Get more value out of your investment

Think beyond a one-time contribution to an RRSP to earn higher returns

Saving for your retirement should be a top priority, but finding spare cash to invest can be tough.

By: Kristin Kent Special to the Star, Published on Fri Jan 17 2014

Tom Hamza isn't a fan of the term “investing season.”

“It's an unfortunate term because it makes people think investing is a one-time-per-year contribution kind of thing,” says Hamza, president of Investor Education Fund, a non-profit created by the Ontario Securities Commission.

“The good news is, at least people are thinking about their RRSPs. But everybody should be investing throughout the year, and for a lot of good reasons,” says Hamza.

Most notable, you can earn more money.

“The fact of the matter is if you're contributing throughout the year rather than the end of the year, you're actually going to earn significantly more because your balance will be higher for a longer period of time,” says Hamza.

Noel D'Souza, a Toronto-based financial planner, says many of his new clients are eager to invest but aren't in a financial position to do so.

“When we dig into their situation, often times we find they haven't taken care of many of the other pressing needs in their life,” says D'Souza.

“They haven't dealt with high-interest debt, they haven't set up an emergency fund, they haven't purchased the necessary protection for themselves and their family,” he says.

“Investing is about taking on varying levels of risk. And this should happen only after you've addressed the risks you already have in your life,” he says.

“A lot of people don't think about that.”

But RRSPs are increasingly important, given that fewer Canadians will retire with company pension plans. They were introduced in 1957 as a way to help supplement the Canadian Pension Plan (CPP) and to help us save for our own retirements.

Yet only 24 per cent of eligible tax filers contributed to their RRSPs in 2011, the last year for which data are available, says Statistics Canada.

The average person contributed just $2,830 that year. RRSPs in themselves are not investments. It's just an account that offers certain advantages.

“We always hear the term ‘buying RRSPs' when in actual fact it's an account and they have to buy something within the account,” says D'Souza.

Some things to consider: will you choose to invest in cash, bonds, guaranteed investment certificates, mutual funds, exchange-traded funds or stocks? How much can you put aside? What is your timeline? What kind of return do you need?

Knowing what you're saving for will give you a better idea of how much you'll need and where to put your money.

“Many of these decisions will naturally fall from your goals,” says D'Souza.

“Some people tend to take on more risk than they need to. If they understand their goals then they can invest in something that's balanced and appropriate for them.”

The Financial Consumer Agency of Canada encourages all Canadians to consider RRSPs, as they come with attractive tax benefits. The contributions you make to your RRSP are tax-deductible. That means, if you put in $1,000 to your RRSP, you can deduct $1,000 from your taxable income when filing your taxes.

You may receive a tax refund.

Hamza points out the money is not a gift from the government; it is being returned to you because it was yours in the first place.

“So many people see that money as a gift. It's not and it should be reinvested. This is a big part of being a disciplined investor,” he says.

“And over the course of a lifetime, that money alone can make a huge impact.”

Another key tax benefit of RRSPs is your money grows and compounds tax-free until you withdraw.

That doesn't mean you avoid taxes altogether. RRSPs are fully taxable. The logic here is you make contributions while you're in a higher tax bracket and withdraw when you're in a lower one. This means, you'll pay less tax. It also means, the full balance of your portfolio isn't yours.

If your portfolio sits at $1 million at the time of retirement and you're in a 30 per cent tax bracket, that's a good chunk of change going to the government. The question then becomes: are they worth it? According to Hamza, yes.

“Even though you will be taxed, those decades will work out in your favour,” he says. Consider what happens when you invest outside of an RRSP. For argument's sake, let's say you make $100,000 per year and take home 60 cents on the dollar. Your income is being taxed.

If you're also investing in something like a dividend stock, Those stocks are being taxed as well.

“It's like lots of little bites instead of one big bite,” says Hamza.

“You're getting taxed on your income and you're getting taxed on your investment return as opposed to putting it in an RRSP where you're getting that gain.

In the end, you have more money that has more time to grow.”

Getting the most value out of an RRSP boils down to how much you contribute. You can to contribute up to 18 per cent of your previous year's income, to a maximum amount, which was $23,820 in 2013. If you have extra contribution room, your limit could be higher.

“By maxing out your RRSPs, you'll take care of much of your retirement. As a rule of thumb you're going to be in pretty good shape if you do that,” says Hamza.

“But you have to know how much you can contribute and you have to have the goal of closing that gap,” he says.

“You want as little room left as possible in your RRSP by the time you retire. That's a pretty important thing to be aware of as you start saving for retirement.”

Setting up an RRSP

Here's what the Financial Consumer Agency of Canada would like you to know.

Where can I get an account?

There are many ways to set up an account.

You can visit a financial institution, such as a bank, credit union, trust or insurance company.

You can also set up an account online.

What kind of accounts

are on offer?

There are four types of RRSPs: individual, spousal or common law and group plans. These are managed for you.

Then there are self-directed plans, meaning you have the ability to build and manage your own portfolio.

When can I contribute?

Ideally you should set a plan in place that enables regular contributions. This could be taken from every pay cheque or it could be taken once a month.

Choose a frequency that works for you. There is a contribution deadline. You need to contribute to an RRSP by March 1 for the previous tax year.

What costs can I expect?

Fees vary depending on the type of investment you choose and how you make the purchase.

Fees will impact your returns to a certain degree.

These costs usually fall into the following five categories: the cost to buy an investment, the cost to sell an investment, investment management fees, financial adviser fees and administration fees for registered plans. At times, sales commissions are included in the price. It's important to understand the product you are purchasing, know all associated costs and determine their worth.

What if I withdraw?

RRSPs are designed for long-term savings. If you choose to withdraw, some of it will go to taxes. There are two exceptions. As part of the Home Buyers Plan, first-time homebuyers can borrow up to $25,000 from their RRSPs, tax free, to use as a down payment. You have 15 years to repay the borrowed funds in full. As part of the Lifelong Learning Program, you can borrow money from you RRSP to help pay for your education or your spouse's or common-law partner's education. In this case, you'd have 10 years to repay.