4.3. Savings & Investments - RRSPs

RRSPs

Registered Retirement Savings Plans or RRSPs are a form of retirement savings vehicle with some additional features. As the name suggests, RRSPs are intended to be used specifically to help you save money for retirement. They are registered with the Canada Revenue Agency and there is a limit to how much you are allowed to contribute to your RRSP each year which is determined and confirmed by your Notice of Assessment.

There are some advantages to an RRSP, the biggest of which is that it reduces your taxable income when you contribute to your RRSP and it defers or puts off the taxes on the growth you earn until you withdraw the money. The basic theory behind RRSPs is that they allow you to pay lower taxes when your earning potential is highest and you may be in a higher tax bracket. Then, when you retire and withdraw the money, you have less income and may be in a lower tax bracket when you have to pay taxes on the money in your RRSP. When you make a contribution to your RRSP, you can claim it as a tax deduction which will reduce the amount you pay in taxes that year. RRSPs also allow you to defer the taxes on the growth your RRSP earns until you withdraw the money so they can grow tax-free as well. While RRSPs are intended to be used as savings for retirement, you can usually withdraw the money prior to retirement within the limits of the terms and conditions of the RRSP investment vehicle you chose. However, you will be taxed on the money when you withdraw it so most people find it beneficial to wait until they retire, when their income is usually lower and therefore in theory, their income tax rates are lower.

Besides all the tax benefits RRSPs provide, they are also simply a great vehicle for saving for retirement. The money is less accessible than when you put it in a savings account which can help to ensure the funds don’t get used for other purposes. And if you start investing money when you’re young (which is highly recommended), you are able to invest over a longer period of time which, depending on your RRSP investment vehicle, has potential for a much higher rate of return than a simple savings account or shorter-term investments.

There are also specific programs that the Government of Canada has set up that allow you to access the funds from your RRSP for specific purposes without having to pay the taxes on the money. The Lifelong Learning Plan (LLP) is a program that allows you to withdraw money from your RRSP tax-free. Under this program, you can withdraw up to a certain amount from your RRSP tax-free to finance full-time training or education for yourself or your spouse or common-law partner. You then have up to 10 years to repay the funds to your RRSP.

The Home Buyers’ Plan (HBP) is another way you can withdraw money from your RRSP tax free. Under this program, a first-time home buyer can withdraw up to a maximum limit set by the government from their RRSP tax free to use to buy or build a qualifying home and they have up to 15 years to repay the funds to their RRSP.

A Spousal RRSP is another way you can use RRSPs and income splitting to save money in taxes. If one spouse earns more than the other and is in a higher tax bracket, the higher earning spouse can set up a Spousal RRSP in the name of their spouse. The higher earning spouse then contributes to the RRSP and receives the immediate tax benefits. Then, when they retire and withdraw the money, their tax bracket will hopefully be lower when they withdraw from two smaller RRSPs than it would if they had withdrawn the money from one larger RRSP.

You can open multiple RRSPs but you do need to be careful because there is a limit to how much you can invest in an RRSP each year. Be aware that this limit is not per RRSP but is per person and applies across all of your RRSPs combined. The limit is currently 18% of your previous year's earned income or a yearly maximum amount set by the government, whichever is lower. If you don't use all of your RRSP room in a given year, that amount will carry forward and you can contribute that unused amount in a future year. If you contribute more than your RRSP deduction limit by more than $2,000, you will have to pay a tax which is calculated per month until you withdraw the excess amount.

Most FIs will offer a variety of RRSP options similar to their standard GIC or term deposit options. These offer little to no risk and usually offer a guaranteed but relatively low rate of return. Mutual funds, stocks or bonds are also possible RRSP investment options. These are not insured or guaranteed and any potential growth will depend on your tolerance for risk.

You can contribute to your RRSP until December 31 of the year you turn 71 or, in the case of a Spousal RRSP, until December 31 of the year your spouse turns 71.

You can choose to withdraw the money from your RRSP at any time until the end of the year you turn 71, at which time you will need to convert it into a Registered Retirement Income Fund (RRIF).