Feb
07
2022

RRSPs, Taxes and Profitable Investing

By admin

The RRSP deadline for 2021 deposits is fast approaching on March 1st. Some of the basics of the benefits of RRSPs are worth repeating, especially for Millennials and other younger, or beginner investors.

The goal of building investment assets is to someday (retire) be able to sustain your desired lifestyle without having to work to earn an income. This is often referred to as passive income where the assets generate the monthly income needed to maintain your standard of living.

One key question that must always be asked is: "*Considering your personal marginal tax rate and your annual savings rate what is the most efficient way to save for retirement?*"

The RRSP is designed to allow you to invest on a pre-tax basis. This means you can grow your assets faster than investing the same money after you have paid taxes on those earnings. For those in a 35% or higher marginal tax rate (MTR), this can mean having a lot more capital growing in your retirement plan from Day 1.

For example, $10,000 invested in an RRSP can compound faster, than investing the same amount outside an RRSP after paying an MTR of 35%. If you can do this for 30 or 40 years the differences will be huge.

People have criticized RRSPs because of the requirement to pay tax once income is removed for retirement expenses. The strategy is that your retirement income level will be lower than your working years - therefore the actual income taxes paid should be a lot less than the taxes you would have paid in your higher income working years.

The capital created in an RRSP - versus the same capital invested outside an RRSP after taxes, with the same assumed return on investment (ROI) - will generally be much larger. If you are a doubting Thomas, get a calculator and do the math for yourself. The end result will very likely be a much larger net retirement income.

If RRSPs did not exist as a tax deferred investment vehicle, people would still need to save money to build their retirement assets. Using an RRSP as a primary retirement savings vehicle is easier than any other method and should be the primary focus of all younger investors.

The flip side of RRSP investing is what to invest in? It is a truism that the majority of Canadians would prefer to invest only in GICs or other fixed income investments for a smooth worry-free ride to retirement. No one generally likes to invest when they are nervous or uncertain about the future.

Unfortunately, interest rates are so low today that investing only in fixed income investments may not create enough growth in your assets to fund a comfortable retirement. The reality is that very few people can save their way to a $1 million portfolio, which is the amount surveys show the average Canadian needs to generate their ideal retirement income of $50,000, at a 5% ROI.

Thus, it becomes necessary to take some type of risk by investing in the equity markets. The best time to purchase equity investments is usually when there is a lot of fear. As the world's most successful investor Warren Buffet has been quoted as saying, “the best time to invest is when you have the money!" The second-best time, is when the investment markets have a large correction, like in the spring of 2020 when investments were on sale.

So be encouraged to keep adding to your retirement portfolio because a young investor with 20, 30 or 40 years to go before retirement has no idea how much money will be required for a comfortable retirement.

The only thing you can control is how many assets you own and the quality of those assets. You can control the number of single-family homes you own or the number of shares you own of a great mutual fund. Buying quality often has been a great long term financial strategy for a very long time.

Call us today [1] to discuss your retirement growth strategy and how you can increase the number of assets you own over time. There are other strategies and considerations for those closer to retirement or needing to generate income. We offer complimentary portfolio reviews in these situations.

Tags: investment planning [2]

Source URL:https://caledonhillsprivatewealth.ca/e-newsletter/2022/2022-02/article-1.htm

Links
[1] https://caledonhillsprivatewealth.ca/contact-us [2] https://caledonhillsprivatewealth.ca/taxonomy/term/3