Canada Revenue Agency: 1 Huge RRSP Mistake to Avoid

Description

The Registered Retirement Savings Plan (RRSP) is the original investment vehicle for Canadians. It's been 63 years since the federal government introduced the financial account in 1957. The primary objective is to promote the theme of "saving for retirement."

Canadians are opening and contributing to their RRSPs because the plan offers several benefits. A user can hold many types of investments in an RRSP, including bonds, GICs, mutual funds, stocks, and cash. However, some account holders commit one huge mistake. If you want to realize the maximum benefit of your RRSP, avoid the blunder.

1. Don't put in cash alone

The salient feature of the RRSP is the tax-free compounding effect on investments inside the account. If you're putting in cash only and not invest it, your savings will not grow faster or not grow at all. A prosperous alternative is to retain a portion in cash and convert some to higher-yielding investments like dividend stocks.

More RRSP benefits

The Canada Revenue Agency (CRA) allows an individual to put up 18% of earnings in the previous year to the RRSP or not exceeding the maximum contribution limit ($27,230 in 2020). You can over-contribute up to the extent of $2,000 only, which is the CRA buffer. Otherwise, you pay the penalty.

Resist making RRSP withdrawals before your retirement as much as possible. You give up years of tax-deferred money growth due to early withdrawal. You can also take advantage of the spousal RRSP to lessen tax burden or derive tax savings.

A higher-income spouse or common-law partner can contribute to the RRSP of a lower-income spouse or common-law partner. Spouses or partners can split retirement income equally between them to reduce total tax payments to the CRA.

First time home buyers can borrow from the RRSP up to $25,000 to use as a down payment for a home. The facility is called the Home Buyers' Plan (HBP). If you or your spouse needs to enroll in school, the Lifelong Learning Plan (LLP) is available. You can take out up to $20,000 to pay for education costs.

Ideal RRSP stock

Manulife Financial Corporation (TSX:MFC)(NYSE:MFC), Canada's largest life insurance company and the second-largest in North America, is an ideal holding in your RRSP. This well-known insurer has a market capitalization of $40.51 billion, and the stock trades at $20.39 per share. The dividend offer is a high 5.36%.

If you use at least $75,000 of your cash to purchase Manulife shares, you will generate $4,020 in passive income. By not withdrawing from your RRSP for 20 years, the money will compound tax-free to $213,096.59. Remember that taxes are due only upon withdrawal from your RRSP.

Manulife has transformed from a life insurance business to a leading international provider of financial advisory, wealth and asset management solutions. The geographic reach is global, while its distribution platform is diversified.

Management is investing heavily in technology to adapt to the fast-growing digitization trends. Manulife is the pioneer in Canada to use artificial intelligence when underwriting.

Immeasurable help

There's nothing wrong with keeping cash to stay liquid at all times. However, it would be best to take it a step further by allowing the money to work for you. The RRSP can help you immeasurably in achieving long-term financial goals.

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Date
2025/07/08
Date Created
2020/11/12
Author
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