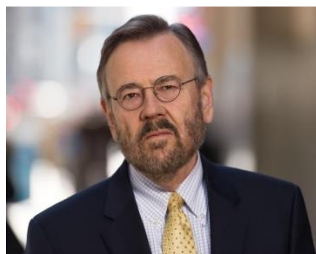
TURNER INVESTMENTS COMMENTARY



Hon. Garth Turner PC

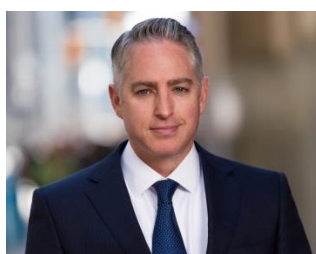
*Senior Vice President,
Private Client Group,
Financial Advisor*

416-346-0086

Douglas Rowat

*Senior Vice President,
Private Client Group,
Portfolio Manager*

416-777-6403



Ryan Lewenza

*Senior Vice President,
Private Client Group,
Portfolio Manager*

416-777-6416

RRSPs: WHAT YOU NEED TO KNOW

We receive many questions from our clients regarding RRSP contributions, so this month we've asked Turner Investments financial planner Sebastien Skupek to provide additional insight into what a correct RRSP contribution strategy should be. Sebastien joined Turner Investments in 2012 and is a Certified Financial Planner (CFP) and holds the Chartered Investment Manager (CIM) designation. Sebastien is always available to answer your tax strategy questions and assist with your long-term financial planning, particularly as it relates to your retirement.

We have all heard of registered retirement savings plans (RRSPs)—this is the account you contribute towards to get a tax refund from the government, right? This may be technically correct, but there are many factors to consider before allocating your savings to an RRSP because once your funds are sheltered in an RRSP, accessing these funds again makes them taxable (say goodbye to that tax refund!).

An RRSP is primarily used as a tax-sheltering and tax-deferral vehicle. With tax sheltering, you don't pay tax while assets are growing and generating investment income within an RRSP. With tax deferral, you pay tax only when you withdraw funds from an RRSP. If used correctly, an RRSP can provide tax *savings*. In the words of Benjamin Franklin, nothing is certain except death and taxes; however, you can at least minimize taxes.

The tax-free savings account (TFSA) also gives Canadians another alternative to an RRSP. A TFSA contribution, unfortunately, won't give you that nice tax refund you may be accustomed to receiving with an RRSP; however, all the growth within a TFSA and the eventual withdrawals are tax-free. It's important to understand the key differences between both types of accounts, which we detail below.

Know Your Marginal Tax Rate

With Canada's tiered tax system, the more money you make, the more taxes you pay. Your marginal tax rate is the amount of tax you pay for every extra dollar of income you earn. The adjacent table provides an example of the combined federal and provincial tax rates for an Ontario resident.

RRSP contributions can help save you tax, but in order to contribute the correct amount, you need to know your current marginal tax rate and, more importantly, you need to *anticipate* what this rate might be in the future. As a fast rule, you should try to make contributions when your income is high and, conversely, make withdrawals when your income is low. Your RRSP contributions are worth more in tax savings when you are in a higher marginal tax rate. So, if you have a low income year, it may make sense to carry over your RRSP contribution to a future year when you expect to earn more income. Essentially, an RRSP strategy is only as effective as the 'spread' between your tax rate when you contribute and your tax rate when you withdraw.

Combined Federal and Ontario Tax Brackets For 2016

Income ($)	Marginal Tax Rate (%)
First 41,536	20.05
41,537–45,282	24.15
45,283–73,145	29.65
73,146–83,075	31.48
83,076–86,176	33.89
86,177–90,563	37.91
90,564–140,388	43.41
140,389–150,000	46.41
150,001–200,000	47.97
200,001–220,000	51.97
220,000+	53.53

Source: www.taxtips.ca

For example: In Ontario, if you made $100,000 in income this year and you made a contribution of $1,000 to your RRSP, your contribution would save you $434 in taxes (assuming a marginal tax rate of 43.4%). However, these saved taxes are only temporary: you will have to pay tax again on these funds once you withdraw them from the RRSP—therefore you are technically only deferring the taxes to a later date.

With this in mind, it's now important to project what your marginal tax rate will be when you're going to draw from your RRSP. If your marginal tax rate is lower at the time of withdrawal, you'll save on tax. If you withdraw the same $1,000 when you're retired with only $40,000 in taxable annual income, for example, you'll have to only pay about $200 in taxes on this amount (assuming a marginal tax rate of 20%). In this example, you end up saving 53% in taxes on the $1,000 contribution.

Even if you are quite certain that your future marginal tax rate will be lower, there are still some disadvantages to excessive RRSP contributions. With our tiered tax system, the more you contribute to an RRSP in a single year the less of a tax refund you may receive on a percentage basis (see adjacent table). If you contribute enough to push yourself into a lower tax bracket, what you contribute offers less bang for the buck (see adjacent table). Therefore moderation is often the key with RRSP contributions.

