Immigrants should build TFSAs while waiting for RRSP eligibility

Globe and Mail Update
Published Monday, Feb. 27, 2012 3:14PM EST

Shortly after she moved to Toronto from Hong Kong 20 years ago, May Fung learned about a fifth season in Canada, one that didn't appear anywhere on her calendar: RRSP season.

"When I found out about the tax rates in Canada – which were very high compared to what I was accustomed to in my home city – I was eager to participate in a program that would give me instant relief from taxes," says Ms. Fung, who is now senior manager of retirement planning at Bank of Montreal. "The idea of long term tax-free compounding for my investments also had great appeal."

There was one problem. Like all newcomers to Canada, Ms. Fung could not immediately take advantage of the tax and savings benefits of an RRSP. That's because RRSP contribution room is based on a percentage of income earned from the previous year. For immigrants just starting their lives – and careers – in Canada, this adds up to zero RRSP contribution room.

If they can't contribute right away to an RRSP, are there other investment strategies new Canadians can use to save for retirement while reducing or deferring their taxes?

Absolutely, says Simeen Gaidhar-Bhanji, a chartered accountant in Vancouver. As a starting point, she recommends that newcomers put their money into a tax-free savings account (TFSA).

Introduced in 2009 by the federal government, a TFSA lets Canadians save up to $5,000 a year without incurring taxes on interest earned or withdrawals. Unlike money put into an RRSP, TFSA contributions are not tax-deductible.

"You don't need to have earned income to be able to contribute to a TFSA," Ms. Gaidhar–Bhanji says. "So in their first year, even their first day in Canada, new immigrants can start contributing to a TFSA right away."

Ms. Fung agrees, noting that the tax deductions from an RRSP would not be particularly useful for new Canadians who are starting jobs on the low end of the wage scale. Families who have more than $5,000 to put away can open TFSAs for both spouses, which gives them $10,000 of tax-free savings. Those with adult children can also put money into a TFSA under each child's name, Ms. Fung says.

When they have built RRSP contribution room, they can withdraw the money from their TFSA and put it in an RRSP.

"The best thing is to have both an RRSP and a TFSA," she says. "If you're taking money out of an TFSA and putting it into an RRSP, keep in mind that you can later re-contribute the same amount into your TFSA."

In cases where one spouse finds work while the other remains unemployed for an extended period – a scenario not uncommon among new immigrants – putting money into a spousal RRSP is a good idea, Ms. Fung says.

"I see this commonly in the medical profession, where one spouse is a doctor and the other spouse is not working," she says. "A spousal RRSP, which uses the contribution room of the working spouse, helps to equalize their income in retirement and reduce their tax liabilities overall in retirement."

There are no statistics tracking the money immigrants bring when they move to Canada, but financial experts say many come with substantial assets, particularly those who were accepted into the country as immigrant investors or entrepreneurs.

This moneyed class of newcomers can boost their RRSP contribution room by buying a rental property, Ms. Fung says.

"Net income from a rental property is considered by Canada Revenue Agency to be earned income," she says. "If you can't get employment right away and have money to put towards a house or condominium, this is one way to create RRSP contribution room. And if you are working, then it's a good way to increase your contribution room."

Karin Mizgala, chief executive officer of Money Coaches Canada Inc., a Vancouver-based fee-for-service network of financial planning professionals, says money spent to renovate or maintain a rental property may also be tax-deductible. And while the owners will need to pay tax on capital gains when they sell the property, they will in the meantime enjoy deferral of these taxes.

Newcomers also build RRSP room when they're earning income from their own business, Ms. Mizgala says.

“Within a year, they will have that RRSP room available,” she says.

Until that RRSP room becomes available, newcomers with money to invest could also look into a buying a home, Ms. Mizgala says.

“Your principal residence is tax-exempt, so that could be a good place to put your money,” she says.
Ms. Fung at Bank of Montreal says new Canadians who want to start building an investment portfolio right away should make sure they allocate their non-registered assets in a way that minimizes their tax liability. For instance, a tax credit applies to eligible dividends from Canadian companies, while capital gains are subject to income tax.

Ms. Fung urges newcomers to start saving money in an RRSP as soon as they’ve built up contribution room. That’s what she did. About a year after she started working – she began her career in Canada as a lawyer – she opened her first registered savings plan.

“New Canadians should not ignore the RRSP,” she says. “They may not have a lot of contribution room to play with, but over time, it builds up.”