms. Consequently, your monthly payments would not change. There will be a benefit if the rate of return on the mortgage exceeds the return you would have otherwise received on your RRSP funds. However, you will also have to take into account that a mortgage of this sort is generally more expensive to arrange.

If you are a first-time home buyer, it is possible to withdraw up to $20,000 from your RRSP when you buy a qualifying home. Your spouse can also withdraw up to $20,000 from his or her RRSP. If the amount withdrawn is repaid over 15 years, there won't be an income inclusion for the withdrawal. Contact your BDO advisor for more information on The Home Buyers' Plan.

B9. Can my RRSP invest in my own business?

It is possible to use your RRSP to invest in a Canadian-controlled private corporation (CCPC). However, if you, together with persons related to you, own more than 10% of the shares of the CCPC, the investment may not be a qualifying RRSP asset. If you deal at arm's length with the CCPC, and the cost of the shares you hold in the CCPC or a related corporation is less than $25,000, you can invest your RRSP in shares of the company. If you own less than 10% of the shares, there are generally no restrictions on the amount you can invest.

In determining the amount and cost of the shares that you own, you have to consider shares owned by persons related to you, both inside and outside their RRSPs. Also, all or substantially all of the company's assets must be business assets at the time the shares are purchased by your RRSP.

If you have a qualifying investment in a CCPC in your RRSP, your foreign content limit is automatically increased over the limits discussed above. As mentioned in question B6, the additional amount that can be invested in foreign property is three times the cost of your CCPC investment, up to a maximum of 50% of the cost of all property held in your RRSP, for taxation years after 2000 (prior to 2001, lower limits applied).

Contact your BDO advisor for more information on how you can use your RRSP to invest in your

business.

B10. Are Labour-Sponsored Venture Capital Corporations (LSVCCs) qualified investments for my RRSP?

LSVCCs are investment funds which are mandated to invest in small and medium-sized privately held businesses with the potential for high returns. However, the investment risks can be high.

The federal government offers attractive tax credits for LSVCC investors. The tax credit is now 15% on a maximum investment of $5,000. Several provinces offer matching credits.

These credits are available to you if you contribute cash to your RRSP to buy the investment in the LSVCC. The credits can lower the after-tax cost of a $5,000 investment in an LSVCC to $3,500. However, you must leave your money in the LSVCC for at least eight years, or you will have to repay the credits (five years for investments acquired before March 6, 1996).

In the past, some brochures have claimed that the after-tax cost of an LSVCC is only about $1,000 for a $5,000 investment. These calculations take into account the value of the $5,000 RRSP deduction at the highest marginal tax rates. However, the real cost of the LSVCC is $3,500, as you would get the benefit of the RRSP deduction for any RRSP contribution, whether the funds are used to purchase units in an LSVCC or another investment such as a GIC.

As mentioned in question B6, if you invest in an LSVCC, you will increase your foreign property limit by an additional amount of up to three times the cost of your LSVCC investment (using the same rule described in B9). Keep in mind that you can't increase your foreign content limit, in 2002, to more than 50% of the cost of all investments in your RRSP.

Contact your BDO advisor before investing in an LSVCC if you have any questions as to the potential risks and rewards.

Making withdrawals from your RRSP

C1. When can I withdraw money from my RRSP?

Generally, you can withdraw money from your RRSP at any time. There are no tax rules preventing you from doing so. The only exception to this is if the funds in the RRSP were originally transferred in from a pension plan. In certain cases, these funds must be transferred to a locked-in RRSP, which can only be accessed as allowed under provincial pension legislation.

From a practical perspective, you may have difficulty in withdrawing funds from your RRSP if it has invested in securities which cannot be liquidated, such as non-redeemable GICs. There may also be a cancellation penalty for early redemptions.

If you withdraw an amount from your RRSP, the full amount of the withdrawal is taxable. This is true whether the withdrawal represents money you contributed to your RRSP or income earned on these funds.

