Strategies to maximize the growth of your RRSPs

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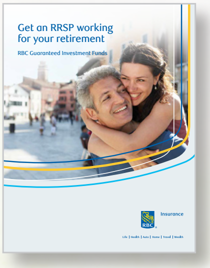
Are you ready for RRSP season?

Before you know it, RRSP season will be here. For most Canadians, RRSPs represent a key source of retirement income, and many of us work hard to accumulate these savings over many years. RRSPs have become one of the investment vehicles of choice because contributions are tax-deductible and asset growth is sheltered from taxes.

That's why it's important to lay out the groundwork for an investment plan throughout the year. Incorporating RBC® Guaranteed Investment Funds (GIFs) into your retirement strategy is one of the best ways to establish and build wealth so you can meet your RRSP objectives and create a sound financial plan. RBC GIFs are a smart investment choice that can help you to further achieve your RRSP objectives since your assets are protected through principal guarantees.

This guide has been designed to provide valuable information and strategies to help maximize your RRSPs. Using this guide with the "**Get an RRSP working for your retirement**" brochure will provide you with a holistic perspective on retirement planning. We hope you find this guide beneficial when planning for your future.



RRSP strategies

There are many strategies for maximizing your RRSP contributions. We'd like to share some of these strategies with you so you can get a full understanding of how to take advantage of them.

The earlier you contribute, the greater the sum

Start early and invest regularly

Many of us wait until the RRSP deadline to invest a single lump sum in our RRSP. The truth is, monthly contributions versus yearly lump-sum contributions not only are easier to manage, but also provide the greater benefits of dollar cost averaging (see section titled "The benefits of dollar cost averaging") and compounding. Making regular contributions to an RRSP can greatly increase your retirement savings!

That's why setting up a pre-authorized debit (PAD) schedule of contributions is a smart decision. And if you can a make a lump-sum contribution, such as a bonus or an income tax refund, early in the year, on top of your monthly contributions, you'll have an even greater advantage.

With a PAD schedule, you authorize regular withdrawals from your chequing account with the proceeds going to your RRSP, which eliminates the hassle of writing and mailing cheques. Under this arrangement, your monthly or quarterly contributions are automatic, and you can budget for it accordingly.

Why pre-authorized payments make it easier

When you choose to contribute through monthly pre-authorized payments, you choose how much and how often contributions are withdrawn from your account and invested in your RRSP. This way, you don't have to worry about having the funds to make a lump sum contribution, and you can plan for small payments every month.

Many people with a pre-authorized payment plan find that they don't even miss the money. Setting aside a small portion of your money becomes a habit you won't even think about. Another good habit is to put at least half of your bonus into your RRSP. And, if you get a raise, you can increase your monthly contributions to reflect the wage increase — you're already used to living without it, so you won't even notice the difference.

Case study: Why invest early and regularly

Let's take a look at 30-year-old Eric's* RRSP contributions. He likes to wait until the RRSP contribution deadline to contribute, and he's usually able to afford to contribute $5,000 as a lump sum. Eric plans to contribute until he's 65. At a 6% growth rate, his RRSP will be worth $557,174 when he retires.

Now let's take a look at 30-year-old Mark, who has chosen to contribute the same $5,000 per year but on a monthly basis. Based on the same 6% rate of return, his RRSP at age 65 would be worth $575,581. This means, Mark's retirement fund would be $18,407 larger than Eric's, for the simple reason that he contributed earlier in the year.

* All case studies are for illustrative purposes only and are not true accounts.

No lasting impression with last-minute contributions

As you can see from this example, making regular contributions to an RRSP can greatly increase the money you'll have when you're ready to retire. Just by making a contribution in January of the current year, you'll have the opportunity for the return on your investment to compound tax-deferred over an additional 14 months. Whereas, if you leave the contribution until February of the following year, you'll miss out on some of the major benefits that time can provide your investments.

In addition to the time frame for growth, you will also get a tax break on your contributions. Every dollar you contribute to your RRSP can be deducted from your taxable income for the year. What's the result? Less tax to pay and possibly even a refund! However, you should know that there are limits to how much you can contribute each year. You should verify your contribution limits on your Notice of Assessment, or call the CRA TIPS Hotline at 1-800-267-6999 to find out your limit.

Belong to a pension plan?

If you belong to your employer's Registered Pension Plan (RPP), the amount of contributions that you can make to an RRSP will be less. However, you should still consider contributing to an RRSP to the fullest extent possible to supplement your pension benefits.

Your employer is responsible for calculating your pension adjustment and reporting it on your T4 tax form. Since the RRSP deduction limit uses the prior year's pension adjustment figure, you can refer to your prior year's T4, which is usually issued in February of the current year, to calculate your current year's RRSP limit.

