Thinking of Contributing to an RRSP? Don’t Make This Mistake

Description

Investing in an RRSP is a good way to build your savings for your retirement, but there are times when it just doesn’t make sense to make a contribution. While many people have been trained to believe that it’s the smart and responsible thing to do, oftentimes, people don’t really understand the benefit or the purpose of doing so.

While the initial appeal of an RRSP contribution is that it can reduce your taxable income, that’s only one side of the equation. Ultimately, you’ll end up getting taxed on that contribution plus any gains when you go to withdraw the funds, usually when you retire.

Why you shouldn’t contribute if you’re in the lowest tax bracket

There’s one big problem that many people fail to realize: if you contribute in years when you’re in a lower tax bracket than when you withdraw, you’ll actually be paying more in taxes. RRSPs help you defer taxes, but that only works well if you contribute when you’re in a higher tax bracket than when you retire.

While this may be true for most people, it’s not a given. I’ve seen many people that were early into their careers or in the lowest tax brackets and still contributing to RRSPs. In those cases, the best you can hope for is to come out even in the end, which defeats a big advantage of contributing into an RRSP in the first place.

If you’re in a high tax bracket, then you’re more than likely to see a bigger advantage from deferring taxes, since it’s likely you’ll be making less when it comes time to draw the funds out.

The problem is that many people consider investing in an RRSPs as a forgone conclusion and one that isn’t given sufficient thought. While it might seem like the responsible thing to do to contribute in an RRSP, perhaps holding within it a portfolio of safe bank stocks like **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) or **Royal Bank of Canada** (TSX:RY)(NYSE:RY), it’s important to make that assessment yourself and determine if the numbers make sense.

TFSAs might offer more appealing options

It’s also important to note that RRSPs aren’t the only vehicle you can use to save and store your money for retirement. If an RRSP isn’t optimal, consider putting your money into a TFSA. While TFSA accounts won’t give you a deduction for a contribution up front, you will be able to grow your income within the account tax free.

Why retirement itself might be a big assumption

Personal debt levels continue to climb, and that creates a big question mark about what retirement will look like for many people. It’s a very real possibility that people may have to delay their retirement, or worse — not have one at all.

We are seeing many technological changes take place, including self-driving automobiles and stores that are less reliant on wage staff, and these changes could put many jobs in jeopardy in the years to come. This puts a lot of risk to many workers today that can jeopardize what their retirements will look like in the future.

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