Canada Revenue Agency: This RRSP Trick Can Save You Thousands in Taxes

Description

Registered Retirement Savings Plans (RRSPs) are a wonderful financial planning tool that can be leveraged by Canadians to lower their taxes. The contributions towards this account are tax-deductible and you can allocate up to 18% of your net earnings to the RRSP.

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So, if you earned $100,000 in 2019, you were eligible to contribute $18,000 towards your RRSP which would lower your taxable income to $82,000. However, there is an issue that aggressive RRSP savers are running into.

Several Canadians hold over $1 million or more in their RRSP by the time they turn 65. This is the age when you must start withdrawing your contributions and if you are not careful, you might face a huge tax bill, from the Canada Revenue Agency.

RRSPs are not just for retirement

In case you are several years away from retirement doing this may help you reduce your tax bill. You do not have to wait until retirement to begin withdrawing cash from the RRSP. So, if you have a lean year at work or have lost your job due to the pandemic tapping into the RRSP can be a smart decision.

For example, if you earned $10,000 in the first two months of 2020 before getting laid off, you would normally utilize your emergency fund for essential expenses. Alternatively, you can also tap into your RRSP savings for just enough cash to ensure you stay in a lower tax bracket.

These tax savings could be significant. So, if you are anticipating a $60,000 annual windfall from your RRSP your tax bill will be about $12,000 per year. If you decide to strategically withdraw from your RRSP in a lean year and take out $30,000 the tax bill will be just $3,700.

If you do this twice you can save over $4,000 in taxes. Another way to leverage this strategy is when you are looking to retire early. Here you can withdraw cash from your RRSP before you start CPP or OAS payments. You need to limit withdrawals to years without any earned income and you can create significant tax savings.

How to reach $1 million in RRSP savings?

While having $1 million dollars in your RRSP account is a good problem to have, you can achieve this goal by being a disciplined investor. In order to figure out how much you should be saving, run your numbers through a compound interest calculator, and derive the magic number.

You need to know the age you want to retire and the expected rate of return you intend to earn on your investments. This will help you create a plan to help you reach your goal of $1 million in savings.

If you start by saving $300 per month at the age of 30 and earn a return of 7% a year on investments, you can reach $1 million by the age of 65. Alternatively, you can also invest $1,400 per month to reach the $1 million in savings within 25 years, keeping the 7% annual rate as a constant.

You can look to invest in ETFs such as the **iShares Core S&P 500 Fund** that will give you exposure to the 500 largest companies south of the border. This ETF replicates the returns of the S&P 500 which is one of the most popular indexes in the world.

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This ETF is hedged, which means investors will not have to worry about exchange rate fluctuations as well. Investing in ETFs such as the **S&P 500** will diversify your risk significantly and is the ideal vehicle for Canadians who do not have the time or expertise to pick individual stocks.

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