77% of Canadians Are Making This RRSP Mistake… and the CRA Is Reaping the Rewards!

Description

Most Canadians are aware of the importance of saving for retirement. According to Ipsos, 52% of Canadians have RRSPs, suggesting that they know it's important to have one. However, their actual contribution rates tell a different story.

According to a 2018 Statistics Canada report, only 22.5% of tax filers actually *contributed* to their RRSPs in 2016. So while a majority of Canadians *have* RRSPs, a full 77% aren't regularly contributing.

This could be a major mistake

RRSPs offer the most generous combination of tax breaks of any registered plan in Canada. Providing both tax deductions and tax-deferred growth, they give you a double whammy of tax savings.

While RRSPs do become taxable upon withdrawal, they can spare you taxes if you earn a lower income in retirement. If you don't contribute to one, you're effectively handing over money to the CRA unnecessarily.

If you want to retire with a decent supplement to CPP and OAS, it's vital that you build up your RRSP holdings. TFSAs are a nice alternative, but their low contribution room makes them less viable for building long-term savings.

As of 2020, the absolute *maximum cumulative amount* you can contribute to a TFSA is $69,500. If you were younger than 18 in 2009, the amount is even less than that. With RRSPs, in contrast, you can gain up to $26,500 in contribution space in a *single year.*

In light of this fact, it's vital that you contribute to your RRSP regularly. Providing tax deferrals, tax deductions, and ample contribution room, it can go a long way toward funding your retirement. In the short term, it can also lower the income tax you pay to the CRA.

But contributing is only half the battle. If you just hold cash in your RRSP, you don't get to enjoy tax-deferred growth. Without that, the plan could end up *costing* you more in taxes than it saves you. So, the question becomes: *what do you hold in your RRSP to ensure that you get the maximum possible value from it?*

What to hold in your RRSP

If you're retired or soon to be retired, it's best to hold low-risk, income-producing assets in your RRSP. There are three reasons for this:

1. If you're not an investing expert, low risk investments are the least likely to get you in trouble.
2. If you're older, you don't have the time to wait out market crashes, which reduces your ability to bear risk.
3. If you're like most retirees, you need regular cash income, not capital gains that may or may not materialize.

For these reasons, an obvious RRSP pick would be bonds and bond ETFs. Bond income is much safer than dividends, because bond holders get paid before shareholders do. If a company is running out of money, it may suspend its dividend, but it legally has to keep paying its bond interest (unless it goes bankrupt). So bonds are an obvious choice.

If you're willing to take a little more risk, you can consider stock ETFs like the **iShares S&P/TSX 60 Index Fund** (TSX:XIU). Index funds provide built-in diversification, which reduces portfolio risk. For a Canadian, XIU would be a great index fund choice.

First and foremost, it gives you the home field advantage that comes with investing in your home country's equities. Second, it spares you dividend withholding taxes–a type of foreign tax that RRSPs can't always spare you.

Finally, the fund is about as low risk as equity funds can get, owing to its focus on blue chips and significant diversification. Overall, it's a great investment to put your RRSP money to work for you.

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