



## Retirement Savers: Are You Part of the 34% of Canadians Making This RRSP Mistake?

### Description

According to a **Bank of Montreal** study from earlier this year, 34% of Canadians are making a major RRSP mistake — a mistake that could cost them dearly come tax time.

It's a trap that most investors are aware of, yet many still find themselves falling into when times are tough.

If you've got major expenses looming, it's easy to find yourself committing this mistake even when you've sworn you'd never do so.

Fortunately, as you're about to see, there's an easy way to avoid the trap—even if you think you've got a truckload of expenses coming up on the horizon.

## Withdrawing from your RRSP before retirement

Withdrawing from your RRSP before retirement is generally acknowledged as a major mistake. Although RRSP investments *grow* tax-free (i.e., you pay no dividend or capital gains taxes while your investments are *in* the account), [funds are taxable upon withdrawal](#).

If you're still earning an income, that tax can be very high since it's based on your marginal rate. If you're earning over \$210,000 a year, expect to pay 33% in federal taxes alone.

There are a few exceptions that permit you to withdraw from an RRSP early without a tax penalty. If you're planning on buying a home, you can withdraw up to \$25,000 under what's called the [Home Buyer's Plan](#).

You can also withdraw up to \$10,000 a year tax-free into a Lifelong Learner's Plan—a different type of registered account with its own rules and regulations.

## Why it's a mistake

The reason withdrawing from an RRSP early is such a big mistake is because it defies the logic of having an RRSP in the first place.

The reason people open RRSPs is to enjoy tax savings.

If you're withdrawing early and paying a tax of over 20% on what you've earned, that defeats the purpose of opening the account.

Of course, it all depends on the amount of tax-free gains you've managed to accumulate. If you withdraw from an RRSP after netting a 1000% return on a speculative growth play, it's still a net winner even after factoring in all the taxes.

However, apart from an RRSP, only 50% of a capital gain is taxed, and you need an actual gain to even *be* taxed. When you withdraw money from an RRSP it's taxed even if your investments went nowhere.

## What to do instead

The most obvious objection to everything I've said so far would be something along the lines of, *"Of course I'm not planning on withdrawing early, but what if a financial emergency comes up?"*

It's true that if you need money to pay for emergency expenses at the last minute, you may have to cash out of your RRSP—assuming that's the only retirement vehicle you own.

However, if you have a long time-horizon ahead of you, you can easily avoid ever having to do that.

How? Well, by spreading your retirement investments *across* a TFSA and an RRSP.

TFSAs allow you to grow your investments tax-free just like RRSPs. However, unlike RRSPs, TFSA funds aren't taxable on withdrawal. Further, TFSAs let you re-contribute withdrawn income in the next year, giving you a double dose of flexibility.

So, if you have part of your retirement savings in a TFSA, you can withdraw it without the slightest pang of guilt.

Consider the case of an investor holding a position in **iShares S&P/TSX Capped Composite Index ETF (TSX:XIC)**, who suddenly has to pay expenses related to property damage but has no cash savings.

XIC, as a highly liquid fund, can easily be sold on the market and used to finance sudden expenses like this, so the investor has that option available. However, if they hold their entire position in XIC in their RRSP, they'll have to weigh the costs of withdrawing their RRSP funds vs borrowing money—if they're a high earner, borrowing may well be cheaper!

The investor holding an XIC position spread *across* an RRSP and TFSA faces no such dilemma. With

their liquid ETF sitting happily in a TFSA, they can cash out, withdraw and easily cover any expenses that come up—without worrying about a tax bill.

## CATEGORY

1. Dividend Stocks
2. Investing

## TICKERS GLOBAL

1. TSX:XIC (iShares Core S&P/TSX Capped Composite Index ETF)

## PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

## Category

1. Dividend Stocks
2. Investing

## Date

2025/06/29

## Date Created

2019/11/12

## Author

andrewbutton

default watermark

default watermark