

RRSPs offer one of best tax breaks

A contribution of \$5,000 could save you \$1,725 in taxes

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TORONTO - There are two powerful reasons to take advantage of a registered retirement savings plan when you want to sock away money toward a comfortable post-workplace life.

One is the discipline of regularly contributing to your retirement.

The other, even more compelling, reason has to do with tax -- every dollar you put into your RRSP comes off your taxable income.

"So somebody making \$60,000 -- if they make a contribution of \$5,000, what they will save in taxes is \$1,725," noted TD Waterhouse vice-president Patricia Lovett-Reid.

"Not bad."

And the gains made through interest or appreciating mutual funds or stocks won't be taxed until you start withdrawing some of the funds, ideally at a time when your tax rate is less than the one you received during your working life.

"Hopefully, you're putting it in and getting a deduction at a higher tax rate than when you're taking it out," said Denis Tew CFO at Franklin Templeton Investments.

Just because you have made a contribution to your RRSP, that doesn't mean you have to claim it when you next file your tax return.

You may find it advantageous to wait and claim the deduction in a year when you're making more than you are now.

"So for example, you could postpone a claim, claiming the deduction when you're making lower than normal income and it could be for a whole host of reasons," said Lovett-Reid.

"Maybe you're on maternity leave, a leave of absence, you've had a reduction in the shift you're working on and then you know you can always make the claim later when you revert back to previous income or your income levels increase."

Many couples are also able to take advantage of income splitting.

That's where the highest-earning member of the family, likely in a higher tax bracket, moves income to someone earning less and ideally in a lower tax bracket.

"Spousal RRSPs can help split the income and save money on taxes because it equalize the amount of money coming in to a greater extent," observes Lovette-Reid.

You could set up a spousal RRSP for the lower-earning spouse, where one spouse makes contributions on behalf of the other.

But remember, the combined contributions from both spouses cannot exceed the total RRSP room of the spouse with the higher income.

There are also tax issues that arise should you decide to raid your RRSP account.

Suppose you have a household emergency and want to withdraw \$5,000 for, say, a new furnace.

"The government puts a withholding tax on it, immediately," said Tew, noting that it usually comes in at around 10 per cent.

That money you withdraw will be lumped in with your taxable income and you will pay income tax on the amount.

However, the government does allow you to take out a maximum of \$20,000 without penalty to buy a new house.

This must be repaid within 15 years. If you don't repay the one-15th amount, the money will be tacked on to your taxable income.