

Kathy Edwards

RRSP: *Be Careful Not to Overcontribute!*

Taxpayers are generally aware that contributing to their registered retirement savings plans (RRSP) is often part of a good tax plan.

They may not be aware, however, that contributing beyond their allowable RRSP limit can cost them money!

Canada Revenue Agency (CRA) appears to have commenced reviewing this matter; many taxpayers are now receiving CRA letters that request information about their RRSP contributions for the current and past years. This is the first step by CRA in assessing whether or not a penalty tax should apply for excess RRSP contributions.

The Penalty

If you have made excess contributions to an RRSP, you may have to self-assess and remit a special penalty tax. This penalty tax is calculated at 1 percent per month, based upon the amount of your excess contribution and could apply to such excess contributions made in 1991 and later years. This works out to a 12 percent tax on an annual basis—a pretty stiff penalty, especially when you factor in potential interest, compounded daily!

This penalty tax would continue to apply until you no longer have an excess contribution, for example, an excess contribution may be eliminated if it is absorbed by increases in your RRSP room in subsequent years or by withdrawal of the excess funds. It can even apply after your RRSP has been rolled into a RRIF (although withdrawals from your RRIF in excess of the minimum amount will be considered as withdrawals of the excess RRSP contributions).

The best way to avoid the potential application of this penalty is to know your limit. Don't contribute beyond that amount.

You should be aware that any withdrawals from your RRSP should be included in your income tax return. A corresponding deduction for the same amount may be available, however, *if* certain criteria are met.

Know Your Limit

The best way to avoid the potential application of this penalty is to know your limit. Don't contribute beyond that amount.

Your RRSP limit for 2007 is determined based upon your earned

income from the prior year and includes any unused RRSP room from earlier years, as well. As “earned income” is specifically defined in the *Income Tax Act*, and your RRSP limit for 2007 will also include any unused RRSP room from prior years, we recommend you refer to your 2006 Notice of Assessment (or Reassessment) for confirmation of your 2007 RRSP limit.

Generally, you have made excess contributions to an RRSP under which you, your spouse, or common-law partner is the annuitant if your unused contributions from the current and prior calendar years add up to more than your RRSP deduction limit shown on your latest Notice of Assessment, Notice of Reassessment, or Form T1028, plus



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\$2000. The \$2000 is reduced when you have a negative RRSP deduction limit that may be due to Past Service Pension Adjustments. Also, if you were under 18 years of age at any time during the year, you do not qualify for the additional \$2000 amount.

If you have made RRSP contributions in amounts that exceed your limit, or you have claimed fewer deductions than your contributions made, you will have unused RRSP contributions carried forward. You should then complete Schedule 7 each year to help keep track of your unused RRSP contributions. This schedule is available on CRA's Website. www.cra-arc.gc.ca

How Is This Penalty Reported?

If you determine you have to pay this penalty tax, you are required to pay it no later than 90 days after the end of the year in which the excess contributions arose. To calculate the amount of the penalty, you must complete CRA's form T1-OVP. Separate charts have also been made available by CRA to assist you with calculating the amount of the excess contributions.

All these forms can be found on CRA's Website. CRA also provides a helpful guidebook called "T4040 – RRSPs and Other Registered Plans for Retirement 2006," which addresses these rules in more detail.

Caution

The issues relating to excess RRSP contributions are discussed in general terms only in this article; the rules surrounding RRSP excess contributions can be very complicated. Each individual's circumstances are different and should be considered when assessing the potential application of this penalty. A visit to your tax advisor is always recommended to ensure you comply with the rules and to assist with the appropriate tax planning, should you find yourself subject to this penalty tax. ▲

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