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### **RRSPs: It pays to do your homework**

A little bit of planning can go a long way

A recent Investors Group RRSP Intentions Poll advises that 76% of Canadians either already have an RRSP or plan to start one this year. Of those planning to invest, 83% intend to match or exceed their 2010 contributions, even though markets continue to be erratic. It seems these investors understand that there are ways to improve their long-term financial picture by maximizing their RRSPs.

It begins with the way in which RRSPs are invested, and basic principles apply. Generally speaking, bonds and other interest-bearing investments are best kept within an RRSP to remain tax sheltered while the most favorably taxed investments should be outside the RRSP, including those that produce capital gains and dividends.

Investors who choose to hold dividend-paying investments inside their RRSP should consider dividend reinvestment plans (DRIPs) where they reinvest dividends in additional shares instead of receiving cash payouts. This allows them to acquire shares cost-effectively and benefit from dollar-cost averaging with cash dividends reinvested on a regular schedule at prevailing prices. During market corrections this is especially beneficial because investors can acquire shares when prices dip, lowering the total average cost base.

RRSP structure plays an important role. Those in higher tax brackets than their spouses or common-law partners can take advantage of spousal RRSPs. A higher-earning partner can contribute to a spousal RRSP registered in the name of the lower-income spouse and achieve income-splitting. The contributor earns an immediate tax deduction, while the annuitant spouse reports the income for tax purposes when funds are withdrawn, ultimately reducing taxes. Care should be taken not to over-contribute, as contributions made to the spouse or common-law partner reduce the contributor's RRSP deduction limit.

When it's time to draw from spousal RRSPs, income splitting can be achieved once more. The contributor and spouse can make equal withdrawals to ensure taxation at the same rate and, if income levels are kept below Old Age Security thresholds, it may reduce or eliminate OAS clawbacks.

RRSPs have benefits beyond financial investments. The Home Buyers' Plan allows eligible individuals to withdraw up to \$25,000 tax-free from their RRSP to acquire a primary residence. It applies to persons, including former homeowners, who have not owned a home they occupied as a principal place of residence at any time during the four-year period before the date of withdrawal of funds. And there are criteria to help disabled persons acquire a more accessible home.

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*Continued from Page 1*

The home must be in Canada and must be purchased before October 1<sup>st</sup> of the year following the year of the RRSP withdrawal. The withdrawal must be repaid in equal annual installments over 15 years, beginning in the second year. Any payment shortfall must be reported as taxable income in the year it occurred.

RRSPs have advantages for students. Individuals or their spouses can make use of the Lifelong Learning Plan. A fulltime student, acquiring qualifying full-time post secondary education at a designated institute, can withdraw up to \$10,000 in a given year from their RRSP over a 4-year period as long as the total does not exceed \$20,000. They must repay it in equal installments

over 10 years; otherwise it becomes a taxable withdrawal.

There is more to RRSP planning than just putting the money in and waiting for a tax refund. It is wise to do your homework.

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