The benefits of dollar cost averaging

What is dollar cost averaging?

Dollar cost averaging is an investment strategy involving regular deposits to a particular investment at regular intervals over a period of time. The period could be over several weeks, months or even years. This method of investing can be a powerful risk reduction strategy during times of market volatility or uncertainty. Dollar cost averaging can lower your average price and increase the number of units of your investment(s).

How does it work?

The amount of money invested remains the same over time, but the number of units purchased varies based on the unit value of the funds at the time of the purchase. When the markets are up, you buy fewer units per dollar invested due to the higher cost per fund. When the markets are down, the situation is reversed and you purchase a greater number of units per dollar invested.

It's a strategic way to invest since you buy units at varying unit prices each month, giving you an average unit cost over time. This means you don't have to invest the time and effort to monitor market movements and strategically time your investments.

What are the benefits?

By investing regularly, you're doing so regardless of what's going on in the market. This means you don't have to worry about trying to follow the market and guess when the right time to buy or sell is.

How can you set up your own dollar cost averaging plan?

First, you have to decide how much money you can afford to invest each month. Take a look at your monthly expenses and see how much you have left over, then decide from that amount how much you realistically don't need for those other expenses that come up such as lunches, entertainment and gifts. It's important to keep the amount consistent from month to month; otherwise you won't see the full benefits.

Secondly, you need to decide on the type of investment and how much risk you are comfortable with. Guaranteed Investment Funds (GIFs) are a smart way to know your RRSPs are well invested and well protected, and provide a combination of growth potential and principal guarantees.

Finally, you must arrange for the money to be withdrawn automatically so you don't have to remember to invest, or come up with an excuse as to why you can't afford it this month.

Conclusion

As you can see dollar cost averaging is a simple strategy that can help you build wealth over time while averaging out the cost of your investment. Take the time today to decide how much money you can afford to invest every month. The sooner you get started, the easier it will be to achieve your goals.

Accelerate your RRSP savings using your income tax refund

When you think about it, investing in RRSPs is one of the best ways to achieve your long-term financial goals for retirement. Developing a plan for your income tax refund is essential in accelerating the savings in your RRSPs.

In taking a closer look at your choices, you'll see that you have two options. The first is to simply spend your refund, and the second is to combine several strategies that will help to accelerate your wealth and reach your retirement goals sooner.

Why it's not a good idea to spend your refund

When you spend your refund, you're significantly reducing your retirement benefits. For example, for every $1,000 investment in a 50% marginal tax bracket, you get back a $500 refund, which means your after-tax cost is reduced to $500. By spending the refund, your after-tax commitment to your retirement goal is really only $500. Your RRSP still grows, but misses out on additional contributions.

Reinvest your refund in an RRSP

When you reinvest your refund in your RRSP (provided you have available contribution room), you increase your investment by the same percentage as your refund. For example, if you are in a 40% tax bracket, investing the 40% tax refund will increase your RRSP by the same 40%.

Borrowing to make an RRSP contribution

Why is it beneficial to borrow your RRSP contribution?

For some, it makes sense to borrow money to make the maximum allowable RRSP contribution. Although the interest on the loan isn't tax-deductible, taxes saved on the contribution amount, along with any earnings on your investments, can help offset the cost of borrowing.

This strategy proves most advantageous when you can expect to pay off the loan right away or at least within one year and use your refund towards paying down the loan, thereby minimizing interest. Even better, the taxes you save on your RRSP contribution and the earnings in your RRSP could more than compensate for the interest you may pay.

You should also keep in mind, if you decide not to borrow this year, you can carry forward your unused contribution limit to the following year when cash may be available, or if you wish to borrow at that time.

Gross up or top up to maximize your RRSP contribution

If you still have contribution room but don't have the extra money to invest, you can borrow funds to "gross up" or "top up" your RRSP contributions. What this does is make each dollar of your RRSP work to its maximum potential for each dollar you've invested. If you have room to contribute $10,000 to your RRSP but only have $7,000 to invest, you can borrow the extra $3,000 to top up your RRSP. This way you're making the most out of your contribution limit. When you receive your income tax refund, you can use it to pay off a portion of the loan with little or no interest.

Catch-up loan

If you have not been able to maximize your RRSP contribution for a few years, you will have unused contribution room available. This is when you should consider an RSP loan to catch up on your RRSP. For example, if you have unused RRSP contribution room of $30,000 and take out a loan for this amount, assuming you are in a 50% tax bracket, you could then use your $15,000 refund to pay back a portion of the loan. The rest of the $15,000 could be paid off at a low interest rate over a few years. By using this strategy, you could catch up on your RRSP savings for retirement and help achieve your goals faster.

