RRSP basics — the ABCs of RRSPs

As one of the more popular accounts in Canada, it's important for investors to understand a few of the basics of registered retirement savings plans (RRSP, or RSP for short). Below you'll find information about:

- What is an RRSP?
- What are the benefits of an RRSP?
- What types of investments you can hold in an RRSP
- How much you can contribute to an RRSP
- What happens if you withdraw from an RRSP
- Where to learn more about RRSPs

What is an RRSP?

An RRSP is an account designed to help you save for your retirement. It's one of the most popular accounts in Canada because contributions you make to an RRSP provide a tax deduction on your current earnings, and the investment income in the RRSP remains tax sheltered until you withdraw the funds. The aim is to defer taxes payable on your income until retirement, when you are usually in a lower tax bracket. Ideally, with an RRSP contribution, you save on your taxes now and then save on them later, too. You can use the contributions to purchase investments, and the gains and income generated from those investments are not taxed as long as the funds remain in the RRSP. However, withdrawals from your RRSP are treated as taxable income.

RSP versus RRSP

You'll see these accounts referred to both as "RSPs" and "RRSPs". There is no difference between them; both are the same type of registered plan. One is just a shorter form version of the same account.

What are the benefits of an RRSP?
Beyond the simple advantages of saving your money to fund your retirement, an RRSP provides other benefits.

1. Short- and long-term tax advantages. In the short term, your RRSP contributions can reduce the amount of tax you pay on your annual return. Longer term, when you withdraw from your RRSP at retirement, you're usually in a lower tax bracket, and therefore, will pay less tax on those withdrawn funds.

2. Tax-sheltered investment income. Any income, dividends and capital gains you earn on your investments while in the RRSP will be tax sheltered. You don't have to pay taxes on those earnings until they are removed from the RRSP.

3. An RRSP can be used for other things than retirement. There are programs available that allow you to use the money saved in your RRSP for a down payment on a home (Home Buyer's Plan) or for furthering your education (Lifelong Learning Plan). **What is a self-directed RRSP?** With a self-directed RRSP, you have the freedom to oversee the investments in your RRSP. You can make all the decisions about which investments to buy or sell, and manage your account when it's most convenient for you.

What types of investments can I hold in my RRSP?

You can hold a wide range of investments within an RRSP, including stocks, exchange-traded funds (ETFs), mutual funds, bonds, guaranteed investment certificates (GICs), and cash. There are a few restrictions for registered accounts to be aware of. Anything held in a registered account must be an "investment in properties (except real property), including money, guaranteed investment certificates, government and corporate bonds, mutual funds, and securities listed on a designated stock exchange." For more details on what the Canadian government considers a "qualified investment" for registered accounts, please visit their website.

How much can I contribute to my RRSP?

There are limits to how much you can contribute each year to your RRSP or to your spouse's RRSP. Your allowable contribution room is the lower of:
• 18% of the earned income reported on your tax return for the previous year
• The maximum annual contribution limit for the year, which is set by the government
• The remaining limit after any employer-sponsored pension plan contribution known as your "pension adjustment", found on your T4 or T4A slip). You can carry forward unused RRSP contribution room since 1991. If there are income-earning years in which you did not make an RRSP contribution, you can use that room to catch up on your contributions. Your excess RRSP contribution room is listed on your previous year's Notice of Assessment, or by logging in to the Government of Canada's My Account.

What is the annual deadline to contribute to an RRSP?

In order to be eligible for an RRSP deduction in a specific taxation year, you can make contributions anytime during that calendar year, or up to 60 days into the following year.

How long can I contribute to my RRSP?

You can contribute to your RRSP until December 31 of the year in which you turn 71. After that, you must withdraw the assets, convert them into a registered retirement income fund (RRIF) or purchase an annuity. If you're past the maximum age to contribute to an RRSP, consider investing in a tax-free savings account (TFSA), which also has tax advantages, but has no maximum age limit for contributions.

When can I start contributing to my RRSP?

There is no minimum contribution age, but you must have earned income and have filed a tax return with the Canada Revenue Agency. The sooner you start contributing to your RRSP, the better, in order to take advantage of the power of compounding.

What happens if I withdraw from my RRSP?

While contributions to an RRSP can provide tax advantages, withdrawing the funds can have significant tax implications. Any withdrawal from your RRSP (except in the case of the Home Buyer's Plan or Lifelong Learning Plan) is subject to withholding tax. The financial institution where you hold your RRSP will hold back a percentage of the amount.

- 10% on withdrawals up to $5,000 (5% in Quebec)
- 20% on withdrawals between $5,000 and $15,000 (10% in Quebec)
- 30% on withdrawals over $15,000 (15% in Quebec) In addition, the amount withdrawn from your RRSP will be taxable as income in the year it is withdrawn.

What is a spousal RRSP?

You can also contribute to an RRSP for your spouse (including common-law) to help them save for retirement and potentially reduce your combined tax bill. When you contribute to your spouse's RRSP, you reduce your own contribution limit but receive the deduction on your taxes. If your spouse earns a significantly lower income than you, that deduction could make a bigger difference on your tax return than on theirs. But be aware that if spousal RRSP contributions are withdrawn within three years, you must pay the tax on that income. If it's been in the spousal RRSP longer than that, it is claimed by and taxed at your spouse's tax rate.

What is a locked-in RRSP?

If you leave a job that included pension plan savings, you can transfer those pension funds to a locked-in retirement account (LIRA) or locked-in RSP (LRSP). These plans can hold the same types of investments as regular RRSPs, but you can't make any further contributions to them. You also cannot withdraw funds under normal circumstances, as they are designed to help fund your life in retirement. Depending on your pension jurisdiction (provincial or federal) there may be provisions that allow for early withdrawal from locked-in plans. For more information, please refer to the pension board for your pension's jurisdiction.
