RICHARDSONGMP Ellis Wealth

Could you earn twice the return with an RRSP?

How an RRSP can turn a 7% into an 18% rate of return.

A sad fact is that many high-income Canadians have substantial sums of unused RRSP contribution room.

Many are in a use it or lose it situation. They need to use their RRSP contribution room while they are in their high-income years to get the biggest reward for contributions, but high levels of taxation and the high cost of living make it difficult to catch up.

Do you feel that you are in this situation? Could you be missing out on a large opportunity?

Facts of the situation:

Taxable Income	$240,000
Years Till Retirement	4
RRSP Balance (assumed for simplicity)	$0
RRSP Contribution Limit Carried Forward	$200,000
RRSP Annual Contribution Limit	$25,000

- A taxable income of $240,000 means that every $10,000 invested in your RRSP will result in a $5,000 tax refund.
- Over the next 4 years, your RRSP limit will grow from $200,000 to $300,000.

Is it possible to fully utilize your RRSP limit before retirement? Why is this so appealing?

Let's look at two scenarios and compare the outcome. Scenario 1 shows the effect of investing just your cash savings and Scenario 2 showcases the impact of also using leverage.

Scenario 1: Invest $20,000 a Year from Cash Savings

	2019	2020	2021	2022
Cash Savings	20,000	20,000	20,000	20,000
RRSP Contribution	20,000	20,000	20,000	20,000
RRSP Earnings (7%)	1,400	2,898	4,501	6,216
RRSP Balance	**21,400**	**44,298**	**68,799**	**95,015**

If you were to only invest your cash savings, at the end of the 4 years, you would have:

- An RRSP worth $95,015.
- Unused RRSP contribution room of $220,000, which has limited tax savings value when retired.

Is it still possible to use up that extra contribution room? Well, imagine that you saved the same amount, but you also decided to borrow money using a Line of Credit to fund a larger contribution. You plan to pay down the Line of Credit each year using your RRSP tax refund.

How will this scenario turn out?

Scenario 2: Invest $75,000 a Year from Cash Savings and a Line of Credit

	2019	2020	2021	2022
Cash Savings	20,000	20,000	20,000	20,000
Line of Credit Draw	55,000	55,000	55,000	55,000
RRSP Contribution	75,000	75,000	75,000	75,000
RRSP Earnings (7%)	5,250	10,868	16,878	23,310
RRSP Balance	**80,250**	**166,188**	**257,996**	**356,305**

Use Tax Refund to Pay Down Line of Credit Borrowing

Line of Credit Draw	55,000	55,000	55,000	55,000
Tax Refund	-37,500	-37,500	-37,500	-37,500
Interest on Line of Credit at 4%	700	1,428	2,185	2,973
Line of Credit Balance	**18,200**	**37,128**	**56,813**	**77,286**

If you make use of a Line of Credit, investing $75,000 in your RRSP for 4 years, you end up with:

- An RRSP worth $356,305.
- No unused RRSP contribution room.
- A Line of Credit balance of $77,286.

The real fruits of your labour are not yet realized however. What is the longer term impact of your hard work and smart planning that led you to invest in your RRSP with leverage?

RRSP Balance (2022)	356,305
Earnings (2023-2029)	80,255
Line of Credit Repayment (2023-2024)	-78,457
Income Tax* on RRSP Withdrawals (2023-2030)	-87,312
RRSP Withdrawals After-Tax (2023-2030)	**270,791**

*Income tax of 20% charged on income up to $77,000.

Because you smartly invested $20,000 a year for your final 4 high-income years (2019-2022) along with drawing on a Line of Credit to use up your contribution limit, your $80,000 investment resulted in $270,791 in after-tax withdrawals over the following 8 years (2023-2030).

In other words, you yielded an 18% after-tax rate of return on every dollar you contributed over those 4 years because of this strategy.

Lessons We Can Learn

Leverage. When you can earn more on your money than it costs to borrow, you can substantially increase your after-tax rate of return by borrowing money to invest.

Tax-deferral. Delay paying tax on your income till you're in your low-income years. By shifting income from high-income years to low-income years, you can greatly increase your after-tax rate of return. You can also earn income on the taxes you would otherwise have paid.

Financial Planning. Consulting a professional is important, because as outlined above, investing smartly involves more than just picking the right investment. In this instance, the end after-tax return was more than doubled by making use of the right tools. You get what you pay for in terms of advice.

The Result of this Strategy

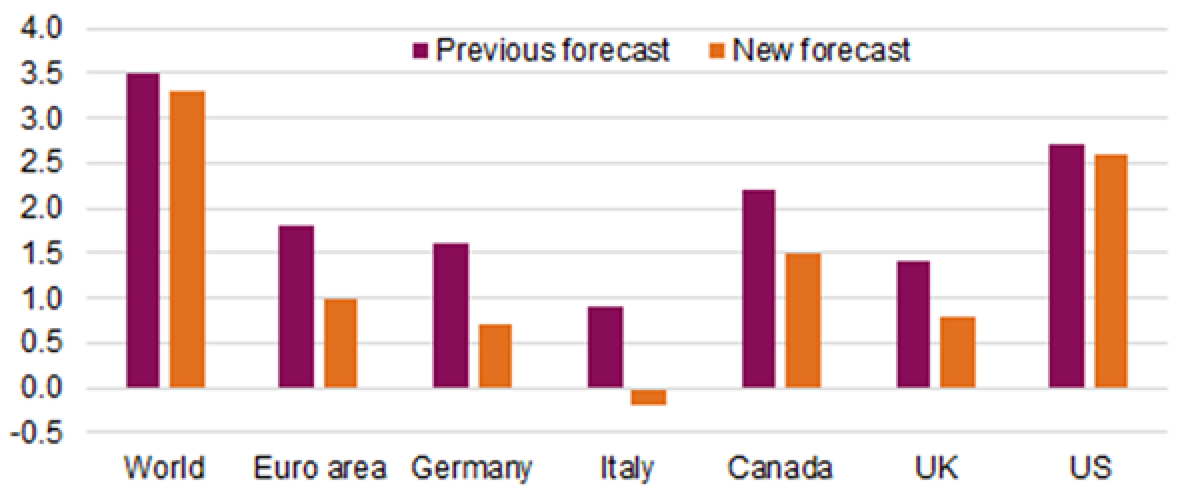
An 18% after-tax rate of return on every dollar invested.

We would be happy to discuss your unique financial situation. We do our best to make the conversation helpful and worth your while, whether or not we decide to work together. Our focus is to support our clients in planning for the next phase of life, both personal and financial.

Click here to contact us and schedule a conversation.

Adjusted expectations, but still growing.

OECD adjusts 2019 economic growth forecast.



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