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A savings plan good for life

From buying a home to paying for school

By all accounts, Canadians are not taking advantage of their registered retirement savings plans. According to a recent RBC RRSP poll, only 35% of Canadians will be contributing to an RRSP for the 2009 tax year - the lowest percentage since 1996.

That's too bad, because there are many ways to maximize RRSPs. Here are some alternative ways to use your RRSP:

INCOME SPLITTING

Those who are married or with a common-law partner should investigate the advantages of spousal plans.

A higher-earning partner can contribute to an RRSP registered in the name of the lower-income spouse to achieve a form of income-splitting. The contributor earns an immediate tax deduction, while the receiving spouse reports the income for tax purposes when the funds are withdrawn, ultimately reducing taxes.

When it's time to draw from their RRSPs, the contributor and spouse can once again achieve income-splitting by equalizing their withdrawals so that they are taxed at the same rate.

At age 65 this will also help mitigate Old Age Security claw-backs, either reducing or eliminating them depending on how much the two income levels are below OAS thresholds.

Spousal RRSP withdrawals must be in accordance with the three-year attribution rules, but making the contributions in December rather than January or February can reduce the impact.

BUYING A HOME

RRSP savings can also help people buy their first home. The First-time Home Buyers' Plan is designed so individuals can withdraw up to $25,000 from their RRSP to be used towards the purchase of a primary residence. It is restricted to first-time home buyers and those who have not owned and lived in a home in the past five calendar years.

The home must be in Canada and must be purchased before Oct. 1 of the year following the year of the RRSP withdrawal. The withdrawal must be repaid in equal, annual installments over 15 years, beginning in the second year. Any payment shortfall must be included as taxable income in the year it occurred.

EDUCATION

Individuals or their spouses can also make use of the Lifelong Learning Plan. A fulltime student, acquiring qualifying full-time post-secondary education at a designated institute, can withdraw up to $10,000 in a given year from his RRSP over a 4-year period, as long as the total does not exceed $20,000. He must repay it in equal installments over 10 years, otherwise it becomes a taxable withdrawal.

While the withdrawals are not taxable, the tax-free compounding savings achieved through RRSPs is lost. Also, individuals must be certain they can maintain the cash-flow requirements of the repayment schedules.

LEARNING TOOL

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The concept of RRSPs is very useful in teaching children about money and planning. Tax returns should be filed as soon as possible, even though a child's income may only be from a paper route or babysitting. Although they cannot open an RRSP until they are 18 years old, they can reap future benefits.

By filing returns, the child can claim deductions and tax credits that are carried forward indefinitely, ultimately providing extra contribution room for her future RRSP. This can be particularly beneficial when she reaches peak earning years, with the extra contribution room offsetting higher taxes. When she turns 19, she may even receive the GST credit, a tidy quarterly payment, just for filing.

As with all tax planning, people should be sure they understand the tactics thoroughly. There are many rules, so it is imperative to do your homework before choosing any course of action.

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