

## Registered Retirement Savings Plan (RRSP) Basics

Registered Retirement Savings Plans (RRSPs) were created by federal legislation in 1957 as an incentive for Canadians to save for their retirement income needs. Although changes have been made over the years, the basic mechanics of RRSPs are quite simple. You can benefit from RRSPs by:

**Postponing taxes** - Canada Revenue Agency (CRA) enforces the rules as to how much we can contribute to our RRSP. For the 2010 tax year, it's 18% of 2009 income to a maximum of \$22,000, minus any Pension Adjustment, plus any unused contribution room from previous years. Deposits made to an RRSP within the above limits are deductible from income. Deductions can actually be delayed to a future year when income is greater, thereby making the tax savings larger.

When income is taken from an RRSP, it will be fully taxable. In most cases, however, total annual income is lower in retirement than when the deductions were taken, so the tax impact may be less.

Income taxes on the RRSP growth are also postponed. For example, John commits to saving \$10,000 of his *income* each year. Because an RRSP deposit is tax deductible, the full amount is invested. If John were to deposit instead to a non-RRSP account, he would only be able to invest \$6,500 (assumes a 35% marginal tax bracket) which is what he would have left over after paying taxes. As taxes on growth are also postponed inside an RRSP, his \$10,000 per year would grow to about \$1,383,369 in 35 years at 7%. His non-RRSP account would only

grow to about \$535,164 over the same period because John's growth will be taxed along the way.

**Starting young** - It's so easy to put things off. The 18 year old says, "I can't save now because I'm burdened with my education costs." The 25 year old says, "We're just getting started and our income is low right now. Besides, we want to have a little fun while we're young." The 35 year old says, "Our family is growing and we have a big mortgage. We should be able to do more when the kids are older." The 45 year old says, "The kids are in college and we just can't spare a cent until they're done." And the excuses go on and on.

Assuming a 7% annual compounded rate of return and a desire to accumulate \$1 million in an RRSP at age 65, Sarah, starting at age 18, would need to deposit only \$3,038 per year. Roy, at age 25, would need to make deposits of \$5,010 annually. \$10,587 is the RRSP deposit amount Grace would have to make from age 35 on. And Bill, age 45, would need to deposit a staggering \$24,393 to his RRSP each year.

**Leaving them alone** - The temptation can be great to cash out a portion of an RRSP account to pay off some debt. Brad and Carol have about \$10,000 of credit card debt that they are carrying from month to month. To get that amount out of their RRSP, they would have to cash out about \$15,400 to net the amount needed, assuming a 35% income tax rate. At age 35, this withdrawal would reduce their retirement savings at age 65 by about \$114,184 assuming a 7% annual compound interest rate.

**Want help with your retirement planning? Call today!**



**John Peters**

J. Peters Financial Consulting  
3391 W. 7th Ave., Vancouver, BC V6R 1V9  
**(604) 736-7810 john@johnpeters.ca**

For more financial topics, go to [www.johnpeters.ca](http://www.johnpeters.ca)