national union

pensions backgrounder #4

Private Retirement Savings

Part 4 in a Series

The full series of pension backgrounders are contained in the National Union's Pensions Manual, Fourth Edition—available from the National Office

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BACKGROUNDER #4

Private Retirement Savings

••• Registered Retirement Savings Plans (RRSPs)

RRSPs are individual, personally managed savings plans and are the most popular method of personal savings for retirement, especially for those workers who do not participate in an employer pension plan. RRSPs now receive more money each year than employer pension plans (RPPs). In 2004, just over 6 million Canadians contributed $28.8 billion to RRSPs – although this only represented 8% of what Canadians were entitled to contribute. In comparison, 4.5 million Canadians belonged to about 1,400 registered pension plans in 2004 and the total contributions to those plans were $19.3 billion (from employers and workers).

An individual must have earned income from employment, professional or business activity in order to contribute to an RRSP and may also contribute to an RRSP for her / his spouse or common-law partner. Like employer pensions, savings in an RRSP receive tax assistance – contributions are tax deductible and investment income is not taxed as it is earned.

RRSPs Invested in Wide Range of Financial Products

RRSP funds may be invested in a range of financial products and investment vehicles, including savings accounts, Canada Savings Bonds, term deposits, guaranteed investment certificates and mutual funds. An RRSP can be set up through most financial institutions – banks, credit unions, trust companies, mutual fund companies, insurance companies and investment dealers or brokerage firms. An individual may also set up a self-directed RRSP which may hold a wider range of investment vehicles (such as individual stocks) and allows the individual to directly manage the investments.

RRSP Contribution Limits

The allowable RRSP contribution for the current year is the lower of:

- 18% of earned income from the previous year, or
- The maximum annual contribution limit for the taxation year, or
- The remaining limit after any company sponsored pension plan contributions.

Earned income includes salary or wages, alimony received, and rental income, among other income sources, but does not include items such as investment income.

As a result of changes introduced in the 2005 federal budget, the following limits and deadlines apply annually.

Maximum Annual
RRSP Contribution Limits

Year	**Total Annual Contribution**
2005	$16,500
2006	$18,000
2007	$19,000
2008	$20,000
2009	$21,000
2010	$22,000

Any money withdrawn is taxed at a rate applicable to the individual's annual income during the year that the funds are withdrawn. Funds withdrawn from an RRSP will be charged an amount to cover some or all of the taxes charged on that amount of income. This amount must be held back by the plan administrator and remitted to the government on your behalf. Effective January 1, 2005, the following withholding tax rates apply:

Amount of RRSP Withdrawal	All Provinces except Québec	Québec
Up to and including $5,000	10%	21%
$5,001 to $15,000	20%	26%
More than $15,000	30%	31%

So if a worker withdraws funds while still receiving employment income, he or she will be faced with a high tax bill.

Two programs allow an individual to make withdrawals of RRSP funds without paying tax immediately: the Lifelong Learning Plan and the Home Buyers' Plan.

Home Buyers' Plan

The Home Buyers' Plan allows the individual to borrow funds from his / her RRSP to purchase their first home. Here are some of the key facts:

- The individual and their spouse can each borrow up to $20,000.
- The funds must have been deposited at least 90 days before they were withdrawn.
- At least 1/15 of the funds must be repaid each year, beginning two years after the funds were withdrawn.
- A signed agreement to buy or build a qualifying home is required.
- An individual can only participate in the program once.

Lifelong Learning Plan

The Lifelong Learning Plan allows one to pay for training or education with RRSP funds. Here are some of the key facts:

- Up to $10,000 per calendar year can be withdrawn to finance full-time training or post-secondary education.
- The student can be the individual or their spouse, but not their children.
- If the student meets disability requirements, the training / education can be on a part-time basis.
- The total amount that can be withdrawn is $20,000 with withdrawals over a maximum of four consecutive years.
- Amounts that are withdrawn are not subject to taxes on withdrawal.
- At least 10% of the amount borrowed must be repaid each year, over a maximum period of 10 years.

If the individual withdraws RRSP funds under one of these plans, they will receive a statement of account that tells them how much they have to repay each year. If they miss an annual repayment, the amount will be included in their income for tax purposes.

••• Registered Retirement Income Fund (RRIF)

An individual may contribute to an RRSP up until the end of the year in which they turn 71. They must then either be cashed in, or converted into an annuity or Registered Retirement Income Fund (RRIF). RRIFs are the most popular option for converting RRSPs. That's because an RRIF is like the continuation of an RRSP. The individual's funds remain tax sheltered, and they continue to choose how their funds are invested. But instead of putting money into an RRSP, the RRIF is designed to pay money out as income for one to live on.

In an RRIF, one must withdraw a minimum amount each year. The individual will be required to pay tax on this income. Their RRSP or RRIF withdrawals add to their income and could affect the amount of their OAS benefits.

••• Who Contributes to RRSPs?

It's not surprising to learn that the higher income an individual earns, the more likely he / she will contribute more of their annual income to an RRSP. For those Canadians who earn under $50,000 a year, less than half were able to contribute to an RRSP. Of those Canadians who made over $60,000 a year, at least two-thirds of them were able to contribute to an RRSP.

For Canadians with incomes over $115,000, their RRSP deduction pays for almost half of their retirement savings. But for Canadians with incomes under $36,000, the RRSP deduction pays for less than one-quarter of their retirement savings.

Many low-income Canadians can actually be worse off if they contribute to an RRSP. The deduction in their future OAS / GIS payments, combined with extra fees for other means-tested services, can more than offset the modest tax savings they receive from their RRSP. In some situations, low-income earners would ultimately be better off using money they contribute to an RRSP to pay down debt or increase their mortgage payments. It's important to stress that these situations are very much based on a low-income earner's personal financial situation, and therefore individuals who find themselves in this situation should work with their union to seek our professional investment advice.

••• Individuals Assume all the Investment Risk with RRSPs

On a final note on RRSPs, it's worth noting that the individual assumes all the investment risks associated with RRSPs. This means that the value of an RRSP will depend on an individual's ability to choose investment funds that do well and the individual's ability to make appropriate changes if they are not doing well. Often RRSP buyers enlist the help of professional financial planners in making choices regarding the type of investments to purchase for their RRSP account. Although such advice might be beneficial in terms of overall investment returns, it does not come with a guarantee. If the investment strategy is not successful, then the individual RRSP investor has nothing to fall back.

••• Other Personal Savings and Investments

There are many other ways individuals set aside money for retirement. For each of these different types of investments the tax treatment can vary. This is important to remember as you develop your retirement income strategy.

The following is a list of some of the most common types of investments.

Personal Savings – Personal assets represent additional potential sources of income whether in the form of bank accounts; stocks; bonds; mutual funds; guaranteed investment certificates; Canada Savings Bonds; real estate; art, stamp or coin collections; antiques; etc.

Home Ownership – Equity in a home is a form of savings. In addition, although still uncommon in Canada, reverse annuity mortgages enable homeowners to draw on the equity in their home as a source of income (either temporarily or for their lifetimes).

Life insurance – The primary purpose of life insurance is to provide survivors with cash upon the death of the insured. However, some policies include an investment component that you can draw upon in retirement.

Despite all of these options, many Canadians' retirement needs are not being met. The retirement income system must therefore continue to evolve, in response to both current problems and the ongoing changes in Canadian society. This may prove to be an even more difficult problem in the future.