



A 3-Way Win: Invest in an RRSP

Description

Don't just dream about your retirement. Make plans and set goals. Including an RRSP in your plan allows you to reduce your taxes and invest for your retirement. An RRSP also gives you the benefit of tax-deferred compounding.

That is, you can use your money to earn you more money and let the snowball roll. And you don't pay taxes until you withdraw money from your account years down the road.

Reduce income taxes

Investors have until February 29 to make their 2015 RRSP contributions. However, by contributing to an RRSP this month and next, you can actually apply those contributions toward either the 2015 year or the 2016 year. In doing so, you'll reduce your income taxes for the year.

Invest for your retirement

An RRSP account is a tool for you to invest in your future—your retirement. You can only withdraw from an RRSP without penalty in a few scenarios, such as buying your first home or studying full time in an admissible program in a recognized educational institution.

So, that means most of the time the money you contribute to an RRSP is in there working hard for you. For example, you can buy U.S. dividend stocks, such as **Johnson & Johnson** ([NYSE:JNJ](#)) and **The Coca-Cola Co** ([NYSE:KO](#)), which pay 3% yields. If you hold these stocks in an RRSP, you won't get a 15% withholding tax on U.S. dividends.

Some investors hold real estate investment trusts (REITs) in an RRSP to avoid the hassle at tax-reporting time due to their distributions, which aren't entirely dividends.

Many REITs are much cheaper and offer higher yields than they did a year ago, including **H&R Real Estate Investment Trust** ([TSX:HR.UN](#)), a diversified REIT that yields 7.2%, **RioCan Real Estate Investment Trust** ([TSX:REI.UN](#)), Canada's largest retail REIT that yields 6.2%, and **Boardwalk REIT** ([TSX:BEI.UN](#)), a residential REIT that yields 4.8%.

REIT distributions can consist of other income, capital gains, foreign non-business income and return of capital. Other income and foreign non-business income are taxed at your marginal tax rate, while capital gains are taxed at half your marginal tax rate.

The return of capital portion reduces your adjusted cost basis. This means that that portion is tax deferred until you sell your units or until your adjusted cost basis turns negative.

If you buy REITs in a non-registered account, you'll need to track changes in the adjusted cost basis. The T3 that you'll receive will help you figure out the new adjusted cost basis.

If you run out of TFSA room and want to avoid tax-reporting hassles, you can invest REITs in an RRSP.

Tax-deferred compounding

If you invested \$500 every month in an RRSP for a 7% return that is compounded annually, you would end up with \$86,542 a decade later (\$500 per month implies you put in a total of \$60,000, and \$26,542 was what you earned from investing). If you averaged a 10% return, you'd end up with \$102,422.

If you invested \$1,000 every month in an RRSP for a 7% return that is compounded annually, you would end up with \$173,085 a decade later (\$1,000 per month implies you put in a total of \$120,000, and \$53,085 was what you earned from investing). If you averaged a 10% return, you'd end up with \$204,845.

The longer you invest, the longer your investments can compound.

If you invested in a non-registered account instead, your portfolio growth would be dampened by taxes paid on capital gains, dividends, or interests.

Summary

Investing in an RRSP is a three-way win: you reduce your taxes, you're investing for your retirement, and you can compound tax deferred until you're 71. If you contribute regularly to an RRSP, make the right investments there, and earn an average rate of return of 7-10%, you'll be setting up yourself for a comfortable retirement.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:JNJ (Johnson & Johnson)
2. NYSE:KO (The Coca-Cola Company)

3. TSX:BEI.UN (Boardwalk Real Estate Investment Trust)
4. TSX:HR.UN (H&R Real Estate Investment Trust)
5. TSX:REI.UN (RioCan Real Estate Investment Trust)

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