Tick Tock: RRSP Season is Here!

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I am continually amazed at the number of people, who have high incomes and savings, that fail to take full advantage of the preferential tax treatment of RRSPs versus other types of investment or savings accounts. This is especially true for business owners who often have retained earnings in their corporations while also having massive amounts, sometimes $50,000 or more, in unused RRSP contribution room.

With the recent Federal Government's rewriting of tax policies for business owners, it is especially important to review fundamental tax planning assumptions and the use of RRSPs as a vehicle to build personal pension programs. One area of concern is the large and rapid build-up of retained earnings within corporations (usually holding companies) as a form of tax-advantaged asset accumulation and aggressive pension savings.

One way we recommend avoiding punitive taxes on retained earnings, at marginal tax rates estimated to be over 70% by the CIBC's tax expert Jamie Golombek*, as noted in various media articles, is to strip out retained earnings from your corporation to avoid future punitive tax rates. You can use your RRSP unused contribution room to do this.

For example, if you have unused room of $100,000, then you can take that amount as straight earned income from your corporation and contribute it to your RRSP. The extra income is dollar for dollar deductible personally as an RRSP contribution with no additional personal tax payable. Even if you were to subsequently withdraw those funds from your RRSP in future years, your maximum marginal tax rate (MTR) will be about 53% depending upon which province you live in.

Another common situation, when reviewing client financial strategies, is finding that many people have TFSAs while also having unused RRSP contribution room. The best tax saving strategy for high income earners, is to first use up all your RRSP contribution room before building additional savings in a TFSA.

If you have a 40% MTR, then a $10,000 contribution to an RRSP will only cost you $6,000 in after-tax dollars, while the same contribution to a TFSA will cost you around $16,680 in pre-tax earnings ($16,680 minus 40% in taxes to net just over $10,000 for the TFSA contribution). The RRSP contribution results in a cash flow savings of $6,680, all else being equal on your tax return. Afterwards, the net result is that both accounts have $10,000 available for you to invest and grow your wealth.

Finally, while there is heated debate in the financial services community about the relevance of RRSPs for young people such as Millennials or low-income Canadians with incomes of $50,000 or less, the correct answer will often depend upon the specific situation, career outlook and income potential for each individual.

Many low-income Canadians may find themselves in a low tax bracket temporarily as they migrate to higher incomes over time. RRSPs will then have a place for these Canadians as part of their tax, asset building and retirement planning. Getting used to the process of investing in RRSPs, even when they are just at the beginning of their career, can be an invaluable lesson in learning how to handle the emotional ups-and-downs of markets that appear to create more excitement, thrills, and spills than your local roller coaster ride. Mastering the emotional roller coaster is, what history has taught us, the price you will pay to achieve financial success in life!

Call us today to review your specific situation and to determine if and how much you should be contributing to a 2017 RRSP before the March 1st deadline.

*** Financial Post,** *Why it's time to pay attention to — and fix — the marginal effective tax rate, especially for families* **[1]. Retrieved on January 17, 2018.**

Want to learn whether a TFSA or RRSP is better for you? Contact our office. **[2]**

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