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Tax News

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It is a sometimes confusing and not well understood fact, but over contributions to your RRSP may be subject to penalties. This penalty tax is exorbitant! To help avoid this additional tax burden, read the following tips on RRSP Planning and advance strategies.

Avoid RRSP Over contribution Penalties

If you inadvertently contribute more than your contribution limit, you will be subject to a 1% penalty tax per month to the extent that the over contribution amount exceeds $2,000.

RRSP tips:
This penalty tax is exorbitant so it is not worthwhile to make over contributions above the limit. Canada Revenue Agency has stepped up its monitoring of RRSP over contributions lately, so here are some tips to help avoid paying this additional tax burden.

One time Over Contributions:
You can make an extra one-time $2,000 over-contribution to your RRSP without being subject to the 1% per month penalty tax on over contributions. 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 over contributions. However, 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 it could also cause problems for other individuals.

Reversing over contributions:
Although it is possible to remove inadvertent over contributions from an RRSP without tax (an offsetting deduction is provided), this remedy is not available where the over contribution was made intentionally.

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.

Using subsequent years:
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 71 (which is the year in which you must collapse your RRSP) 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.

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