Wealth Management

the Navigator

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES

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Transferring a bonus to your registered retirement savings plan (RRSP) without withholding tax

If you receive a bonus or other lump-sum payment as part of your compensation, and you have RRSP contribution room, consider asking your employer to pay the amount directly into your RRSP without withholding income tax. This article explains how you can transfer your bonus or other lump-sum payment to your RRSP and eliminate the requirement for withholding tax.

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

The strategy

When your employer pays you a bonus or other lump-sum payment (such as vacation pay or an ineligible retiring allowance), they're generally required to deduct withholding tax at source. If you want to reduce your taxable income for the year and have sufficient RRSP contribution room, you can contribute the net amount to your RRSP. You can then deduct the amount of the RRSP contribution from your taxable income, which lowers the taxes you pay in the year you claim the deduction. You receive the benefit of your RRSP contribution when you file your income tax return the following year, either in the form of a refund, or as a reduction in the taxes you owe.

However, there is a way to maximize your RRSP contribution. You can request that your employer contribute all or a portion of your bonus or lump-sum payment directly to your RRSP or your spouse's RRSP (as a spousal contribution). If your employer makes this RRSP contribution directly, and certain conditions are met (discussed in the section, "How it works"), the requirement to withhold income tax on that amount is eliminated. The benefit of transferring the amount directly is that you can invest the full amount without withholding tax, rather than the net after-tax amount, in your RRSP.

Let's look at an example. Say you receive a bonus this year of $20,000 and you have sufficient RRSP contribution room to make a $20,000 contribution. Let's also assume you have a marginal tax rate of 40%. If you receive your bonus directly and contribute the funds to your RRSP yourself, you'll only have the net amount of $12,000 from your bonus to contribute. This is because your employer is required to withhold $8,000 ($20,000 x 40%) for income tax purposes. In this scenario, your tax savings will only be $4,800 ($12,000 x 40%) and you'll need to wait until you file your tax return the following year to get your refund and contribute those additional funds to your RRSP. If you wanted to make use of your full RRSP contribution room, you'd need to use another source of funds to top off the RRSP contribution. If, instead, you asked your employer to contribute your bonus directly to your RRSP, your employer could contribute the full $20,000 to your RRSP and you wouldn't need to find another source of funds to maximize your RRSP contribution.

Keep in mind that if the bonus or lump-sum payment is paid to you early in the year, your employer may need to withhold Canada Pension Plan (CPP) and Employment Insurance (EI) contributions from your compensation. If the bonus or lump-sum payment is paid to you at the end of the year, you may have already reached the maximum annual amount for CPP and EI, so the amount you'll be able to put into your RRSP might be greater.

How it works

In order for your employer to directly transfer the gross amount of your bonus or other lump-sum payment to your RRSP without withholding tax, your employer needs to have reasonable grounds to believe you can deduct the RRSP contribution for the year. Providing your employer with a copy of your most current Notice of Assessment, which indicates your RRSP deduction limit, might be sufficient for their records. Alternatively, your employer may ask you to sign a confirmation that you can deduct the contribution for the year. There's no prescribed Canada Revenue Agency (CRA) form for this direct contribution.

Please note that your employer is not obligated to provide this service to you and reduce withholding tax. Some employers won't transfer your bonus or lump-sum payment directly to your RRSP and will instead pay you the amount less withholding tax.

An alternative way to reduce withholding tax on compensation

An alternative option exists where you make RRSP contributions yourself during the year. You may be able to request that your employer reduce withholding tax on your regular salary or on your bonus or other lump-sum payment. For your employer to reduce withholding tax, they may require you to provide them with authorization

An alternative option exists where you make RRSP contributions yourself during the year. You may be able to request that your employer reduce withholding tax on your regular salary or on your bonus or other lump-sum payment. For your employer to reduce withholding tax, they may require you to provide them with authorization from the CRA to reduce the withholding tax. To obtain approval from the CRA, you'll need to send them a completed Form T1213,

from the CRA to reduce the withholding tax. To obtain approval from the CRA, you'll need to send them a completed Form T1213, *Request to Reduce Tax Deductions at Source*. Quebec residents may need to use Form TP-1016-V, *Application for a Reduction in Source Deductions of Income Tax* to request Revenu Québec to authorize an employer to reduce the amount of income tax withheld at source. The CRA may not approve your request if you haven't filed all your previous years' income tax returns and paid all your taxes owing.

Conclusion

Asking your employer to directly contribute your bonus or lump-sum payment to your RRSP may provide you with immediate tax savings for the year, which may enable you to put more into your RRSP. In addition, contributing directly allows your RRSP contribution to be made earlier, effectively boosting your RRSP's opportunity for more growth. This is because by contributing early, your RRSP assets will have more time to benefit from tax-deferred compound growth.

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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