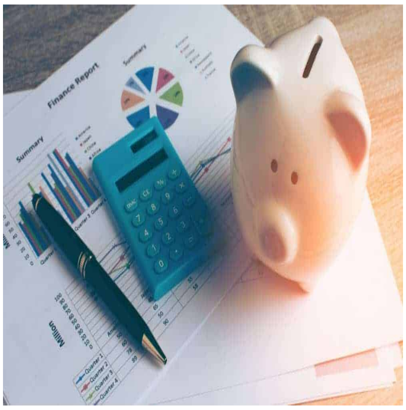

When Shouldn’t You Contribute to Your RRSP?

Description

RRSPs are a tax haven for middle- and high-income-earning Canadians. Not only do they exempt you from paying taxes on investment gains and interest, but they also allow you to deduct contributions from your taxable income, lowering how much you owe in overall taxes.

But here’s the truth: only *half* of Canadians really use RRSPs. And with the country fairly divided over their usefulness, you might be wondering if contributing is in *your* best interest. To help you decide, let’s look at some circumstances when an RRSP may not be the best account for you.

1. You’re in a low tax bracket

In general, RRSPs are ideal for Canadians with a relatively high income. The reason: you’ll likely save more on taxes when you withdraw from an RRSP in retirement.

When you contribute to an RRSP, you put in “pre-tax” dollars — that is, money that hasn’t been taxed. The CRA allows you to defer paying taxes until you withdraw money in retirement. Whenever you withdraw money from your RRSP, the CRA will calculate taxes owed using your marginal tax rate *at the time of withdrawal.*

The CRA is assuming your marginal tax rate will be lower in retirement than it is now. In other words, they’re cutting you some slack. If your household income is, say, $160,000 now, your marginal tax rate will be much higher than a retired person who lives off $70,000 a year.

So, if you expect your marginal tax rate to be lower in retirement than it is now, an RRSP can help you save on taxes. But if you’re already in a low tax bracket, an RRSP might not help you save on taxes. In this case, a TFSA might be better for you, as they come with more flexibility as well as tax benefits.

2. You want to save for short-term goals

RRSPs have amazing tax benefits. But they’re not ideal for short-term goals, like saving for a car.

While you can withdraw from an RRSP at any time (unless it's locked in), you'll likely pay extra taxes if you. You'll have to include your withdrawal in your taxable income, and you'll have to pay a withholding tax, which could be fairly hefty depending on your withdrawal.

You can convert your RRSP to an RRIF as early as 55, but you have to make pesky minimum annual withdrawals as soon as you do.

Again, for short-term goals, a TFSA would better serve you. You don't have to pay a withholding tax when you withdraw from your TFSA. And because you've already paid taxes on your TFSA contributions, you don't have to include TFSA withdrawals in your taxable income.

3. You want to invest in crypto or NFTs

As of right now, your RRSP cannot hold cryptocurrencies, nor can they hold NTFs (non-fungible tokens). They can only hold qualified investments, which include securities listed on a stock exchange and cold, hard cash. While you can invest in a fund, like an ETF, that tracks the crypto market, you cannot use your RRSP to buy crypto directly.

For those investors who want to buy crypto or NFTs, one of Canada's best brokerage accounts would better serve you. You can still use your RRSP to buy stocks and funds. It just means you'll have to own more than one investment account.

Should you open an RRSP?

Unless you're in a low-income bracket, an RRSP could help you immensely in your retirement planning. The tax-deferred benefit on RRSPs will help you earn more money in your investments, and the tax deductions on contributions could help you save on your taxes, too. By opening an RRSP early, and by contributing frequently, you can sock away a hefty amount for your golden years.

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