Why You Should Avoid Dipping Into Your RRSPs

Description

A Registered Retirement Savings Plan (RRSP) is a way for Canadians to defer taxes and grow their wealth over the years. It's a good place to put dividend stocks and other blue-chip stocks that are likely to increase in value over the long term. In a perfect scenario, you'd withdraw the funds when you've retired and are no longer working. And if you've got no other income, you'll be in the lowest tax bracket. That's important, because anytime you withdraw from an RRSP, that's income that you'll be taxed on in that year.

The problem is, if you withdraw funds before you've retired, you'll get hit with a withholding tax. If you withdraw more than $15,000, it can be as high as 30%. And since the money will be income in the year that you withdraw it from your account, you could potentially get bumped into a higher tax bracket, and you may end up having to pay more taxes on it later on.

This is why, unless you absolutely need to, you should avoid pulling money out from an RRSP. If you've been working this year or may go back to work at some point, the danger is that your income may end up being a lot higher than you expect, and a higher tax rate may negate the benefit of the RRSP. If you withdraw funds when you're in a higher tax bracket than when you contributed them, then it defeats the purpose of putting money into an RRSP in the first place. While it's a savings account, the primary benefit is paying less tax, not more.

TFSAs offer investors more flexible options

Unlike an RRSP, you won't have to pay a withholding tax on amounts you withdraw from a Tax-Free Savings Account (TFSA). The reason is simple: the funds you contributed to a TFSA were already taxed. With a TFSA, investors get the benefit of avoiding tax on income that's earned within a TFSA rather than simply deferring taxes. And so, if you invest $10,000 and your TFSA eventually grows to $100,000, you won't be taxed on the $90,000 that you made while your funds were in the TFSA — assuming, of course, you weren't day trading in the account and were investing in eligible investments (e.g., a stock that's traded on a major exchange).

Bottom line

There are many ways that investors can save for retirement, and it's important to know when to use them and when not to. An RRSP or TFSA are good places for buy-and-forget stocks like **Bank of Montreal** or **Fortis**. Those are investments that should remain steady and provide your portfolio with lots of dividend income over the years. Riskier investments, including pot stocks like **Aurora Cannabis** or **Canopy Growth**, however, are better off in non-registered accounts; if you incur losses, you can use them to offset gains elsewhere.

There's no one-size-fits-all solution or account that investors should or shouldn't use. It depends on your strategy and your ultimate goal. The coronavirus pandemic reminds us how important it is to have cash easily accessible amid a market crash, whether it's in a TFSA or a regular savings account, where it's a lot easier to pull from than an RRSP.

CATEGORY

1. Investing

PARTNER-FEEDS

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

Category

1. Investing

Date
2025/08/18
Date Created
2020/04/25
Author
djagielski