In order to determine which strategy would work best for you, please speak with your advisor.

Can you make extra contributions to your RRSP?

Yes, certain qualifying income may be transferred to your RRSP in any year or within 60 days of the next calendar year. Ask your advisor to find out if you have income that qualifies.

What happens if you overcontribute?

In 1996 it became allowable to make a $2,000 overcontribution to your RRSP without being subject to penalty tax. But, if you have an RRSP overcontribution in excess of the $2,000 limit, you'll be charged 1% per month on the excess amount.

Benefits of spousal RRSPs

What is a spousal RRSP?

It is a plan opened in your spouse's name that you contribute to. Your spouse is the legal owner of the plan.

Who claims the contribution on their income tax return?

When a spousal RRSP contribution is made, the spouse making the contribution claims the contribution on their income tax return. While the contribution is deposited into the spouse's RRSP, the amount contributed is included as part of the contributing spouse's RRSP deduction limit. The end result is that both you and your spouse pay less tax overall.

What is the age cutoff for contributing to a Spousal RRSP?

If you are 71 or older and you have an earned income, you can still contribute to a spousal RRSP and claim the tax deduction if your spouse is age 71 or under.

Who gets taxed when a withdrawal is made?

Withdrawals from a spousal RRSP are taxed in your spouse's hands provided you (the contributor) have not invested any amount in any spousal plan in the current or previous two years.

What happens when a withdrawal is made before maturity?

If a spouse makes a withdrawal before maturity and the contributor has deposited cash or other assets into the spousal RRSP in the current or previous two years, the amount withdrawn (up to the amount of the contributor's deposit) is included in the contributor's income for that year.

What is the three-year attribution rule?

If you are considering a spousal RRSP, it's important that you understand the impact of the three-year attribution rule. This rule is designed to prevent a high-income spouse from contributing to a spousal plan and having the funds almost immediately withdrawn and taxed to the lower income earning spouse.

What's key to the rule is that the three years are based on calendar years. For example, if your last contribution was made on December 2021, a withdrawal would be taxable as your income until January 2024.

In this way, if your spouse withdraws from their spousal RRSP within three calendar years of your last contribution to any spousal RRSP, the withdrawal will be treated as income on your personal tax return. While, if the withdrawal is made more than three years after the contribution, the withdrawal will be treated as income on your spouse's tax return.

When doesn't the three-year attribution rule apply?

There are some instances when the three-year rule doesn't apply: if you and your spouse are going through a separation or divorce and are living apart; if the spouse who contributed dies in the year a withdrawal is made; if either you or your spouse becomes a non-Canadian resident for tax purposes; and if you transfer your RRSPs to an annuity.

Tax planning strategies

Most people use the first months of the new year to relax and recover from the holidays. But really, it's an ideal time to focus on important deadlines and financial opportunities that lie ahead.

Each year, Canada Revenue Agency (CRA) sends out, along with a Notice of Assessment for your income tax return, a calculation of what your RRSP contribution is for the year. You can use this number to plan how you want to maximize your tax deduction and return to their fullest potential.

How to use your tax deduction to your advantage

One of the key benefits of an RRSP is its tax deductibility. When you make an eligible contribution to your RRSP, it reduces your taxable income since money invested in your RRSP is tax sheltered. For example, if you contribute $5,000 to your RRSP, you'll reduce your taxable income by the same amount. If you're in a 40% tax bracket, that means your $5,000 will generate a tax benefit of $2,000. This will result in a reduction in the amount of tax you have to pay and could even generate an income tax refund.

Using income-splitting strategies between spouses can provide significant tax savings!

If you expect the future tax rate of your spouse to be lower than yours, you should consider income splitting by directing your contributions to a spousal RRSP. It gives you the tax deduction, plus when the money is withdrawn, it is taxed at your spouse's lower tax rate. It essentially helps to defer taxes right away while also reducing taxes in retirement.

Income-splitting case study

The following case study illustrates how setting up an income-splitting RRSP helped one couple save a significant amount of taxes.

Brad and Julie* have been married for 40 years and Brad has decided to retire. He has worked as a director of a large firm for over 30 years and has accumulated a large pension and other investment income, putting him in a tax bracket of 40%. On the other hand, Julie has worked as an advertising executive and has made significantly less income than her husband, putting her in a tax bracket of 20%.

Knowing Julie still has $30,000 in RRSP contribution room, they have decided to transfer $30,000 of Brad's eligible pension income to Julie's RRSP. This will reduce Brad's taxable income and provide a tax deduction since it will be taxed at Julie's tax rate of 20% compared to Brad's 40%.

* All case studies are for illustrative purposes only and are not true accounts.

