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RRSPs Beyond Retirement

This time of year, we are bombarded with advertisements about the advantages of contributing to RRSPs at an early age and maximizing our contributions.

I agree an RRSP is an effective way to save for retirement. The current and long-term tax savings should not be disputed.

There are, however, advantages to using your RRSP as an effective short-term planning and tax tool. Using your RRSP to fund education or a home purchase through the Lifelong Learning Plan or Home Buyer's Plan has no effect on your total allowable lifetime contributions. The only effect on your retirement savings is in the form of investment income not earned while the funds are being used elsewhere.

When compared to paying student loans or trying to save for a downpayment without using your RRSP, I believe the long-term benefits outweigh any loss of retirement income in most cases.

The funds can be used for yourself, your children, your spouse or common law partner, or his or her children.

Saving for an Education

Under the Lifelong Learning Plan, an individual can withdraw up to $10,000 per year, to a maximum of $20,000, over 4 years, for qualifying postsecondary education or training. The funds can be used for yourself, your children, your spouse or common law partner, or his or her children. The money must be repaid over 10 years, starting 5 years from the initial withdrawal. You can even participate in the Plan more than once, as long as the initial loan has been repaid.

Saving to Buy a Home

Under the Home Buyer's Plan, an individual and a spouse can each withdraw $20,000 from their respective RRSPs, without paying tax, to purchase or construct a new home.

The basic rules are that the money

- must have been in your RRSP for at least 90 days prior to the purchase; and
- must be repaid at the rate of 1/15th of the total each year, after the second year.

The Home Buyer's Plan allows a couple or an individual to save for a downpayment faster. A $20,000 contribution to the RRSP at a 43 percent marginal tax rate would give an individual an extra $8600 toward his or her downpayment.

Differing Taxes on Excess Income

Beside using government programs to borrow from your RRSP, it can also be beneficial to withdraw funds outright from your RRSP, under the right circumstances. For instance, if you earn an extraordinarily large income in a particular year—for example, the exercise of options or a large bonus, you may want to contribute those funds to your RRSP if the contribution room is available. You would then withdraw the funds in a year when your marginal tax rate was lower, effectively saving the difference in marginal tax.

Conversely, you may want to supplement your income from your RRSP in a year when your income might put you in a much lower marginal tax bracket—for example, extended maternity leave or a sabbatical.

When removing the funds, you need to remember they will be added to your income and tax will be withheld on the withdrawals at the rate of

- 10 percent on the first $5000;
- 20 percent between $5000 and $15,000; and
- 30 percent above $15,000.

To put this into perspective, you should understand the effect.

If you contributed $18,000 a year to your RRSP from age 30 to 70, and that money earned 7 percent a year compounded, you would have almost $3.6 million in your RRSP at age 70.

If, at age 40, you decided to take a year off, withdraw $50,000, and not make a contribution that year, your total RRSP at age 70 would be reduced by almost $500,000.

Still, it might otherwise be harder to save for that year without using your RRSP. The time off can be worth it! ▲

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