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TIME AGAIN FOR TAXPAYERS TO CONSIDER HOW TO MAKE THE MOST OF THEIR CANADIAN RRSPs

by KPMG LLP, Canada (a KPMG
International member firm)

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In Canada, it's Registered Retirement Savings Plan (RRSP) "season" again and the March 1, 2006 deadline for 2005 tax-deductible contributions is coming up soon. While taxpayers are considering their investment decisions, they may also want to keep in mind the potential tax planning benefits of their RRSPs. The following ideas will help remind them of some options for getting the most out of their RRSPs. Bear in mind that one's retirement strategy, including investments in Canadian RRSPs, should be considered in light of the tax rules that apply in jurisdictions relevant to one's situation. (All currency figures expressed are Canadian dollars.)

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Time Deductions To Increase Tax Savings

The tax savings a taxpayer may earn on his or her 2005 tax return by making a 2005 RRSP contribution by March 1, 2006, will depend on his or her marginal tax rate. Generally, if the taxpayer's income is taxed at the top rate (i.e., about 45 percent, depending on the province), the RRSP deduction will create current tax savings of about 45 percent of the amount the taxpayer contributes.

If the taxpayer's income falls into one of the lower three brackets in 2005, the deduction will be worth proportionally less: about 41 percent of the amount he or she contributes if he or she is in the third bracket, about 34 percent if in the second bracket, and about 24 percent if in the lowest bracket. In light of the different marginal tax rates, keep in mind the following tax saving ideas:

- In a low-income year, the taxpayer should consider making the maximum possible RRSP contribution but deferring claiming the deduction until a later year when the taxpayer's income is taxed at a higher marginal rate. This strategy can maximize the tax-free growth of funds while also maximizing the taxpayer's tax savings.
- Similarly, if the taxpayer is making a large RRSP catch-up contribution, he or she should consider only claiming enough of the resulting deduction to reduce taxable income in the top tax brackets. The taxpayer can carry forward the remaining deduction for greater tax savings in a future year against income that is taxed in the higher tax brackets.

Boost Benefits of RRSP

To increase the RRSP's benefits, taxpayers should keep the following ideas in mind:

- Consider the preferred tax treatment for dividends and capital gains on investments held outside one's RRSP when determining which types of assets to hold inside the RRSP.
- Consider a spousal RRSP for retirement income splitting if the taxpayer expects his or her spouse's retirement income to be lower than his or her own.
- The taxpayer could make the maximum allowable contribution for 2005 to maximize tax savings. Taxpayers can contribute 18 percent of their "earned income" in 2004 or \$16,500, whichever is less (if the taxpayer is a pension plan member, his or her maximum contribution may be reduced).
- Rather than waiting until the March 1, 2007 deadline, consider making one's 2006 contribution now, or as early as one can, to begin accumulating tax-free income on the contribution as soon as possible. For 2006, taxpayers can contribute 18 percent of their earned income in 2005, or \$18,000, whichever is less (again, if the taxpayer is a pension plan member, his or her maximum contribution may be reduced).
- If the taxpayer is turning 69 in 2006, he or she should consider options for maturing his or her RRSP and remember to make a final contribution by December 31, 2006.

Self-directed RRSPs — Broader Range of Investment Options

A self-directed RRSP can offer a wider range of investment choices, though it generally requires more time and attention than a conventional RRSP and may involve more risk, depending on the investments one chooses. If a taxpayer decides to set up a self-directed RRSP, consider the following tax planning ideas for maximizing its benefits:

- Consider transferring securities the taxpayer already owns to his or her self-directed RRSP to shelter future gains and get a tax deduction without any cash outlay (remember that he or she will have to pay tax on any unrealized capital gains when making the transfer).
- Consider triggering capital losses on shares that have declined in value by selling the shares into the market, contributing the cash proceeds to the taxpayer's RRSP and having the RRSP reacquire his or her position after 30 days (remember that if the taxpayer transfers the shares directly to his or her RRSP, he or she won't be able to claim the capital loss).
- Taxpayers should evaluate changing their self-directed RRSP's mix of foreign and domestic holdings to diversify its investments. With the 30-percent limit on foreign property held by RRSPs eliminated in 2005, taxpayers could consider increasing their RRSP's foreign investments, depending on circumstances.
- Transfer shares of start-up or other companies with high growth potential to the taxpayer's self-directed RRSP to shelter future gains from tax.

More Tips in KPMG's Tax Planning for You and Your Family 2006

Of course, these ideas are not an exhaustive list of one's RRSP tax planning options. Taxpayers can find more information on RRSPs and other tax and financial planning matters in *Tax Planning for You and Your Family 2006*, a publication of KPMG in Canada, now available from a KPMG adviser, in bookstores across Canada, or directly from the publisher Thomson Carswell (telephone: 1-800-387-5351).

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