Ask the Experts: RRSPs in COVID

When savings plans get derailed Annie Kvick, CFP and Michael Deepwell, CFP have tips to help you get back on track

Andrew Willis 23 February, 2021

Question: I got COVID. It was touch and go, but I'm OK now. I guess I'm wondering what would have happened to my family if I died. My RRSP is from work, and I don't believe I have a next-of-kin or nomination on there. Do I need one? What happens if I had died?

Annie: One should always have a beneficiary designated on a registered account. If you don't name anyone, then the money will go to your estate and the full RRSP is taxable as income in the year of death, and you have to pay probate fees (based on your province of residence). This can create a huge tax bill depending on the size of the RRSP. (A good conservative estimate can be as high as 50% of the RRSP).

Michael: Where you have not designated a beneficiary, the RRSP becomes part of your estate and is dealt with according to your will. If you don't have a valid will, the rules of intestacy apply. The distribution of your RRSP will depend on your province of residence at death, and whether you have a spouse or partner and children. Your RRSP and other assets would be distributed after settling obligations and taxes of the estate.

Question: Because of COVID, my expenses were low last year, and I was fortunate enough to max out my 2019 RRSP contribution room by November

2020. I still have some money left over. Can I put it into my RRSP in February, and have it count towards my 2020 contribution?

Michael: Yes, if you have RRSP contribution room. There is a significant, but often overlooked, difference between making an RRSP contribution and claiming an RRSP contribution on your tax return. You can make an RRSP contribution as long as you stay within your RRSP limit. However, you could decide to not claim it on your tax return for the year the contribution was made, instead saving it for a future year. The contribution still needs to be reported on your tax return, but not claimed as a deduction.

Your RRSP room begins January 1 but is based on inputs from your tax return that are generally unknown until months later when your return is prepared. RRSP room for the current year (say 2021) is based on your previous year's earned income (think employment income). If you do not have an employer pension, then your RRSP room is generally 18% of your employment income up to the maximum ($27,830 for 2021).

Annie: The question should not be if you can or not, it always needs to be should you put money into an RRSP or not? Will you save taxes by putting money into an RRSP or will you pay more taxes long term? It is important to not just think about what will save you taxes today but what will save you the most amount of tax long term. It is important to compare your current tax rate to the tax rate you will be in retirement (or in a few years).

As a general rule of thumb: If your tax rate is low now, then you will likely be better off by putting money into a TFSA or a non-registered account. If you are in a high tax rate now and will be in a much lower marginal tax rate in retirement, then you will likely benefit from putting money into an RRSP. If you will be in the same tax bracket now as in retirement, then you will likely benefit from using a TFSA or non registered account.

Question: Interest rates are really low and I recently renegotiated my mortgage for a lower rate. I'm wondering if I should use the opportunity to pay off the mortgage. Or should I invest in my RRSP?

Michael: This is a classic question that depends on the numbers involved as well as your attitudes, expectations, and experience. People generally focus on the numbers, but the qualitative side is just as important. Some questions to consider are:
• What's the difference between your mortgage interest rate and the after-tax rate of return on your RRSPs?
• What's your taxable income and would RRSP contributions be significant to reduce your taxes both now and when withdrawn?
• What's the size of your mortgage and RRSP?
• How old are you and when do you plan to start withdrawing from your RRSP?
• What are your expectations for tax rates in the future when you withdraw from your RRSP?
• Can you deduct a portion of your mortgage interest (if you have a rental property)?
• What are the prepayment options on your mortgage?
• What's your attitude towards holding debt? Would you want to pay off the mortgage as soon as possible?
• How experienced of an investor are you? What's your track record?
• How confident are you on achieving investment returns in the future?

• How will changes in interest rates or investment returns impact your personal finances? What could alter your plans and how likely is that to occur?
• Do you have time to manage (or are willing to pay someone to manage) your RRSP?
• How will your mortgage and RRSPs be dealt with upon death?

These questions can help guide you to a decision that's right for you and your particular situation. At a basic level, the simplest approach is to pay off your mortgage: you reduce interest payments without striving for investment returns.

Question: I lost my job due to COVID. Should I withdraw from my RRSP to fund my lifestyle now?

Annie: The first question you need to ask yourself is how much money do you need per month etc.? How long will you need it for? What money do you have available to access? Can you bridge the gap any other way?

The smartest financial strategy to access when our income changes is to adjust our cash flow. If you lost your job or have a reduction in the family income (maybe one partner is still working), can you adjust/reduce the amount of money you need to spend every month? Find out how much you really need to spend and take out any unnecessary items. You might find that you can live on much less than anticipated. When you know what your shortfall is every month going forward, try to figure out what options you have to bridge the gap. Can you generate some income by helping a friend, selling old toys that you haven't used in a very long time etc? Is your basement or closet full of things you can list for sale? If you still need cash, then lastly you find the missing money in your savings or investment accounts. RRSP withdrawals have tax implications whereas TFSA withdrawals and non-registered withdrawals have either none or likely much less. Or ideally, do you have an emergency fund lined up to help you navigate tough times? (if you don't have an emergency fund, make sure you save up for one when you start working again).

Compare the tax implications of withdrawing from an RRSP compared to other investment accounts. If your income was very low that year then using the RRSP might make sense. If you had high income the first few months of the year (before you got laid off), then using the RRSP might put you into a high tax bracket and you have to pay high tax on the RRSP withdrawals – and best is then to avoid that and instead take the money from a TFSA or non-registered account. Or you might have access to a secured line of credit and can borrow money from there instead. Take the time to review your best financial options as your "future you" will be glad you did.