The More You Contribute To An RRSP, The Less Effective The Contribution

Contribution ($)	10,000	30,000	50,000
Tax Refund ($)	4,310	10,920	16,850
Tax Refund %	43	36	34

Source: CRA. Based on $100,000 earned in Ontario

And a final point that also relates to tax brackets: the higher your income, the more the tax savings when you make an

RRSP contribution. To use the above example, your tax savings on a $1,000 RRSP contribution would be $434 on income of $100,000. But your friend who made the same contribution but who only made $50,000 in income this year, would save only $297 in taxes (assuming a marginal tax rate of 29.7%).

What About TFSAs?

In a perfect world, we would want you to max out your TFSA every year. This, of course, isn't always possible and it's important to understand the exact mechanics of both an RRSP and a TFSA in order to make the right decision when allocating available funds. They both provide great ways to save, but the amount to contribute to each depends, once again, on expected future income.

The annual contribution limit for a TFSA is currently $5,500 for the 2016 taxation year. The allowed contributions are cumulative, so if you miss a contribution one year, you don't forfeit the contribution space in subsequent years. The TFSA was introduced to Canadian residents in 2009 and we can now contribute up to $46,500 as per the below table. These contributions are made with after-tax dollars therefore you won't be entitled to a tax refund for making a TFSA contribution.

However, a TFSA provides more withdrawal flexibility. This is its main advantage over an RRSP. Within a TFSA, your money grows tax-free and you can withdraw the funds at any time also tax-free. If you're going to have high income through retirement (for example, if you have a substantial work pension) it makes sense to build up your TFSA to provide savings that will not negatively impact your future taxes. This is one way that a TFSA strategy differs from an RRSP strategy—projected high retirement income is usually a signal *not* to contribute as much to an RRSP.

TFSA Contribution Limits

Years	TFSA Annual Limit ($)	Cumulative Total ($)
2009–2012	5,000	20,000
2013	5,500	25,500
2014	5,500	31,000
2015	10,000	41,000
2016	5,500	46,500

Source: CRA

Overall, if you simply can't determine your future income, and all things being equal, we view a TFSA as a more favourable account type than an RRSP. For instance, you can contribute to your TFSA throughout your lifetime—even after age 71 when you have to start drawing from your RRSPs. Also, if the beneficiary of an RRSP is not a *qualified* beneficiary (spouse, financially dependent child or mentally or physically disabled grandchild), the assets are deemed withdrawn and are taxed as taxable income. This can trigger a significant tax liability if the RRSP is large. In contrast, TFSA assets can be passed on to almost any individual beneficiary tax-free. In other words, with a TFSA you are more likely to bypass income tax consequences that could apply when transferring RRSP assets.

Finally, unlike an RRSP, TFSA withdrawals can be re-deposited to your TFSA. This provides you with flexibility if you require funds for any short-term needs. Once withdrawn, the government will allow you to re-contribute the same value to your TFSA in the next calendar year. In contrast, the money you take from an RRSP can't just be "recontributed". The contribution room is lost forever.

IT'S ALL IN THE FORECASTING

It can be difficult, but forecasting your future income is the best way to maximize the benefits of an RRSP. This isn't always easy. For instance, as we detailed in our May 2016 newsletter *When Can You Retire?*, here are just a few of the factors that could affect future retirement income:

- Will you maintain a part time job?
- What income will your government or work pension provide? Keep in mind, your current employer may not have a pension program, but a future employer might.
- What income will your investment portfolio provide?
- Do you expect an inheritance or an asset sale?
- Other income? A rental property, for example.
- What will future marginal tax rates be? Because of high Canadian debt levels there's a case to be made for higher taxes down the road meaning you could be charged more in the future on the funds coming out of an RRSP.

Any of these items could push your tax bracket higher in retirement and need to be taken into account when determining the amount of your RRSP contributions. However, if you can accurately forecast future income and then correctly utilize an RRSP based on this information, the tax savings can be substantial. All things considered, there is no definitive answer to the "How much should I contribute to my RRSP?" question—it mainly depends on your ability to forecast future income, a particularly difficult task if retirement is decades away. However, I'm always here to help you plan out the road ahead. Sometimes simply discussing future possibilities can reveal the best strategies for the present.

.

TURNER INVESTMENTS OF RAYMOND JAMES LTD.

40 King Street West
Suite 5300, Toronto, Ontario M5H 3Y2
Tel: 416-777-7000 | Fax: 416-777-7020

www.turnerinvestments.ca

TURNER INVESTMENTS | RAYMOND JAMES®

This newsletter has been prepared by Turner Investments, and expresses the opinions of the authors and not necessarily those of Raymond James Ltd. (RJL). Statistics, factual data and other information are from sources RJL believes to be reliable but their accuracy cannot be guaranteed. This newsletter is furnished on the basis and understanding that RJL is to be under no liability whatsoever in respect thereof. It is for information purposes only and is not to be construed as an offer or solicitation for the sale or purchase of securities. RJL and its officers, directors, employees and their families may from time to time invest in the securities discussed in this newsletter. This newsletter is intended for distribution only in those jurisdictions where RJL is registered as a dealer in securities. Any distribution or dissemination of this newsletter in any other jurisdiction is strictly prohibited. Securities-related products and services are offered through Raymond James Ltd., member-Canadian Investor Protection Fund. Insurance products and services are offered through Raymond James Financial Planning Ltd., which is not a member-Canadian Investor Protection Fund.