Try Globe Unlimited - 1 month for just 99¢

See my options!

STRATEGY

Six little known facts about RRSPs that could save you money

JOEL SCHLESINGER
Special to The Globe and Mail

Published Tuesday, Feb. 16, 2016 6:00AM EST
Last updated Tuesday, Feb. 16, 2016 9:00AM EST

Millions of Canadians have registered retirement savings plans. Yet many of them do not give much thought to RRSPs beyond a monthly or annual contribution.

Yet there's plenty to get acquainted with. Here's a look at some lesser known – or poorly understood – facts about RRSPs, and ways they could give you an edge.

Contribute and pay your mortgage

If your RRSP is large enough, you can lend its capital to yourself to finance a mortgage. Referred to as a non-arm's length mortgage, it allows you to own your own mortgage inside your RRSP and pay yourself interest, which provides a healthy fixed-income return, says Jillian Bryan, a portfolio manager with TD Wealth Private Investment Advice in Vancouver.

"Instead of using the cheapest interest rate, like you would if you were borrowing from your financial institution, you'd pick the posted rate because you want to pay as much as you can to yourself." Posted rates are generally double the current return on guaranteed investment certificates (GICs) and non-high-yield bonds.

Save those contributions for later

Working Canadians can contribute up to 18 per cent of pretax income annually to their RRSP to a maximum of $24,930 for the tax year 2015, and unused contribution room can be carried forward indefinitely. Consequently, young earners with low incomes may be better off not contributing, allowing contribution room to grow so they can use it to better advantage in higher-income years later.

Or they can still make contributions but not claim them against current income, says accountant and certified financial planner Marc Lamontagne with Ryan Lamontagne Inc. in Ottawa. "This

would be useful if you made a contribution in a year that you have no or little income to deduct against."

It's not about the refund

People often fixate on the tax refund they receive based on their RRSP contributions. But the real focus should be on saving, says Mr. Lamontagne.

"Most people still treat RRSPs as a pure tax deduction," he says. "What you should do as a first step is calculate how much you need to save to retire, then see if using an RRSP will be more tax efficient" than a tax-free savings account (TFSA), for instance.

People should also remember that they will eventually pay taxes on their holdings when they are withdrawn.

"It doesn't matter what the source is – capital gains, interest or dividends – as soon as it comes out of the RRSP it's fully taxable income," says certified financial planner Colleen Gillam of Servus Wealth Strategies and Credential Securities in Red Deer, Alta.

True tax savings are only realized when the taxes you defer on contributions add up to more than the taxes you pay on withdrawals, when you are more likely to be in a lower tax bracket.

The higher the income, the better

Although all working Canadians can contribute to an RRSP, the benefit is often greater for high-income earners. That's because they are deferring taxes on contributions while they are paying a high marginal tax rate – exceeding 50 per cent in some provinces. The idea is that withdrawals will be made when they retire and are at a lower tax rate.

For individuals earning less, however, RRSP contributions might not make as much sense because they could end up paying more tax on withdrawals than the taxes they saved on contributions. They should consider contributing after-tax income to a TFSA instead.

"If you're in a lower bracket, you're not going to get that much of a deduction with an RRSP, and you get more flexibility with a TFSA," Ms. Bryan says.

While people don't earn a tax deduction upfront on TFSA contributions, they still get tax-free growth. And more importantly they can withdraw money tax-free and the withdrawals will not result in any clawback of Old Age Security and Guaranteed Income Supplement benefits.

Just what the doctor ordered

Created in 1957, the RRSP came into being in part thanks to the lobbying of the Canadian Medical Association. It urged the government to create a retirement savings plan similar to a pension plan

because many physicians were not members of workplace pension plans, Mr. Lamontagne says. And RRSPs are certainly advantageous to high-income, self-employed professionals such as family doctors.

But these high-octane earners have another, better option: the individual pension plan.

"If you run your own company, an individual pension plan allows your company to get the deduction on the contributions that flow into a pension," Ms. Bryan says. "And the amount your company can put in on a yearly basis far exceeds what you can put in an RRSP."

Spousal RRSPs still relevant

Pension splitting makes retirement income more tax efficient for couples, allowing the retiree with an employer pension to attribute half its income to the other spouse, reducing their combined tax bill. For this reason some people consider spousal RRSPs obsolete.

But spousal RRSPs still have value for families without workplace pensions, Ms. Gillam says.

"If one spouse works full time and the other stays at home, we generally recommend creating a spousal and as well as their own [RRSP]", she says. "So the income earner gets the tax benefit for both contributions, but the RRSPs are split more evenly between the couple."

This is particularly helpful during the period before income from a registered retirement income fund (RRIF) can be split with a spouse.

Follow us on Twitter: @GlobeInvestor *[https://twitter.com/@GlobeInvestor]*

ALSO ON THE GLOBE AND MAIL