BMO NESBITT BURNS

RRSPs

Make your money work as hard as you do

Registered Retirement Savings Plans (RRSPs)

There is an old saying: “If it’s to be, it’s up to me”. Nowhere is this more true than when it comes to saving for your retirement.

Originally designed for Canadians without pension plans, an RRSP is a personal pension plan you fund yourself.

Because RRSP contributions are tax deductible and continue to grow on a tax-deferred basis once in the plan, an RRSP should be the very first place you begin your savings program.

RRSP Versus Non-RRSP Savings

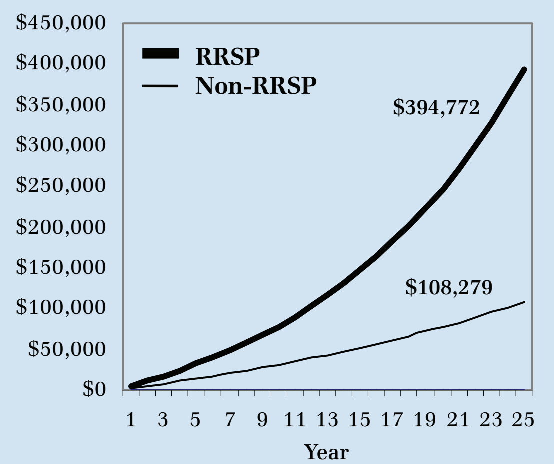
The following chart shows the benefit of using an RRSP to save for retirement.

In our example, two individuals with earned income each have $5,000 to invest each year. One investor chooses to put her $5,000 in an RRSP and the other chooses a non-RRSP investment. If we assume they are both in the 50% tax bracket, even though both investments earn 8% per year, after 25 years the RRSP investor has $286,493 more money. The reason the RRSP investment came out so much further ahead is because the income tax is deferred on both the capital invested and the interest earned.

Unfortunately for the individual who chooses to invest his $5,000 outside the RRSP, his $5,000 must be taxed before it can be invested. That leaves him with only $2,500 to invest. In addition, all of the income his investment earns is taxed each year. Instead of earning 8%, the non-RRSP investor is earning only 4% after tax.

After 25 years, the tax-sheltered RRSP investment has grown to $394,772 while the non-RRSP investment has grown to only $108,279.

RRSP Versus Non-RRSP Savings



Assumes a 50% tax bracket; $5,000 invested annually in an RRSP at 8% per annum; $2,500 after tax invested annually at 4% per annum after tax.

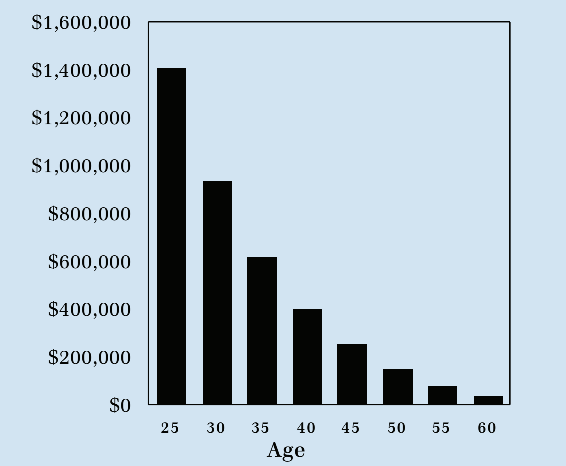
While it’s not a recommended strategy, even if you cashed out your RRSP at the end of Year 25 and paid 50% tax on the entire $394,772, you would still have $197,386. That's 82% more that what you would have saved outside your RRSP.

Start Your RRSP Early

Because of the incredible effect that compounding elements have on the growth of an investment portfolio, you should start saving as early as possible.

Consider what happens if you wait until age 50 to open an RRSP, rather than starting at 30. In the examples provided, the RRSP contributions are $5,000 per year.

Start Your RRSP Early



At 65, the 30-year-old has invested an additional $100,000 but has accumulated $683,889 more than the 50-year-old. The $683,889 difference is all of the income which accumulated and compounded on a tax deferred basis during the extra 20 years the money was invested in the RRSP.

The 2% Difference

Another critical success factor for investing is to get the best return on your investment while remaining within your risk comfort level. Very often you can increase your return by one or two percent with only a marginal increase in risk. Those extra percentage points make a significant difference to the value of your RRSP.

The next chart shows how a $5,000 annual contribution grows through compounding at different rates. Notice how, after 35 years, there is over 57% more money as a result of earning 8% rather than 6%. That's just a 2% improvement in the rate of return.

Spousal RRSP

Pension income splitting can reduce a couple's overall tax bill by taking advantage of a spouse's or common law partner's lower marginal tax rate where retirement incomes of spouses are disproportionate.

The 2% Difference

End of	6%	8%	10%
Year 5	$29,877	$31,680	$33,575
Year 10	69,858	78,225	87,655
Year 15	123,363	146,620	174,750
Year 20	194,964	247,115	315,010
Year 25	290,782	394,770	540,910
Year 30	419,008	611,730	904,715
Year 35	590,604	930,510	1,490,635

Changes to the federal tax rules allows a Canadian resident individual receiving eligible pension income to allocate up to 50% of this income to their spouse.

The use of Spousal RRSPs as an income splitting tool may still be recommended despite the opportunities created by pension income splitting, since Spousal RRSPs will allow for additional income splitting prior to age 65. In addition, a Spousal RRSP provides a further opportunity to increase the amount of income splitting beyond the 50% limitation provided by the new rules.

A spousal RRSP offers income splitting opportunities with your spouse or common-law partner. The most advantageous scenario for a spousal RRSP occurs when the planholder would otherwise have little retirement income, while the contributing spouse would have the majority of the couple's income. For example, if you will be paying tax at the top rate, a $5,000 payment from your RRSP might result in $2,500 of income tax. If your spouse has little retirement income, a $5,000 payment from a spousal RRSP might be received tax free. That's a $2,500 tax saving each year.

The BMO Nesbitt Burns Difference

With careful planning and professional investment advice, you can make your retirement dreams a reality. Let your BMO Nesbitt Burns Investment Advisor show you how to make your money work as hard as you do.

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