Canada Revenue Agency: 1 RRSP Method to Pay Less Tax With Your RRSP

Description

Retirement seems like a far off prospect to most people in their 20s. Why would you be bothered by something that will still take a few decades to arrive? But that kind of mindset, and starting late on retirement planning, is exactly what gets many people into trouble. If you only start worrying about your retirement during your midlife crisis, you won't be able to save enough for a cozy retirement.

Planning early and making use of all the right tools is the simple formula for a flush retirement. The right tools are suitable investments and a great investment vehicle, like the tax-deferred RRSP. The RRSP has been around for ages, and millions of Canadians have benefitted from it. Apart from the core methods to get the best out of your RRSP (good and early investing), there are a few other tricks as well.

One RRSP method

One method that you can use to save taxes with an RRSP is to open up a spousal account. It will help you pay less tax now and later, especially if there is a significant disparity between your earnings and those of your spouse. Let's break it down.

Say you earn $100,000 a year, and your spouse earns $40,000 a year through part-time work. You both have an RRSP and individual contribution limit of 18%. This means you and your spouse can contribute $18,000 and $7,200, respectively. If nothing changes, and you are merely earning a 2.5% interest on your savings, through compounding, you would be sitting at about $1 million in 35 years, while your spouse will have a bit more than $400,000.

This means that as a couple, both of you would pay more in taxes than you would have paid if you both had RRSPs of $700,000 each. It will result in the same combined nest egg, but less tax. So how do you do it? How do you balance out yours and your spouse's RRSPs?

Open a spousal RRSP.

A spousal RRSP will help you, as a couple, create two nest eggs of roughly the same size. Instead of putting all $18,000 in your RRSP, put $12,600 in yours and $5,400 in the spousal RRSP. You will both be saving on taxes the same as before, by marking off your contributions as tax-deductibles. With the same returns, you will have a similar sized RRSP by the time you both retire, and you will be able to save a decent amount in taxes.

Getting more out of your RRSP

Making the most out of your RRSP means putting your money where it will generate the best returns. Even if you don't want to risk investing in growth stocks, there are good ways to get returns higher than 2.5%. The best and safest way would be to invest in a dividend aristocrat, like **Manulife** (TSX:MFC)(NYSE:MFC). The company has increased its dividends for five consecutive years.

It has a very stable payout ratio of 41% and a decent yield of 3.8%. This will get you and your spouse closer to $2 million. Manulife's history of dividends ensures stable and growing payouts that you can depend upon to beef-up your RRSP.

Foolish takeaway

Good financial planning, efficient use of your capital, and proper utilization of investment vehicles; these three elements can translate to a cozy and happy retirement. As a couple, you can truly bring out the power offered by an RRSP. Think of it as a belated wedding present from the government.

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Date
2025/08/26
Date Created
2020/01/09

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