Usually, it's not advisable to withdraw RRSP funds, unless you have an emergency or your income is exceptionally low in one particular year. The purpose of your RRSP is to save for your retirement - withdrawing funds from your RRSP will only undermine this goal. Also, once funds are withdrawn, you will only be able to recontribute them as part of your normal RRSP contribution room.

C2. When should I start to withdraw money from my RRSP?

This depends on your personal situation. In order to take full advantage of the tax deferrals offered by an RRSP, you should wait until the end of the year in which you turn 69 (see C3) and then either purchase an annuity or transfer your RRSP assets to a Registered Retirement Income Fund (RRIF), depending on which best suits your needs (see C4).

However, you may require retirement income from your RRSP prior to age 70. When you do need

money, you can withdraw the funds you need (remembering that withdrawals are fully taxable). You could also purchase an annuity or transfer your RRSP assets to an RRIF at any time prior to the end of the year in which you turn 69.

Also, it may make sense to purchase an annuity with some of your RRSP funds when you turn 65, if you don't have other income that will qualify for the pension income tax credit of $1,000 each year. Income from an annuity purchased with your RRSP is considered to be pension income for purposes of this credit.

C3. What is the deadline for collapsing my RRSP?

You cannot have an RRSP past December 31st of the calendar year in which you turn 69. Prior to that date you must either collapse your RRSP, and pay tax on the fair market value of the plan's assets at that time, or purchase an annuity or transfer your RRSP assets to an RRIF. If you purchase an annuity or transfer the assets to an RRIF, no tax is paid on the conversion.

C4. What are my options when withdrawing money from my RRSP?

As mentioned in question C3, there are basically three ways you can take money out of your RRSP. First, you can collapse all or part of your RRSP. Any amounts withdrawn will be fully taxable to you in the year of withdrawal. Your RRSP issuer will withhold tax on your withdrawal (the withholding tax rate varies with the size of the withdrawal).

You can also purchase an annuity or an RRIF with your RRSP. Generally you would do this when you want to receive retirement income from your RRSP. Withdrawals from an annuity or an RRIF would be taxable only when received by you.

Annuities:

An annuity is a right to receive periodic payments of income, either for life or a fixed number of years. Several types of annuity products are available, such as annuities which will continue to pay income until the later of your death or the death of your spouse. The size of your periodic payment will depend on the length of the annuity term; the longer the term of your annuity, the smaller the payment.

You can use your RRSP to buy an annuity, usually from a life insurance company, to give you a stream of income in your retirement. This income will be fully taxable to you when you receive it as pension income.

The advantage of an annuity is that it gives you a guaranteed stream of income for the annuity term. In exchange for this income stream, you will, in effect, give up the control of your investments to the issuer of the annuity. Also, your purchasing power will be at risk for inflation, unless the annuity has inflation adjustments.

RRIFs:

An RRIF is similar to an RRSP with two main exceptions. The first difference is that, with the exception of certain transfers, contributions cannot be made to an RRIF. Secondly, a minimum amount must be withdrawn from the plan each year. Your RRIF can hold the same investments as your RRSP; you can have a self-directed RRIF in the same manner as your self-directed RRSP.

A minimum percentage must be withdrawn each year, depending on your age. The percentage is applied to the fair market value of plan assets as of January 1st of each year, to determine the dollar amount of the mandatory withdrawal for that year. More than the minimum can be withdrawn, if so desired.

Another option for calculating minimum RRIF withdrawals is to use your spouse's age in place of your own, even if their age is less than 69. This option is for purposes of determining the minimum withdrawal amount only and does not apply for other purposes such as determining when your RRSP matures. This alternative does allow you to defer the taxation of plan assets to the extent that your spouse is younger than you.

The main advantage of an RRIF over an annuity is that you maintain control over your investments. With that, however, comes the risk that your investments will not perform to your expectations.

