Millennials: Why You Need to Open an RRSP in 2020!

Description

If you're a millennial, and you still haven't opened an RRSP, it's time to get on board. According to a 2019 **Bank of Montreal** study, the amount of money held by millennials in RRSPs is on the rise — so much so that the generation is now driving the lion's share of RRSP wealth increases.

From 2015 to 2016, millennials saw the greatest percentage increase in RRSP holdings of any age demographic, with their RRSP savings rising from $15,000 to $29,000. This shows that millennials increasingly see RRSPs as vital to building long-term wealth.

Turns out, they may be right. With pensions declining in the private sector, millennials are unlikely to get the retirement benefits previous generations had. Not only that, but they're likely to see their tax rates increase over time.

It all paints a scary picture. However, there's a light at the end of the tunnel. By investing in RRSPs, you can dramatically lower your tax burden, empowering you to build lasting wealth for the future. Not only that, but you may even be able to withdraw money from your RRSP well before retirement — with no tax penalty. I'll explain how that works in just a minute. First, let's get into the main reason you want to open an RRSP.

Tax savings

The main reason for opening an RRSP is to save on taxes. RRSPs do this in two ways: first, you get a tax deduction on money you contribute; second, your capital gains and dividends grow tax free in the account. You do have to pay taxes eventually, but only when you're retired, and your tax rate is much lower.

To illustrate the tax-saving power of RRSPs, let's consider what would happen if you held **Shopify** (TSX:SHOP)(NYSE:SHOP) stock in one. Shopify is a mega-growth stock that has delivered huge capital gains to its investors. Since its IPO in 2015, it has risen 1,905%. If you'd invested $10,000 in Shopify then and cashed out today, you'd have over $190,000.

What a fantastic gain, right?

Well, yes. The problem is if you were to cash that gain out, you'd pay heavy taxes on it. Under Canadian tax law, you pay your marginal rate on half of any capital gains you realize. So, if you were paying 50% on the highest level of your employment income, you'd have to pay half that on your SHOP shares. So, you'd pay an overall tax of around 25%.

This is not so in an RRSP. As long as you keep the money in the account, you pay no taxes on investments you've sold. You do pay up when you withdraw funds. However, if you're saving up to buy a home for the first time, you can withdraw up to $35,000 tax-free — as long as you repay it within 15 years.

Pensions disappearing and taxes rising

So far, I've explained the main reasons why anyone — millennial or otherwise — would want to open an RRSP. The question is, why is it such a big concern for millennials specifically?

It comes down to two main factors.

First, employer-sponsored pension plans are on the decline, meaning that millennials are unlikely to get as much pension income as their parents did. According to a StatsCan report, the share of Canadians covered by a pension plan fell from 37.5% in 2016 to 37.1% in 2017. That's just a one-year change in a long-term pattern that's been going on since the 1990s.

Second, millennials are likely to see their taxes increase over the course of their lives. Over the next four years, we have CPP enhancement, which will increase CPP contributions from 5.1% to 5.95%. Ostensibly, the increased rates are to provide increased payouts later, but I wouldn't count on it — all that's certain is that it will increase your taxes today. Additionally, ballooning government debt could lead to higher taxes in the future. That one's more up in the air, but as the saying goes, it never hurts to be prepared.

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