CESTNICK

TAX MATTERS

These four RRSP tips can help improve your retirement

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED FEBRUARY 15, 2023

A lot of people are do-it-yourself retirement savers – and that's great. Just make sure you're doing things properly. I recall the story of the 64-year-old man from Gumperda, Germany, who was arrested after drilling a hole through a neighbour's wall in their duplex home. Turns out the man had spent two days trapped in his own basement after laying bricks to block an entrance but forgot to leave himself a way to get out. Oops. He didn't plan that very well.

When it comes to RRSPs, bad planning is not likely to get you arrested, but could affect your lifestyle later. Consider these ideas to improve the outlook for your RRSP savings.

1. Understand how much you'll need.

If you assume that you'll earn, say, 7 per cent on your portfolio each year, you might think you'll be able to withdraw 7 per cent annually in retirement. Not so fast. No portfolio grows in a straight line. If, for example, if you start with $100 and the market declines by 20 per cent and then you withdraw 7 per cent that year, you'll need to earn 37 per cent to get back to that $100 you started with. Prudent folks will assume an acceptable withdrawal rate of no more than 4 per cent annually.

If you want $60,000 annually in retirement, and assume a 4-per cent withdrawal rate, you'll need $1.5 million in your RRSP on your retirement date if you don't want to dip into your original capital. But this ignores inflation and that you'll need to withdraw more than $60,000 annually as the years go by to maintain the same standard of living. One simplistic, back-of-the-napkin approach is to multiply your desired annual income by 30. In this example, $60,000 times 30 would be $1.8 million – the amount to aim for by the time you start withdrawals from your plan.

2. Borrow for a catch-up contribution.

If you've accumulated a lot of RRSP room, borrowing to use up that room can a make huge difference in retirement. Aim to pay off a catch-up loan over five years or less if you can. Suppose you can afford a $300 monthly loan payment. You could take out a $15,000 RRSP loan today (at prime rate of 6.7 per cent) and pay that loan off over five years. Over that time, you'd pay $2,690 in interest, but you would have deferred taxes of $6,000

from the RRSP deduction, assuming a marginal tax rate of 40 per cent. The value of the tax deferral will outweigh your interest costs over several years. Even with interest rates where they are, this idea can still make sense as a forced savings plan because you'll be obligated to make loan payments. To the extent you can earn a return higher than the rate on the loan you'll end up with more in your RRSP in retirement than by simply contributing $300 per month to your plan for the next five years.

3. Equalize incomes in retirement.

If you're married or have a common-law partner, you'll save taxes if you and your spouse have equal incomes in retirement. One way to accomplish this is for the higher-income spouse to contribute to a spousal RRSP. The higher-income spouse will get the RRSP deduction, but the lower-income spouse will pay the tax on withdrawals (to the extent contributions to the spousal plan have not been made in the year of the withdrawal or the two prior years – so planning ahead is important). Another option is for the higher-income spouse to pay the household expenses to allow the lower-income earner to invest their income by making RRSP contributions (or investing in a TFSA or nonregistered account).

4. Pay attention to asset location.

Asset location is simply the particular account where you hold your investments. We're talking about RRSPs here, but there may also be nonregistered accounts in your name, corporate accounts, trust accounts, accounts in the name of family members and more. The decision about what types of investments to hold in which accounts matters because the tax result could be different in each case.

As a general rule, it makes sense to hold interest-bearing investments in your RRSP (or TFSA) to the extent possible since interest is highly taxed, and a registered plan shelters this income from tax. What about equities, or growth assets? If you still have room in your RRSP after fully building out the fixed-income portion of your portfolio, then go ahead and hold equities in your plan as well. But where you've already maxed-out your RRSP contributions and still have money to invest, you should hold your equities outside your RRSP since capital gains and any Canadian dividends will face lower rates of tax than interest income.

There's more to share, so I'll talk about RRSP tips again next time.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca