



Savings not just for retirement

Why advisers say an RRSP is the best investment move you can make

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Ask any financial adviser and you'll be told a registered retirement savings plan is probably the best investment decision you will ever make. The adviser may also tell you to ignore the "registered" and the "retirement" parts of the phrase.

Bottom line, an RRSP is a relatively painless way to create what can be a substantial nest egg.

"I think the retirement part actually puts people off," says Patricia Lovett-Reid, senior vice-president at TD Waterhouse Canada. "Young people, even middle-aged people, have a tough time imagining retirement. There is no immediacy for them. What I tell them is, ignore the retirement part of the name. These are dandy vehicles in which to create wealth."

Put just \$100 a month into a plan with an 8 per cent annual return for 10 years, starting on your 25th birthday. When you hit 65, you will have \$201,399, even if you did not tuck away another penny since you turned 35.

Tracy Broeze, a financial adviser with Oakville-based Cumming & Cumming Wealth Management Inc., agrees about RRSPs.

"On an individual basis, an RRSP is probably the best investment move most people can make," she says.

The reasons are threefold, according to David Phipps, a financial adviser at Assante Capital Management Inc. in Ottawa.

First, annual contributions allow you to defer income taxes normally due on those contributions. You will eventually have to pay the taxes, but unless you take the money out again when you are still in those prime earning years, the tax burden will be based on retirement income, which will probably be much less.

Second, any income from money invested in an RRSP is free of taxes until withdrawal.

Finally, an RRSP is indeed a great way to save for retirement, or maybe for your first home or to pay for continuing education. The rules say you can take money out tax-free for both, as long as you repay your plan within 15 years.

In the case of that first home, the limit is \$20,000 and repayment has to be on a regular annual basis.

"In short, RRSP contributions are one of only two ways to get a dollar-for-dollar reduction in taxable income," says Debby Stern, a partner in Soberman LLP.

"You save \$1 in taxes for every dollar contributed up to the annual limit. The only other similar deduction is legitimate business expenses for the self-employed."

The four financial professionals offer the following guide to RRSPs:

What are they? An RRSP is a government-registered savings plan that allows you to deduct contributions from your taxable income to a maximum amount every year, lowering your tax bill. Any income the money earns while it's in the plan is tax-free until you take it out.

Who can start one? Anybody who pays income taxes may benefit.

How do I open one? Go to any financial institution, financial adviser or accountant and fill out the forms. You have to choose between a plan managed by a third party like a bank, management company or mutual fund company, and what is called a self-directed plan, which means you call the investment shots from a greater variety of investments, although you will probably still use a third party to make the investments.

How much can I contribute a year? Your upper limit depends on your taxable income, but the rule of thumb is 18 per cent of your taxable income, less any company-pension contributions you and your make. The maximum for the 2006 taxation year is \$18,000, rising to \$19,000 for this tax year.

Suppose I don't contribute right up to the limit? The difference between what you did contribute and your limit can be carried over until you hit 69 and can be used at any time to top up your plan.

Why age 69? Because on Jan. 1 in the year after your 69th birthday you have to roll the RRSP into either a registered retirement income fund or an annuity and start drawing down a minimum amount as income every year.

What is the minimum? Divide the total value of the plan by 90 minus your age. That means if you have \$250,000 and you are 70 years old, you need to take out \$12,500 that year.

What can I invest in? Almost anything that earns income. That includes mutual funds, stocks, bonds, guaranteed investment certificates and cash in money market accounts. In fact, you can even use an RRSP to lend yourself money in a mortgage for your home. To some extent, even shares in privately held companies qualify. (If in doubt, check the rules with an accountant or the tax department.)

How much of a return can I expect? That depends on your tolerance for risk. The higher the return, the higher the risk, according to the general rule. Bonds usually have lower returns because these investments are less risky than stocks.

Can I take money out? A Bank of Nova Scotia study shows that 40 per cent of Canadians have made an average of three withdrawals from RRSPs. If you take money out, it becomes earned income in that year, unless it is used to pay for continuing education or for the down payment on your first house. Both have to be paid back into the RRSP within 15 years.

How does that affect my RRSP? First, of course, the value of the plan drops. Equally important, you lose the investment income from the amount withdrawn. In the case of a \$20,000 down payment on a house taken from a plan earning 8 per cent, that would cost you \$1,600 in tax-sheltered interest income in the first year alone.

Can I borrow to make contributions? Sure, but remember, you cannot write off the interest on the loan, so that reduces the tax savings. Also, few people actually use their tax refunds to pay off the debt, which makes the most sense. The end result is a loan that takes longer to repay than expected and dilutes the tax savings that the borrowing was intended to deliver.

What is the best way to contribute? Start young and make regular monthly contributions year in and year out. If your income is unlikely to rise or fall much in the coming year, figure out your RRSP contribution, divide by 12 and then immediately start making monthly contributions.

Should I have more than one RRSP? That begs the question, Why? The experts advise keeping administration to a minimum, so unless a financial adviser comes up with a compelling reason, stick with a single RRSP.

Can I contribute to one for my spouse? You sure can, but understand whatever you contribute comes out of your maximum annual limit. In general though, those same experts also say both spouses should have RRSPs of equal value when it comes to retirement age.

When is it too late to start an RRSP? When you are 69. Even if you are 65, you still have four years before you have to roll everything into a RRIF, four years to save on taxes and see those savings grow tax-free.

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