Canada Revenue Agency: Forget Your RRSP This Year. Do This Instead!

Description

The Registered Retirement Savings Plan (RRSP) is there for Canadians to save for retirement. However, this year, it's a good idea for many Canadians to forget about it and not make any RRSP contributions.

The pandemic triggered the unemployment rate in Canada to spike to 13.7% in May. Although, according to Statistics Canada, the rate had declined over the past few months to 9% in September, it remained worse than the peak unemployment rate of 8.7% during the previous recession of 2008/2009.

Folks who saw a meaningful reduction in their income this year should check if it still makes sense to contribute to their RRSPs for the year 2020.

Do RRSP contributions make sense?

If you're in a lower tax bracket than usual, then you should refrain from contributing to your RRSP this year. This way, you'll have more RRSP room for future years when your income level normalizes.

For example, if you're a British Columbian who normally earns $50,000 a year, your marginal tax rate would be 28.2% this year. If you contribute $1,000 to your RRSP, you'd save $282 in taxes.

However, if the pandemic impacted your income such that you only earn $30,000 this year, your marginal tax rate would be 20.06%, and you'd only save $200.60 in taxes for the $1,000. The bigger the difference between the marginal tax rates, the less in taxes you'd save.

You get additional RRSP contribution room every year when you earn income. You can check what your RRSP contribution room is on your Notice of Assessment from the Canada Revenue Agency that you receive after filing your income taxes every year.

Your RRSP room accumulates over the years. So, you'd want to save room to make bigger contributions in years you earn more income and need to pay more taxes. By contributing to your RRSP in those years, you'll reduce your taxable income and, ideally, lower your tax rate substantially.

Do this instead

If your income is lower this year but you have extra cash, you should prioritize investing in your Tax-Free Savings Account (TFSA) instead. While RRSP contributions reduce your taxable income, TFSA contributions are from after-tax dollars.

So, unless you're in a high tax bracket, in most cases, you'd want to contribute to your TFSA ahead of contributing to your RRSP in any given year.

What's a good TFSA investment right now? This year's contracted economy put a dampener on **Toronto-Dominion's** (TSX:TD)(NYSE:TD) earnings. Don't worry, though. There isn't a recession that it hasn't recovered from. Besides, the quality bank has a margin of safety for its dividend, which is a source of consistent returns.

The bank's dividend yield of 4.46% is still quite attractive. Moreover, it will increase its dividend in the long run, though regulators might force it to put that off for a couple of years.

As investors jumped back into the quality name, the leading bank has just begun its recovery path. So, it's still a decent buy.

TD stock can retreat to the $65 range in the short term if there's unfavourable news relating to the pandemic or vaccine. So, expect a bumpy ride. If the bank stock does dip, investors should scoop up the cheaper shares for bigger dividend income!

The Foolish takeaway

If you experienced a meaningful income cut this year, you should probably forget about contributing to your RRSP. Save your RRSP contribution room for when you are in a higher tax bracket.

If you have extra cash, consider investing in your TFSA first and your non-registered account second. If you still have your sights on building your RRSP, you have the option of transferring your stocks from other accounts in kind to your RRSP in a year you have a higher marginal tax rate.

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