Common queries about RRSP's

Although most financial institutions provide printed information about RRSPs, much of it is slanted towards the more knowledgeable investor. "And even the experienced purchaser can be confused by some of the technical language used," says Terry McIntyre, Branch Manager of First City Trust in Brampton.

Following are answers to some of the more basic questions commonly asked by individuals purchasing RRSPs - in everyday language.

Who is eligible to buy an RRSP?

If you're a Canadian taxpayer with "earned income" (see definition below), you may purchase an RRSP up to the end of the tax year in which you turn age 71. If you do not have any earned income, you are allowed to open an RRSP in your own name by having your spouse make contributions - even if he or she has already reached the maximum age limit.

What is "earned income"?

It is the total of all money you have received from wages, salaries, bonuses, commissions, self-employed income (after deductible expenses), pension and disability benefits, alimony and maintenance, rent, and several other sources of income after you have subtracted your unemployment insurance contributions, union or professional dues, and employment expense deductions for the year.

"Your local taxation office can provide you with a form that will help you determine your earned income and how much you can contribute to your RRSP," says Mr. McIntyre. "Some financial institutions, including First City Trust, also offer a form to help you in this area."

What about investment income and capital gains?

Neither investment income nor taxable capital gains are considered earned income.

How much can I contribute in a year?

If you are self-employed or are not a member of a registered pension plan, you may contribute either 20 per cent of your earned income or *$7,500 - whichever is less.*

If you do belong to a registered pension plan and both you and your employer contribute to it, you are allowed to invest up to 20 per cent of your earned income or $3,500 - again, whichever amount is lower. But first you must subtract the amount of money you put into your company pension plan. If your employer made all your pension plan contributions, you don't have to worry about this; just follow the 20 per cent/$3,500 maximum formula.

Mr. McIntyre adds one more important point: "If you currently are receiving payments from a company pension plan, old age security or the Canada Pension Plan, you may contribute all of these payments over and above the maximum allowable RRSP contribution limits. However, you cannot include these amounts when you figure out your earned income."

Am I allowed only one RRSP?

No. You may own as many as you like, providing the total contributions you make to all of them do not exceed the maximum allowable limit.

Once I have an RRSP, do I have to keep making contributions?

No. If you like, you can open an RRSP and never make another contribution.

What is a "spousal RRSP"?

It is simply an RRSP in which the holder's spouse makes the contributions. Contributions to both your own and your spouse's RRSPs must not exceed your annual limits.

What happens to the money in my RRSP?

That depends on the type of RRSP you purchase. It might be invested in term deposits, mutual funds or a variety of other investment vehicles. When you open your RRSP, you determine where your contributions will be invested for that year.

Am I allowed to withdraw part of the money in my RRSP?

Yes - as much or as little as you like. However, all of the money which you withdraw must be declared as income for that tax year.

Is it possible to borrow money from my RRSP?

With one exception, no. "The exception to the rule involves granting yourself a mortgage, but the regulations are very complex. If you are interested in this area you should talk to your tax officer or the financial institution which handles your RRSPs," recommends Mr McIntyre.

What happens if I die while I still have an RRSP?

There are two possibilities:

1) If the beneficiary named for your RRSP is your spouse and you die before age 71, he or she can either take the money (and declare it as income) or transfer the funds into his or her own RRSP. If your spouse is not eligible for an RRSP, he or she must cash in your plan or purchase an annuity with it.

2) If your RRSP beneficiary is someone other than your spouse, the funds will be taxed as part of your income for that taxation year and what is left over will go to your estate.

The RRSP commitment eases retirement worries

For many people who have not yet started to save for their retirement, the profusion of RRSP advertisements at this time of year is akin to having a nagging toothache. Such individuals berate themselves for not having taken preventative action earlier to avoid their current discomfort.

Yet, just as a trip to the dentist should deaden the pain of a throbbing tooth, so will a firm decision to commit money to an RRSP ease the worry of having no funds set aside for retirement.

"I'm amazed at the number of people, particularly in their mid to late 30s, who think they've missed the boat completely by not starting an RRSP at age 20," said Terry McIntyre, Manager of the First City Trust branch in Brampton.

"There are tremendous financial benefits in starting an RRSP early on, but it is by no means a necessity in attaining retirement security," he said.

For example, a person with 25 working years left who does not participate in a company pension plan could have an RRSP worth approximately $490,000 by retirement if he or she was able to invest $5,000 annually at an average interest rate of 10 per cent. Upon turning 65, that individual could then use those savings to purchase a post-RRSP product such as First City Trust's Term to 90 Annuity and receive a monthly income in excess of $5,000 for the next 25 years - based again on an average interest rate of 10 per cent.

Of course, this is a simplified scenario which does not take into account such important investment considerations as annual cash flow needs, alternative sources of retirement income, and a desire for varying income throughout one's retirement years.

There is no question that an annual commitment of $5,000 would cut heavily into many people's resources. However, even if you were to make a yearly contribution of just $1,500 *for the next 25 years,* your RRSP would still be worth more than $160,000.

If that money was subsequently used to buy a Term to 90 Annuity offering a 10 per cent rate, it would produce a monthly payment of $1,425 and be a healthy supplement to other sources of retirement income.

"Obviously, the longer you put off starting an RRSP, the larger your annual contributions will have to be to achieve your retirement savings goals," said Mr. McIntyre.

The individual who accumulated $490,000 over 25 years through annual payments of $5,000 could have achieved the same result with yearly contributions of just $2,000 if he or she had begun nine years earlier.

"That's why we emphasize the importance of making a firm decision to start an RRSP early in your working life and why we offer RRSP loans and monthly savings plans to help you meet your investment goals," said Mr. McIntyre.