Withdrawals from an RRSP

RRSPs are accumulation products, so you should plan to leave your RRSPs untouched until retirement. However, there may be instances where a withdrawal may be necessary. When you withdraw funds from an RRSP, the amount withdrawn becomes taxable as income and tax will be withheld from the withdrawal amount.

The following chart illustrates the withholding tax rates required:

Amount withdrawn	Quebec	Other provinces
$5,000 or less	20%	10%
$5,001 – $15,000	25%	20%
Over $15,000	30%	30%

What if you become a non-resident and need to make withdrawals?

You'll be responsible for paying a 25% withholding tax, under the Income Tax Act, on both periodic and lump-sum payments from an RRSP or RRIF. If you choose to move to a country Canada has a tax treaty with, the rate may be reduced. You can, however, transfer a lump-sum pension benefit or retiring allowance (within limits) directly to your RRSP without paying withholding tax and transfer certain funds tax-free between RRSPs. When you pass away, your non-resident spouse will be allowed to transfer certain RRSP benefits directly to an RRSP, annuity or RRIF.

How can you minimize withholding tax?

The amount of tax that is withheld by your financial institution for RRSP withdrawals can be minimized by making sure each withdrawal is $5,000 or less and is a separate request.

Maximizing your RRSPs through a final RRSP contribution

In order to maximize your RRSP contributions, there are two ways in which you can make contributions before you close your RRSPs by December 31 of the year in which you turn 71.

Final year RRSP contribution strategy

If you haven't maximized your contributions and have unused carryforward room, you can then make a lump-sum contribution before closing your RRSP. The resulting tax deduction does not have to be used on that year's income tax return. Instead, deductions can be carried forward indefinitely and can be spread out over several years to reduce taxable earnings in retirement.

Overcontribution strategy

If you've earned income in your final RRSP year that has generated room for the following year, you should consider a final December overcontribution before closing your RRSP. Since the contribution is being made in December and the current year's RRSP room has been maximized, an overcontribution penalty of only 1% per month applies on any amount in excess of $2,000. On January 1 of the subsequent year, your overcontribution disappears and you'll get a tax deduction on your next year's income tax return.

Reminder

If you are 71, you do not have a 60-day grace period to make your final RRSP contribution. You must make your final RRSP contribution by December 31 of the year in which you turn 71.

Since RRSP tax deductions can be carried forward long after your RRSPs have closed, a final year RRSP contribution can be an important tool for lowering earned income in retirement and reducing the impact of any clawbacks (when benefits must be returned because investments were sold before maturity) on income-tested government benefits such as Old Age Security (OAS).

What are your RRSP maturity options when you turn 71?

You must convert all RRSP assets by December 31 of the year in which you turn 71. Your options include:

- Converting to a Registered Retirement Income Fund (RRIF)
- Purchasing either a life annuity or term certain annuity to age 90
- Deregistering your RRSP and receiving a lump-sum cash payment

Contributing to a Spousal RRSP after age 71

It's still possible to make RRSP contributions after the year in which you turn 71, just not to your own RRSP. If you have a spouse or common-law partner who is younger than you, you can contribute to a Spousal RRSP set up in their name. This allows you to claim a deduction on your income tax return and reduce your tax bill.

All you need is the RRSP contribution room. If you have unused RRSP contributions carried forward from previous years before your RRSP matured, you can use these to make a spousal RRSP contribution after your own RRSP has matured. If you have maxed out your contributions, many retired people have part-time or consulting jobs that generate earned income, resulting in RRSP contribution room even in retirement.

What happens if you need funds before you turn 71?

It's possible to withdraw or deregister funds from your RRSP at any time, unless they're held in a locked-in RRSP or Locked-in Retirement Account (LIRA). The amount withdrawn must be included in your taxable income in the year of withdrawal. Amounts withdrawn don't retain their original tax treatment and are treated as regular taxable income. When deregistering funds from an RRSP, the federal government requires a withholding tax to be deducted from the amount withdrawn.

Conclusion

RBC GIF: Helping you reach your retirement goals

Once you've planned out your strategies, you can feel good knowing you're on track to reach your retirement goal. But answering all of these questions on your own can be difficult. That's why it's good to talk to your advisor.

Services available through your advisor can help you determine if you're on track with your retirement plans. If your current situation doesn't match your goals, your advisor can provide the direction necessary to put you back on course.

At RBC Insurance®, we offer a variety of tools and resources to help you with RRSP planning. Please speak with your advisor to learn more.

When looking into various investment options for your RRSP, choose RBC Guaranteed Investment Funds to help you meet your financial and retirement goals. With its underlying funds backed by RBC Global Asset Management®, an RBC GIF amounts to a compelling investment solution. Ask your advisor about RBC GIFs today.

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Insurance

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