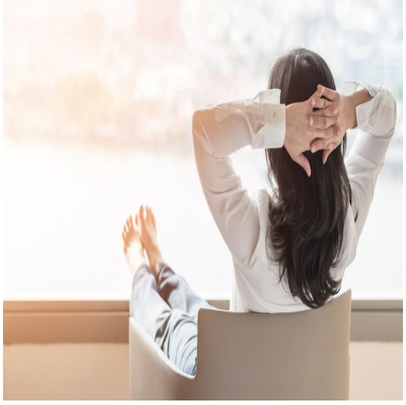

CRA: Here’s 1 Giant Tax Saver for Your RRSP

Description

Your Registered Retirement Savings Plan (RRSP) is an amazing way to grow your wealth for retirement. Converting an RRSP into an RRIF is the common practice. However, once you’ve made the switch, you can no longer contribute.

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Its only purpose is to fund your retirement, which is why it is mandatory to withdraw from RRIF, starting from 5.28% of your total RRIF assets when you are 65, which can be substantial depending upon the size of your withdrawal.

If you withdraw any funds from your RRSP before you turn 71, you have to pay a withholding tax, and the withdrawals are also part of your taxable income. Similarly, the RRIF withdrawals are considered taxable income, but if you withdraw more than the mandated amount, your funds will also be subject to withholding tax.

RRSP/RRIF tax-saving tip

For your RRSP, this tip is usually only helpful if, for the market correction year, you are in a lower tax bracket, and you are likely to be in a higher bracket in the future years.

Say you have a stock in your RRSP that has fallen a lot in a market crash, about 40% to 50%. You’re sure that the stock will recover in no time and start growing again. One thing you can do is to shift that undervalued stock into your TFSA.

Now, you can’t just roll your RRSP assets into TFSA without any tax implications. You have to get them “deregistered” from your RRSP, which means transferring them in-kind to a non-registered account. But that account is considered an RRSP withdrawal and is subject to withholding tax and also adds to your taxable income.

Once inside a non-registered account, the stocks can be transferred in-kind to your TFSA, but only if it’s within your TFSA contribution limit. Otherwise, you’ll have to pay the penalty for that as well.

Why would you do that? Because once it's in TFSA, the stock can grow completely tax-free. You can withdraw it anytime without any tax implications. If it stays in RRSP, you may need to pay huge taxes on it once you withdraw. Even in an RRIF, it will add to your taxable income.

A TFSA could save you a lot in taxes in the long term. This requires a thorough cost-benefit analysis, and it's based on the assumption that the stock will start growing fast after the market correction. Because if it doesn't grow, the whole process might cost you more than if you'd simply let the stock stay in an RRSP.

Stock example

One stock that might help you pull off that tax-saving trick is **Goeasy** (TSX:GSY). It was a fast-growing stock before the crash (over 270% in the past five years). During the crash, the stock fell over 70% from its yearly-high value. But it has already started to recover. If it gets back up on its feet and starts growing from where it left off, it can be explosive in the future.

If you transfer this stock from your RRSP to your TFSA when its 70% down, bearing the withholding and marginal tax, and it starts growing again at its former pace, the tax-free capital gains might more than make up for your intermittent tax costs.

It's also a Dividend Aristocrat with a sizeable payout growth rate. But it's important to note that until it's transferred from RRSP to TFSA, any capital gains realized in between these two accounts, are also taxable.

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Foolish takeaway

A market crash is usually bad news for investors. But if you understand that it's a long-term game and are able to make the best of a market crash, either by using such tax-saving tricks or buying amazing stocks at the dip, you can turn things around for yourself.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:GSY (goeasy Ltd.)

PARTNER-FEEDS

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

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