Canaccord Genuity Wealth Management

Financial Focus

Becker Orr Wealth Management

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When to Make a RRSP Contribution

By Clinton Orr

The Registered Retirement Savings Plan (RRSP) was once a very popular savings tool. However, with the emergence of the Tax Free Savings Account (TFSA) in the last decade, the popularity of the RRSP has diminished. While I agree that the TFSA offers many benefits and is a great way to build wealth, the RRSP still has some merit.

For starters the RRSP offers a tax deduction for any money contributed to the account. That is a significant benefit, one not matched by the TFSA. One benefit both the RRSP and TFSA share is that any money contributed to the account grows tax free. Unfortunately, when you withdraw funds from your RRSP the money is treated as taxable income, which is a drawback the TFSA does not have. So, in my view, one of the main benefits of the RRSP is the upfront tax deduction. There are situations were that upfront tax deduction can lead to significant tax savings.

Before we review the tax saving scenarios it is important to note that the amount you are allowed to contribute to your RRSP is limited. There is a formula that determines your RRSP contribution room. You can contribute 18% of your earned income up to a maximum of $26,500. That maximum is for the 2019 tax year, for the 2020 tax year it will be increased to $27,230. Earned income is money derived from a job or self-employment. Income from investments, pensions or government benefits are not considered earned income. In addition, many folks have a pension plan through their employer. The contributions to your work pension plan will reduce your RRSP contribution room. If you do not use your full RRSP room in a year it rolls over to the next year. An easy way to see how much RRSP contribution room you have is to check your Notice of Assessment. After you file your taxes you will receive a Notice of Assessment, that notice will list your RRSP contribution room.

Assuming you have RRSP room, the best time to contribute to your RRSP is when you are in a high tax bracket. Ideally you want to contribute to your RRSP when you are in a high tax bracket and withdraw the funds when you are in a lower tax bracket.

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An example would be if you sell a property that is not your principal residence. Selling the property could create a taxable capital gain that would increase your income for that year. An RRSP contribution in the year of sale would ease your tax burden. That money could be withdrawn down the road when you are in a lower tax bracket.

As well, for individuals with a high income, regular RRSP contributions can provide significant tax savings. Usually I recommend contributing enough to the RRSP to push your income into a lower tax bracket. For example, for the 2019 tax year the combined provincial and federal marginal tax rate on income of $105,000 is 43.40%. That tax bracket starts at $95,259. If you contributed $10,000 to your RRSP, your taxable income would drop to $95,000, and you would be in a lower tax bracket. A sizable tax savings. As your taxable income declines, your marginal tax rate also drops, that means the tax savings of a RRSP contribution will also be lower and a RRSP contribution is less beneficial. So RRSP contributions at lower income levels might not be worthwhile.

The deadline to contribute to your RRSP and use the tax deduction on your 2019 tax return is March 2, 2020. As mentioned above, there are scenarios where an RRSP contribution is beneficial. Talk to your tax professional to see if an RRSP contribution would make sense for you.

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