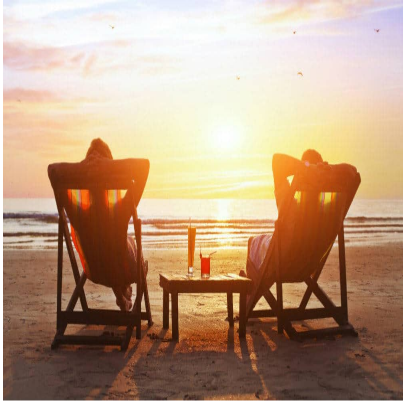

Want to Retire Before 40? Here’s How to Use a TFSA and RRSP Strategically

Description

Retiring before you turn 40 is no easy feat. And, for those who don’t take advantage of registered retirement accounts, like an RRSP and TFSA, the hill is even harder to climb. Though registered retirement accounts were designed for traditional retirement ages, every early retiree can (and should) use them strategically. Let’s take a look at how you can use both accounts on your quest to early retirement.

How to use a RRSP strategically

Hands down, the RRSP is one of the best retirement accounts in Canada. With a contribution space up to 18% of your earned income (or $29,210 for 2022, whichever is less), not to mention immense tax benefits, the RRSP can help you sock away some serious cash.

For one, RRSPs have the benefit of tax deferral. That means whatever gains you make in your RRSP, whether it’s through stocks or ETFs, won’t result in a capital gains tax.

At least, not for now. You *will* pay taxes when you withdraw money from your RRSP in retirement. The amount you pay depends on your marginal tax rate at the time of withdrawal. Ideally, you won’t be making as much income in retirement as you are now, which will put you in a lower tax bracket. As such, you’ll pay less in taxes on withdrawals — much less than what you would have paid had you not contributed the money.

If you plan to withdraw from your RRSP in early retirement, you’ll likely pay a withholding tax, too. The tax rates on RRSP withdrawals depend on the amount you withdraw, but they fall into these three brackets:

- $5,000 or below: 10% (5% in Quebec)
- $5,001 to $15,000: 20% (10% in Quebec)
- $15,001 or above: 30% (15% in Quebec)

Despite these taxes, the RRSP comes with another advantage: the CRA allows you to deduct your

RRSP contributions from your taxable income.

That’s huge. Contributing to your RRSP could put you into a lower tax bracket, which will help you save on taxes now. But here’s where you could get *really* savvy: by saving on taxes, the CRA might give you a tax refund. And what should you do with that tax refund? You guessed it: invest it in your RRSP.

An early retirement strategy might use an RRSP to supplement other sources of retirement income. An RRSP can also come in handy when you need to “top off” your monthly or annual income, especially when your non-registered investments and dividends aren’t earning enough to sustain your lifestyle.

How to use a TFSA strategically

Like RRSPs, a TFSA comes with tax benefits, too. For one, you won’t pay capital gains taxes on your investment gains. In fact, with a TFSA, you’ll have no tax liabilities whatsoever: since you contribute after-tax dollars to your account, the CRA doesn’t require you to pay taxes on your withdrawals. It doesn’t matter how much your money grows. So long as it grows inside a TFSA, you won’t have to pay taxes.

A TFSA has contribution space, too. For 2022, you can contribute a maximum of $6,000 to your TFSA. The good thing about TFSAs — your space rolls over. So, if you’ve never opened a TFSA, and you were 18 or older in 2009 (when the TFSA was created) you could have a total of $81,500 right now.

Like an RRSP, an early retirement strategy might use a TFSA as a way to “top-off” your retirement income. Since your TFSA has more flexibility, you could also stash your emergency savings under the TFSA umbrella.

What about non-registered accounts?

Yes, you will most likely need non-registered accounts. With these accounts, you don’t have strict contribution limits, though you don’t have tax benefits either. You’ll pay capital gains taxes on your investment gains. But if you’re going to retire early, this might be the price you have to pay.

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