This One Financial Move Can Supercharge Your RRSP

Description

Do you want to maximize your RRSP returns and make it all the way to retirement in good shape?

If so, you're already way ahead of many Canadians. Studies show that only 51% of adults have RRSPs, and the percentage is lower for those under age 55. If you have an RRSP, you're doing better than 49% of the population.

But getting the most out of your RRSP requires knowledge of its rules and regulations. Although RRSPs offer tax benefits if used correctly, they can be costly if used the wrong way.

In general, holding assets in an RRSP until you retire is better than holding them in a non-deferred environment. As long as the stocks stay within the RRSP, they're not being taxed (directly); and if you wait until after retirement to withdraw them, they should be taxed at a low rate.

However, contrary to popular misconception, it's actually possible to be taxed within an RRSP even without withdrawing early. Let's take a look at how that can happen.

The dual dividend withholding tax

If you want a slice of America's fast paced economy in your RRSP, you may be tempted to buy American ETFs. However, there are two costs to consider here: one, if you buy on U.S. indexes directly, there will be currency conversion fees; two, if you buy Canadian ETFs that track U.S. indices, you'll get hit with a withholding tax that the RRSP can't exempt you from.

Dividends paid from U.S. companies into Canadian funds get taxed before they hit your RRSP, so the tax sheltered environment doesn't help. Although the RRSP spares you the *personal* withholding tax, it doesn't spare you the tax your ETF pays to Uncle Sam.

So while a Canadian-listed U.S. ETF like the **Vanguard S&P 500 Index Fund** (TSX:VFV) might look tempting, you'll get a lower dividend yield on it than an American investor would–even inside your RRSP.

So what can you do?

It's simple:

Buy Canadian stocks with U.S. exposure

The simplest way to avoid U.S. withholding taxes and currency conversion costs is to buy Canadian stocks with U.S. exposure. These stocks earn money in the U.S., but since they're not U.S. companies, they aren't subject to withholding taxes.

By buying these stocks, you avoid the dividend withholding tax on ETFs, and the currency costs that come with buying U.S. stocks.

A great pick here could be **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD). This bank earns about 30% of its revenue in the U.S., where it is growing at about 30% year-over-year. By buying it, you get a slice of the fast-growing U.S. financial sector without the headaches that come with investing directly in U.S. financial stocks or funds.

TD is already the 8th largest bank in the U.S., and its American presence grows larger every year. So buying TD is a much simpler proposition than buying U.S. stocks or Canadian-listed funds that own them.

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