Canadians: 3 Reasons to Invest in an RRSP

Description

The Registered Retirement Savings Plan (RRSP) and Tax-Free Savings Account (TFSA) are both popular investment vehicles that can help save for your retirement. However, in some cases, the RRSP is a better tool for this purpose.

Your RRSP prevents you from spending your retirement savings

Most of the time, Canadians will get a big tax bill for withdrawing from their RRSPs early, that is before they retire. Unless you withdraw from your RRSP under the Home Buyer's Plan or the Lifelong Learning Plan, the withdrawal amount will be taxed at your marginal tax rate. This discourages Canadians from withdrawing from their RRSP while they're working and can help prevent Canadians from spending their retirement savings. After all, the ultimate purpose of saving and investing in an RRSP is to grow a nest egg for retirement.

Notably, because RRSP withdrawals are taxable income, they, combined with your other income, such as investment income, at retirement can trigger a clawback on your government benefits such as the Old Age Security (OAS). According to SavvyNewCanadians.com, "for July 2021 to June 2022 pay period, OAS clawback is triggered when your net income is $79,054 or higher and this income is based on your 2020 tax return."

Reduce taxable income and get tax-deferred growth

Canadians in high tax brackets can benefit greatly from contributing to their RRSPs. They can save tonnes of income taxes by making RRSP contributions every year. For example, let’s say John Doe lives and earns $110,000 this year in Ontario from working full time. Since a job’s income is counted as other income, his highest tax bracket is 43.41%. His second-highest bracket is 37.91%. If he has sufficient RRSP room and decides to contribute $13,000 to his RRSP this year, he’ll lower his taxable income to $97,000 for this year and save $5,456.74 in income taxes.

If John is able to invest the single $5,456.74 amount for 8% a year and let it compound returns for 25 years, it’ll turn into $37,370.35. None of these returns will be taxed until he withdraws from his RRSP. Of course, he can continue contributing to his RRSP every year for as long as he is working (and has the RRSP room) and grow it into an impressive nest egg. If John contributes and invests $5,000 each year after that, he’ll end up with $371,194.15 at the end of the period.

U.S. dividend stocks

In other investment accounts, you’ll get taxed on your U.S. dividends but not in your RRSP (or RRIF). Warren Buffett holds a stake of roughly 5.3% in **STORE Capital** (NYSE:STOR) as one of the dividend holdings in **Berkshire Hathaway**.

STORE Capital is a triple net lease REIT that collects rental income from a diversified portfolio with US$11.2 billion of assets under management across about 573 customers and 121 industries. The largest customer makes up only about 3% of the portfolio. Its weighted average lease term is approximately 13 years, which is long and has lease escalations of just under 2%.

Since its initial public offering in 2014, STORE Capital has compounded its adjusted funds from operations per share (AFFOPS) at 5.7% and increased its dividend by 6.1% per year. At US$26.39 per share at writing, the dividend stock is undervalued by about 19% and can deliver some solid income in the long run. Right now, it offers a safe yield of 5.8%.

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Date
2025/06/29
Date Created
2022/06/19
Author
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