Contribute to an RRSP to Reduce Your Taxes

Description

Hurry! Investors have until February 29 to make their 2015 RRSP contributions. If you have enough RRSP contribution room to make a big contribution, you can even get a tax refund.

For each dollar you contribute to an RRSP, you reduce your income taxes. If you get a tax refund, you can immediately contribute it to a TFSA to earn tax-free income.

What should you invest in using an RRSP?

Some investors are very conservative in an RRSP and save in a high-interest savings account or GIC to earn an interest rate of 1-3%. However, the big six Canadian banks are paying dividends with yields of 3.8-5.4%.

Understandably, investing in the banks is riskier than saving in interest-earning vehicles, but I trust the banks because they are strong brands that have a long history of operations. Furthermore, most of the banks are priced at a moderate discount.

For example, **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) has a 21% discount at about $56 with a 5% yield, and **National Bank of Canada** (TSX:NA) has a 17% discount at about $40 with a 5.4% yield.

You should also buy U.S. dividend stocks in an RRSP because you won't get a 15% withholding tax on the foreign dividends as you would in a taxable account. So, investors should particularly hold juicy U.S. dividend stocks in an RRSP rather than in a taxable account.

For example, some quality U.S. real estate investment trusts yield 4-5%, including **Realty Income Corp.** (NYSE:O) and **Ventas, Inc.** (NYSE:VTR).

In-kind contributions

If you don't have excess cash to contribute to an RRSP, you can transfer your existing shares. For example, if you hold U.S. dividend stocks in a taxable account, you can transfer the shares into an RRSP. It would be a taxable event, so make sure you have capital gains on the stocks you're transferring.

Do not transfer stocks from your TFSA to an RRSP because the new year has already started and you won’t be able to re-contribute to a TFSA unless you have extra room.

For example, if you used up your TFSA contribution room at the end of 2015, you have $5,500 contribution room for 2016. If you make an in-kind contribution of $10,000 of **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) shares from a TFSA to an RRSP (again, assuming you have capital gains on them), you can only re-contribute $5,500 into a TFSA this year, assuming you haven’t made any TFSA contributions in 2016.

Summary

Self-directed investors should contribute to an RRSP for the 2015 tax year if they haven’t done so because it would reduce their income taxes and may even trigger a tax refund that they can contribute to a TFSA for tax-free investments.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:O (Realty Income Corporation)
3. NYSE:TD (The Toronto-Dominion Bank)
4. TSX:BNS (Bank Of Nova Scotia)
5. TSX:NA (National Bank of Canada)
6. TSX:TD (The Toronto-Dominion Bank)

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