C5. I'm returning to college to upgrade my skills. I heard that I can withdraw money from my RRSP tax-free to help pay my expenses. How does this work?

The Lifelong Learning Plan (LLP) was first announced in the 1998 budget. It allows you to "borrow" up to $10,000 per year, to a maximum of $20,000 over a period of up to four calendar years, from your RRSP to help you finance full-time training or education for you, your spouse or your common-law partner.

The amount withdrawn will not be taxed as a normal RRSP withdrawal. It will be treated like an interest-free loan, generally repayable to your RRSP in equal instalments over a 10-year period. Your first payment is due in the second consecutive year, after the year of withdrawal, in which the eligible student is not entitled to the full-time education credit for a period of at least three months, or in the fifth year following the first year of withdrawal, whichever is earlier. If you don't make the required payment in a year, the unpaid amount will be included in your income for that year. As is the case for RRSP contributions, a payment made in the first 60 days following a given year will qualify as a repayment for that year.

In order to qualify, the LLP student (you, your spouse, or your common-law partner) must be enrolled in full-time training or higher education for at least three consecutive months at a designated educational institution, before March of the year after the LLP withdrawal. If the LLP student is disabled, he or she can enrol on a part-time basis.

If you have recently made a contribution to your RRSP, there is another rule to keep in mind. Only those funds that were in your RRSP at least 90 days before a withdrawal will qualify under this program.

C6. What happens to my RRSP if I die?

On your death, you are deemed to have collapsed any RRSPs that you have. Therefore, you will be taxable on the fair market value of the plan at that time.

However, if your spouse is the beneficiary of your RRSP, the value of your RRSP can be included in their income instead of being included on your final tax return. They can then transfer this amount to their own RRSP, meaning that they will not have to pay any tax on these funds until they withdraw the funds from their plan.

If your spouse is also deceased, a rollover of your RRSP can be achieved if the beneficiaries of your plan are your children or grandchildren who are financially dependent on you for support at the time of your death. On your death, the value of your RRSP will be included in these beneficiaries' incomes. A child or grandchild is considered to be dependent on you for support in any given year if his or her income does not exceed the basic personal tax credit ($7,634 federal credit for 2002). If the child or grandchild was dependent on you for support by reason of mental or physical infirmity, the amount received can be transferred to their RRSP, meaning the funds will not be taxable until they withdraw the funds. If the dependent child or grandchild is not physically or mentally infirm and is under 18, the RRSP can be rolled into an annuity for the child as long as it is a fixed-term annuity that does not extend beyond the year in which the child turns 18. The annuity payments will be taxable to the child in the years they are received.

C7. What happens to my RRIFs and annuities on my death?

The rules for RRIFs are similar to the rules for RRSPs. If you die and the plan assets are not payable to your spouse or to a dependent child or grandchild, the fair market value of the plan is included in your income. If your spouse is entitled to the plan assets, he or she can simply become the annuitant of the RRIF or the RRIF assets can be transferred to a new RRIF for the spouse. This gives your spouse the ability to base the remaining payments on his or her own age or on your age.

If your spouse is also deceased and the RRIF balance is payable to a child or grandchild who was financially dependent on you for support at the time of your death, the RRIF balance is taxable to the recipient in the same manner as an RRSP, as described in C6.

If your spouse is also deceased and the RRIF balance is payable to a child or grandchild who was financially dependent on you for support at the time of your death, the RRIF balance is taxable to the recipient in the same manner as an RRSP, as described in C6.

Summary

RRSPs are an important and effective way to save for your retirement. You should take full advantage of this planning opportunity to ensure that you have sufficient retirement income in the future.

Contact your BDO advisor if you have any questions about your RRSP.

This bulletin is a publication of BDO Dunwoody LLP on developments in the area of taxation. This material is general in nature and should not be relied upon to replace the requirement for specific professional advice. The information in this bulletin is current as of November 12, 2002.