

RRSP is a Gift to your Future

'Tis the season of frothy hot chocolate, moonlit sleigh rides and great tax savings. That's right; RRSP season has begun.

Most people would rather have a root canal than create a financial plan, according to the International Association for Financial Planning, but if you are one of the few who would rather save money on taxes, read on.

In my opinion there is no better way to prevent the January blues, than to save a few hundred dollars in tax. One way to do this is by creating a plan for your retirement.

You will need about 70 per cent of your pre-retirement income to maintain your current lifestyle when you retire.

You could rely solely on the government to take care of your retirement needs, but with so many Baby Boomers retiring at once, it isn't wise.

How can you save for retirement? The best option is an RRSP.

What is an RRSP?

An RRSP (Registered Retirement Savings Plan) is a government approved savings plan, through which you save money for your retirement years. The plan derives its name from the fact that it is a trust agreement registered with Canada Revenue Agency (CRA).

Why should I invest in an RRSP?

Your contributions are tax deductible and the income earned is tax sheltered. This means you can:

Reduce the amount of income tax you have to pay for the year in which the contribution is deducted. Postpone paying income tax on earnings generated from investments until they are withdrawn.



The purpose of an RRSP is to contribute in your higher income years when income tax is higher and withdraw during retirement when income and income tax rates are lower.

Who is eligible to contribute?

Everyone who earns income including non-residents, can contribute to an RRSP up until the end of year in which you or in the case of a joint RRSP, your spouse or common law partner, reaches age 69.

What is earned income?

Some examples of earned income are salary, wages, bonuses, taxable wage loss or long-term disability income resulting from employment. Earned income does not include dividends, interest or capital gains.

What is the deadline for making a contribution?

Although you can contribute any time during the year, by contributing within the first 60 days of the calendar year, your RRSP will grow larger, faster.

When you invest in the first 60 days of the calendar year you can deduct your contribution and reduce taxable income from the previous, current or future calendar year. If you invest after the first 60 days of the calendar year you can only deduct the contribution for the current or future calendar year.

Also, by investing in the first 60 days you will benefit from compounding over long periods of time. Compounding occurs when all income (the principal and the interest you earn) from an investment is reinvested, thereby earning additional income.

Begin early and invest regularly even if you can only afford to make small payments in order to experience the benefits of compounding.

To make the deadline this RRSP season, invest by March 1.

How much can I contribute?

Each year the federal government sets a limit on how much you can contribute to an RRSP. CRA will send you a Notice of Assessment to let you know how much you can contribute to an RRSP for a given year.

As of February 2003, the contribution limit for 2003 was \$14,500 and for 2004 it will be \$15,500. However, your limit may be more or less depending on your earned income, if you have a pension plan, unused contributions from previous years, etc.

How to make the most of your retirement savings:

1. You can start saving for your retirement when you are young by filing your own tax return and investing a small amount in an RRSP. By investing early you will have extra room accumulated in your RRSP so you can invest more than the maximum limit in your higher income earning years.

2. A spousal RRSP is a great option if you are in a higher tax bracket than your spouse/common law partner and will have a higher income than your spouse/common law partner when you retire. You can contribute to an RRSP in the name of your spouse/common law partner and deduct the contribution to reduce your taxable income. This is called income splitting.

A spousal RRSP is also beneficial because you can continue making contributions until the younger spouse/common-law partner reaches age 69.

However, if you and your spouse do not remain together, your spouse/common law partner can cash the RRSP and you pay the tax on the withdrawal if you have contributed to the

RRSP in the year of the withdrawal or the two preceding years. You will be taxed on the lesser of the funds withdrawn or the amount of the contribution.

3. If you have a pension plan, take advantage of it especially if your employer will match your contributions. If your employer will match up to a certain percentage of your salary, be sure to take advantage of the total amount. Who would pass up free money?

4. There are three basic types of RRSP investments - deposit type plans, mutual fund based plans and self-directed plans. Common RRSP-eligible investments are GICs, government bonds, mutual funds*, mortgage secured by real property located in Canada, shares of capital stock of a public corporation and a share of, or similar interest in a credit union. If you are planning to retire in the next few years, you should invest more in lower risk investments like GICs and bonds versus stocks and mutual funds. However, if you are not going to be retiring for several years you can afford to take on more risk and gain the opportunity of higher rates.

5. Over the years, there has been a reduction in fees charged for RRSPs; however, depending on the financial institution and the type of RRSP investment you have, you may be charged a fee. Not all financial institutions actively advertise their fees so you should inquire before deciding on an RRSP.

If you can, try to avoid mutual funds* with a front-end load because the fee is deducted from the principal reducing your investment's growth.

6. To get the most out of your RRSP, plan to keep the money in the investment until retirement. If you do not, you will be taxed on the full amount up to 30 per cent. This pertains to the amount kept at time of withdrawal. It could amount to the highest marginal rate depending on your tax bracket when you file your taxes.

7. If you die before your RRSP matures, you can transfer the funds to your spouse/common law partner tax free into his/her own RRSP or RRIF if you have designated them the beneficiary of the RRSP. If there is no surviving spouse/common law partner, dependent child or named beneficiaries, the proceeds will be transferred to the estate and taxed as if you had withdrawn the entire RRSP in a lump sum.

Mutual funds are offered through Credential Asset Management Inc. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Unless otherwise stated, mutual fund securities and cash balances are not covered by the Canada Deposit Insurance Corporation or by any other government deposit insurer that insures deposits in credit unions. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.