Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

RRSP over-contributions

The tax implications and your options

Please contact us for more information about the topics discussed in this article.

You can contribute to your RRSP or your spouse's RRSP and claim a deduction for your contribution against your taxable income. If you contribute more than your RRSP contribution limit, you will have an over-contribution. You are allowed to make a $2,000 over-contribution to your RRSP without incurring a tax. If you have an RRSP over-contribution above the $2,000 limit (referred to as an "excess contribution"), you will be subject to a tax equal to 1% per month on the excess contribution. This article discusses the tax implications of your over-contribution as well as methods for withdrawing it from your RRSP.

Any reference to a spouse in this article includes a common-law partner.

Tax consequences of an excess contribution

If you made an over-contribution to your RRSP or your spouse's RRSP in excess of $2,000, you are subject to a tax of 1% per month starting from the month you first exceeded your contribution limit by more than $2,000. The tax will continue to apply until the month before you remove the excess or until you accrue new contribution room that is sufficient enough to absorb the excess contribution. New contribution room may become available to you on January 1st of the following year.

To calculate the 1% tax you owe on the excess, you must complete a T1-OVP return. Since this return is quite complex, you may wish to complete it with the assistance of a qualified tax advisor. You must file the T1-OVP return and pay the tax no later than 90 days after the end of the year in which you had the excess contribution.

If you miss the deadline for filing the T1-OVP return, the Canada Revenue Agency (CRA) will charge you a late filing penalty. The late filing penalty is 5% of your balance owing, plus 1% of your balance owing for each month the T1-OVP return is late, to a maximum of 12 months. In addition, the CRA will charge you compound daily interest starting on the day after your return is due on any unpaid amounts that you owe, including the late filing penalty.

Withdrawing an over-contribution

Normally, any withdrawals from your RRSP are included in your income and subject to tax at your marginal tax rate. However, you can withdraw an over-contribution from your RRSP and the income inclusion may be offset by a deduction (so that no income tax is payable) if you make the withdrawal in any of the following years:

- The year in which you made the contribution or the following year; or
- The year in which you are sent a Notice of Assessment or Notice of Reassessment for your T1 income tax and benefit return for the year in which you made the contribution, or the following year.

In addition, to claim the deduction (and have no income tax payable on the withdrawal), you must either:

- Have reasonably expected to be able to deduct the contribution for the year you made it or the immediately previous year; or
- Not have made the contribution with the intention of withdrawing it and deducting an offsetting amount.

Options for withdrawing an over-contribution

You have two options for withdrawing an over-contribution from your RRSP:

1. Withdraw with withholding tax

When you withdraw an over-contribution from your RRSP, withholding tax will be applied to your withdrawal. The withdrawal must be reported as income on your tax return in the year you withdrew the contribution. However, if the necessary criteria previously discussed are met, you can complete Form T746 when you file your income tax return to claim a deduction for the withdrawal so that no income tax is payable. The taxes withheld on the RRSP withdrawal will be used to reduce your other taxes owing or refunded to you if you owe no other taxes.

2. Withdraw without withholding tax

If you meet all the necessary criteria for the deduction and have not already withdrawn the over-contribution from your RRSP, you can withdraw it without having tax withheld. To do this, you can complete Form T3012A and have it approved by the CRA. If the CRA approves your completed form, you can withdraw the over-contribution with no withholding tax applied by providing the form to your financial institution at the time of withdrawal.

The 1% tax will continue to apply until you withdraw the excess contribution from your RRSP. If there is a delay in getting the form approved, the tax will continue to apply until the month before you remove the excess.

When you withdraw an over-contribution from your RRSP, withholding tax will be applied to your withdrawal. The withdrawal must be reported as income on your tax return in the year you withdrew the contribution.

This withdrawal option simply avoids the withholding tax at source on the withdrawal. Regardless of the withholding tax exemption, the withdrawal is still considered income that must be reported for tax purposes. However, you can claim an offsetting deduction for the over-contribution withdrawn on line 23200 of your income tax return so that no tax is owing.

Withdrawing from a spousal RRSP

If you made an over-contribution to your spouse's RRSP, the excess needs to be removed for the 1% tax to stop applying. You can reduce the over-contribution by withdrawing it from either your own RRSP or have your spouse withdraw the over-contribution from their spousal RRSP. If your spouse withdraws the over-contribution, the withdrawal will generally be included in your spouse's income. However, if you contributed to the spousal RRSP in the year of the withdrawal or in either of the two immediately preceding years, the income will attribute back to you. In this case, the offsetting deduction for the income inclusion may still be available to you, so long as the withdrawal is included in your income and the other conditions previously mentioned have been met. The taxes withheld on the withdrawal from your spouse's RRSP will not attribute back to you even if the income does.

Withdrawing from a RRIF

If you made an over-contribution to your RRSP, the 1% tax will continue to apply on the excess contribution even after your RRSP has been converted to a RRIF. You will need to complete and file the T1-OVP return by the appropriate deadline and pay any tax owing.

The 1% tax will continue to apply each month there is an excess contribution remaining in your RRIF at the end of that month. Any withdrawal from your RRIF will be considered a withdrawal of an excess RRSP contribution for the purpose of applying the 1% tax. Note that you cannot use Form T3012A for withdrawing an RRSP over-contribution that was transferred to your RRIF. Your financial institution is required to withhold tax on any RRIF withdrawal above the minimum payment required for the year.

If you could not deduct the RRSP over-contribution before converting to a RRIF or you will not earn any more RRSP contribution room to absorb the over-contribution, you may still be able to claim a deduction for this contribution when you withdraw it from your RRIF. To claim a deduction (using Form T746) for the over-contribution withdrawn, in addition to meeting the criteria previously discussed, you will need to remove the over-contribution by taking a withdrawal greater than your RRIF minimum amount for the year. If you are not able to claim a deduction for the over-contribution, you will be taxed twice on this amount. This is because you were denied a deduction when you first contributed the funds to your RRSP, and you will pay tax on the receipt of the funds when you withdraw them from your RRIF.

An alternative to withdrawing the over-contribution

Instead of withdrawing the over-contribution from your or your spouse's RRSP or RRIF, you can wait until January 1st of the following year if you expect new RRSP deduction room to be created. If you decide to wait until your over-contribution can be absorbed, the 1% tax will continue to apply on the excess contribution for each month, for the remainder of the year and you will be required to file a T1-OVP return. The over-contributed amount in the current year is carried forward and is an unused RRSP contribution for the following year. An unused RRSP contribution is a contribution that was made to your RRSP but not claimed as a deduction on your T1 return yet.

This alternative may be appropriate if you made the over-contribution late in the year or you do not discover the over-contribution until the following year and you have already earned new RRSP deduction room.

Conclusion

If you think you may have over-contributed to your RRSP, it is important to seek advice from a qualified tax advisor to determine the next steps that are most appropriate for you.

This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax, or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal, and/or insurance advisor before acting on any of the information in this article.

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