Why Investing in an RRSP Isn’t Always the Right Decision

Description

Investing in RRSPs is something that many Canadians have been taught, or trained, to do. In most cases, I believe it’s the latter rather than the former, since many people don’t understand the purpose or the risks involved, other than believing that putting money into an RRSP is a responsible way to save. However, it’s not the only way to save for retirement, and it shouldn’t always be assumed to be the right decision.

An RRSP is just a tax-deferral vehicle

In essence, an RRSP allows you to defer when you’re paying taxes on your earnings. In the immediate term, contributions that you make to your RRSP will bring down your current tax bill. And while that may be appealing in the short term, there are many other factors that Canadians simply aren’t considering.

If you’re in the lowest tax bracket, then there is little to no benefit of investing in an RRSP, unless you expect taxes to go down, but that’s a whole other discussion.

When you contribute to an RRSP you’re creating a tax shield for yourself, and you avoid paying the tax at your marginal rate. However, when you withdraw the funds, then the amounts will be taxed at your marginal tax rate at that time. The problem with that is, you’re making an assumption that when you go to withdraw, you’ll be at a lower tax bracket than when you contribute.

This is where RRSPs draw the most benefit: defer taxes from a high-bracket year to one when you’re in a lower bracket. The reason I say that this is a problem is because with household debt levels on the rise, many people are working into what are normally their retirement years. The end result is that you could be withdrawing the funds at a higher-than-expected tax rate.

In a recent poll done by **Bank of Montreal** (TSX:BMO)(NYSE:BMO), it found that nearly 40% of Canadians dipped into their RRSPs early, and that is an increase from last year’s survey. However, one of the flaws in the survey is that it was not asking just those people that had RRSPs, and so the percentage of RRSP owners that withdrew would be even higher.

While you can take advantage of the Home Buyers' Plan and withdraw from an RRSP to help purchase a home, less than a third of those that dipped into their savings said that was their reason for doing so.

Bottom line

There are many expected situations that can come up in life that can change a person's needs, and people need to remember that an RRSP is not the only way to save for retirement. A TFSA will also allow you to store your savings, with the added benefit of any gains not being taxed on withdrawal — something that an RRSP lacks.

As for what to put in your RRSP or TFSA, stocks that grow their dividends are great options for the long term. Specifically, utility stocks like **Fortis Inc.** (TSX:FTS)(NYSE:FTS) and **Hydro One Ltd.** (TSX:H) are great choices that will provide you with stability and regular streams of income over the years.

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Author
djagielski