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## RRSPs are getting a bum rap as a tax trap

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*Part of the misconception around the savings account relates to federal rules on how they're used*

Regret is something you're supposed to feel for not contributing to RRSPs.

But for years now, Jamie Golombek has been hearing from retirees who rue the day they started down the road of using registered retirement savings plans and, in turn, registered retirement income funds (RRIF).

"I get e-mails about it, I get phone calls about it and I get rants on web pages about it," says the managing director of tax and estate planning at Canadian Imperial Bank of Commerce. "They're from people who are paying taxes of something like 50 per cent on every dollar they take out of their RRIF. They're angry and they say, 'I should never have done this.'"

There is a Rodney Dangerfield-ification of RRSPs happening. A long-term decline in usage of RRSPs highlights the loss of respect. But unless you're in a low income bracket, you probably need RRSPs as part of your retirement savings.

Mr. Golombek's latest research highlights how RRSPs are no worse than other savings options if your tax rate is the same in the year you contribute to your plan as when you withdraw money. Most people will have a lower tax rate in retirement, which means they'll have a bigger benefit from RRSPs.

Mr. Golombek asks you to imagine you have \$3,000 of pretax income to put into both an RRSP and a tax-free savings account (TFSA), which a growing number of people regard as a better retirement savings tool. You'll have \$3,000 for the RRSP on an after-tax basis because of the tax deduction you get for making the contribution (this assumes your tax deduction goes into your RRSP and isn't spent elsewhere).

Your \$3,000 pretax money for the TFSA becomes a net \$2,000 if we assume a 33.3-per-cent tax rate.

Let's say you make 5 per cent on both investments over a year. Your \$3,000 RRSP grows to \$3,150, or \$2,100 after applying your 33.3-per-cent tax rate on withdrawals. Meanwhile, the TFSA grows by 5 per cent and leaves you with the same \$2,100 (no tax applies on a TFSA withdrawal). Mr. Golombek did a third example using a non-registered account. Here the \$3,000 pretax investment turns into \$2,083 on a net after-tax basis

(assuming the increase in value is treated as a capital gain). The bottom line in these numbers is that RRSPs are not a tax trap.

Part of the reason why people think otherwise relates to federal rules on how they're used. By the end of the year you turn 71, you have to convert them into RRIFs and make annual withdrawals with a mandatory minimum specified by the federal government.

Regret over using RRSPs is most likely to kick in with the tax bill associated with these RRIF withdrawals. But Mr. Golombek urges retirees to remember that they essentially didn't pay tax on the income they used in their working years to contribute to an RRSP and that they benefited from years of tax-free compounding.

CIBC did some polling to support Mr. Golombek's research and it indicates that more than half of people believe TFSAs are the better retirement savings vehicle than RRSPs. But this is only true if you will have a higher tax rate in retirement than in your working years, or if you will face a clawback of Old Age Security benefits. Money taken from a TFSA in retirement is not added to your income and thus won't trigger a clawback, while the opposite is true of RRSP or RRIF withdrawals.

TFSAs are an ideal retirement savings tool for lower-income Canadians because withdrawals from one of these accounts won't trigger a clawback of the Guaranteed Income Supplement. But for others, annual TFSA contributions may not be enough to build sufficient retirement savings. The contribution limit in 2018 is \$5,500 and future increases are to be triggered only by rising inflation.

Mr. Golombek said that in 2015, just 35 per cent of households made an RRSP contribution and unused RRSP room exceeded \$1-trillion. The percentage of tax filers who make an RRSP contribution has been on a downward slide for 15 years, and the number of withdrawals before retirement has been rising. The economy's ups and downs over the past 10 years help explain this, but so does the misinformed view that RRSPs should be avoided.

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