



CRA Tax Benefits: Last Chance to Reduce Your 2020 Tax Bill Using an RRSP

Description

February is almost over. It's time to take your income tax filing seriously. You have until March 1 if you want to save some tax using the Registered Retirement Savings Plan (RRSP). If you are eligible to file your tax return, you are eligible to open an RRSP and contribute up to 18% of your earnings, or \$27,230, whichever is lower. The Canada Revenue Agency (CRA) allows you to deduct your RRSP contribution from your 2020 taxable income.

If your taxable income is \$50,000, you can reduce it to as much as \$41,000 by contributing \$9,000 (18% of \$50,000) to an RRSP. These deductions can save you as much as \$2,500 in the tax bill. But is a \$2,500 tax saving a good trade-off for a \$9,000 investment?

The drawbacks of RRSP

Don't invest a huge chunk of your salary in your RRSP. The account has its drawbacks when it comes to withdrawals. The RRSP aims to encourage retirement savings, and for that, you need to be invested until you retire. It encourages you to save by giving tax benefits and keeps you invested until age 71 by withholding tax:

- 10% for the first \$5,000 withdrawal
- 20% for withdrawal ranging from \$5,000 to \$15,000
- 30% for a withdrawal above \$15,000.

Moreover, the CRA adds your RRSP withdrawals to your taxable income. This makes RRSP attractive only to high-income earners who have plenty of income and are looking for instruments to reduce taxes.

According to the [2016 Census](#), on average, 35% of households contributed to an RRSP. Canadians prefer contributing to the Tax-Free Savings Account (TFSA), as it taxes your contributions but exempts your withdrawals. Because of the taxes charged on withdrawals, the RRSP is not quite the investment choice. But it has one advantage. The CRA lets your investment grow tax-free in RRSP.

How to save taxes using an RRSP

If you want to use a RRSP, calculate your taxable income and deduct all [eligible tax deductions](#) and credits. For 2020, you can deduct as much as \$1,984 in basic personal income tax credit, \$400 in home-office-expense deduction, \$75 in digital news subscription credit, or \$250 in the Canada Training credit.

Once you arrive at the final tax bill, see how much of a tax-saving RRSP can give you. Only invest the amount that you don't need before retirement.

2020 Taxable Income	Tax rate
\$1 to \$48,535	15%
Over \$48,535 to \$97,069	20.5%
Over \$97,069 to \$150,473	26%
Over \$150,473 to \$214,368	29%
Over \$214,368	33%

For instance, John has a taxable income of \$50,000. He avails all the above four tax benefits, which brings his final tax bill to \$5,190. As per the 2020 income tax bracket, his \$1,065 taxable income falls under 20.5%. So, he can invest around \$1,200-\$1,500 in RRSP, which will reduce his taxable income to \$48,100 (RRSP tax deduction of \$1,500 + home office expense deduction of \$400). A \$1,500 RRSP contribution will reduce John's federal tax bill by \$284. There will be additional saving in provincial tax. Now, this is a reasonable trade-off.

One top stock to buy and hold forever

As RRSP is a long-term bet, put your money in stocks that you can buy and hold forever. What kind of a company will exist even after 20 years? It'll be the one that is a market leader and in a business that is a necessary good or service.

Enbridge ([TSX:ENB](#))([NYSE:ENB](#)) is well placed to do business for the next 20-30 years. It has already existed for over 60 years and paid incremental dividends for 26 years. What keeps the pipeline operator steady is the management's ability to complete new projects and generate strong returns from them. Over the years, it has built many projects and now has the largest pipeline infrastructure in North America.

The oil and natural gas that flows through its pipelines generated enough cash to increase its dividend per share at an average annual rate of 10% in these 26 years. This dividend growth will leave you with a significant amount for retirement that will keep you in profit, even after accounting for taxes.

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