Here's what happens if you overcontribute to your RRSP and TFSA

There are limits as to how much you can invest in a registered account, so keep an eye on it to avoid being penalized by the CRA.

Registered accounts such as the RRSP and TFSA are great vehicles/options to help you minimize your tax as you grow your investments. But because of their special tax treatment, there are limits on what you can contribute. If you invest too much, you could get dinged with some hefty penalties.

Those who use RRSPs and TFSAs should get acquainted with their contribution limits. While a financial professional can help to make sure you're not putting too much into these accounts, if you invest on your own, it's up to you to pay attention.

Here's what you need to know about overcontributing.

TAX-FREE SAVINGS ACCOUNTS

How TFSA contribution room works

Once you turn 18, you start accumulating contribution room in your TFSA. Since 2018, that's been $6,000 a year. If you turned 18 before the TFSA was introduced in 2009, never made any contributions, and have been living in Canada since then, you'll have $75,500 of space to use in 2021. If you withdraw money from your TFSA you will get room back—including space created from your asset's growth—but only on January 1st of the following year.

What constitutes an overcontribution?

Any amount that exceeds your total contribution room. Say, for instance, you had $7,000 of space inside the TFSA at the beginning of 2020 ($1,000 carried forward from 2019 and $6,000 in new contribution room). If in January you deposited $8,000 in your TFSA account—you're now $1,000 over your limit.

It gets confusing if you remove money during the year and then want to reinvest before January 1st. Let's say you had $2,000 of room available and you withdrew $3,000 from your TFSA. A few months later, your cash flow stabilizes, so you re-deposit the full $3,000 those funds. However, because you only had $2,000 in remaining contribution room at the start of the year, that deposit put you $1,000 over your limit—at least until the new calendar year.

Taxes on TFSA overcontributions

Overcontributions to a TFSA are subject to a 1% tax per month either until you withdraw those excess funds or your contribution room increases enough to make up for the additional dollars. So, in our example above, that would be 1% of $1,000 (or $10) for each month from August until a withdrawal is made, or until January 1, 2021, when you'd get another $6,000 in contribution room (plus the $2,000 in room you had at the beginning of 2020).

Filing/payment deadlines and penalties

If you overcontribute to your TFSA, you must file Form RC243, Tax-Free Savings Account (TFSA) Return and pay any applicable taxes by June 30th of the following year. (If you are unaware of your overcontribution, the CRA will let you know and send you a TFSA Return package.) Those who miss the filing deadline will be charged a late-filing penalty of 5% of the balance owing, plus 1% for each full month that the return is late to a maximum of 12 months. Those who miss the payment deadline (whether they file on time or not) will be charged compound daily interest on the outstanding balance starting on July 1st. Needless to say, it's a good idea to remove that overcontribution as soon as you realize you've made a mistake.

REGISTERED RETIREMENT SAVINGS PLANS

How RRSP contribution room works

RRSP contribution room is based on income. Each year, your contribution room grows by 18% of your previous year's earned income, up to a maximum amount, which is $27,230 in 2020 and $27,830 in 2021. If you belong to a workplace pension plan, a pension adjustment amount (provided by your employer) will be deducted from your RRSP contribution room each year. Unused contribution room is carried forward into subsequent years. You can find your cumulative RRSP contribution limit on your Notice of Assessment. It's important to remember that, unlike a TFSA, if you withdraw from an RRSP you lose the contribution room forever.

What constitutes an overcontribution?

Any deposits you make to your (or your spouse's) RRSPs that exceeds the limit that appears on your previous year's tax assessment is considered an overcontribution and cannot be deducted from your current year's taxable income.

Taxes on RRSP overcontributions

You can overcontribute, over your lifetime, $2,000 without penalty. If you overcontribute more than that you will pay a tax of 1% per month on the amount in excess of $2,000 until you withdraw the extra amount or gain enough additional RRSP contribution room to accommodate the surplus. (Canadians under age 18 will have to pay tax on overcontributions of any amount.)

There are two situations where you may be exempt from paying tax:

- You noticed your overcontribution right away and withdrew the excess amounts
- Your contributions were mandatorily made to a qualifying group plan.

Also, if your overcontributions were a result of a reasonable error and you are taking steps to eliminate the excess amount, you can write to the Canada Revenue Agency explaining your situation and request that it waive the excess contribution tax. Be sure to include all supporting documents with your letter, such as copies of your plan statements.

Filing/payment deadlines and penalties

If your RRSP overcontributions are taxable, you must file Form T1-OVP-S and pay any applicable taxes no later than 90 days after the end of the year in which you made the excess contributions (which usually works out to March 31 of the following year). Those who miss the filing deadline will be charged a late-filing penalty of 5% of the balance owing, plus 1% for each full month that the return is late to a maximum of 12 months. Those who miss the payment deadline (whether they file on time or not) will be charged compound daily interest on the outstanding balance starting the next day—usually April 1st.

Stay on top of your contributions

While a financial professional can help you figure out if you've put more into these accounts than you should, it's ultimately your responsibility to get it right. People often have multiple TFSAs or RRSPs, which can make it hard to stay on top of things—for you and for your advisor.

To determine whether your accounts are in line with the rules, go to the CRA website (or phone them) log into your profile and see how much room you have left in your accounts. However, it's not foolproof—it's not updated in real time (this is a problem with TFSAs in particular), so it possible for the site to say you have room when you don't. Look at the site, but cross-check it with transaction reports from your respective accounts to get an accurate picture.

Clearly, overcontributing to your registered accounts can be an expensive endeavour, so be careful. Make sure to check your TFSA and RRSP contribution limits before setting up automated monthly deposits or making any lump-sum contributions.