

Is too late to contribute to an RRSP?

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Question: I'm already 38 years old and I cashed in my RRSP to pay off my debt five years ago. I guess my question is, is it still okay for me to start contributing to my retirement plan. Am I too late to contribute and also I'm in the low income bracket but I think I can afford to put in \$2000. a year towards my RRSP.

Answer: It is not too late to start contributing to an RRSP since you do not have to start taking money out of your RRSP until the year after you turn 69. This means you have over 30 years to enjoy the benefit of tax-deferred growth that is offered by an RRSP. In fact, even after age 69, the money still continues to grow in a tax-deferred account. Over 30 years of tax-deferred growth will magnify the size of your retirement nest-egg compared to investing outside of an RRSP.

The low-income bracket part of your question is a little more complicated. Should a person with a low income contribute to an RRSP? The answer is "not always." The reason for this is that retirees with very low incomes are eligible for extra government support. Sometimes the income that a low-income retiree receives from their RRSP will actually make them ineligible for this extra government money. In these situations, the individual may have been better to have saved outside of an RRSP. As a general rule, the key source of financial security for a low-income Canadian is to have a modest dwelling that is owned with no mortgage. This eliminates rent payments during retirement, but does not reduce government benefits. Many retirees would enjoy a higher standard of living with a home that is paid for and no RRSP as opposed to having a small RRSP and paying rent.

Obviously, the best situation is to have a home that is fully paid for and an RRSP at retirement. By starting to plan now, hopefully you can accomplish both. Remember though, the target should be to have a home that is paid for at the date you wish to retire. Set up a plan to achieve that, and then add to your RRSP as you are able.

Question: A bank recently sold my son a \$1,000 GIC RRSP. Since his income is low, in fact below the tax threshold, it seems to me that this is tantamount to converting post-tax money into pre-tax money. Can he defer using the 2004 tax deduction receipt to a future year when his income will be above the tax threshold?

Answer: Yes, your son can defer using the deduction for his RRSP contribution until he is in a higher-tax bracket. By putting the money in the RRSP now, your son will receive two important benefits. The first benefit is that, by starting an RRSP at such a young age, your son will get a head-start on learning about investing and the importance of retirement savings. He is forming good habits now and these habits will be worth more to him over the long-run than any short-term tax implications. The second benefit is that the money invested in the RRSP will start to grow in a tax-deferred account. The longer the money is allowed to grow within an RRSP before it is withdrawn at retirement, the more powerful is the impact of this tax-deferred growth.

Assuming your son is earning something less than \$10,000 per year, it is probably best that he not deduct the contribution from his income as he will receive virtually no tax-savings. Better to delay until his income is higher. There is one small caveat to put on this statement which is that, assuming he would achieve even a small tax-savings by using the deduction immediately, the longer he waits to get the tax-savings, the longer he has to wait to get the refund on the RRSP contribution. Technically, you would have to consider the time-value of money to understand the disadvantage of not receiving the tax-savings immediately and compare this to the potential increased tax-savings that would be received by waiting to use the deduction until he is in a higher tax-bracket. Assuming that his income will jump significantly in the near future, this time-value of money issue is probably not something to worry about.

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