Money Matters

New RRSP rules will affect your tax returns

By PAUL J. ROCKEL

Recent articles about the success of the 1991 "RRSP season" hinted that it was not as successful as some of the financial institutions that were interviewed had hoped for.

One reason is that we are in a recession, and many jobs have been lost, and for those still employed, overtime has been cut. Many people not affected by the economic downturn have been conversing cash due to all of the bad news overload.

But, economic downturns have a way of ending and this one will surely end, and none too soon for many.

This year is the first year of a major change in the rules for RRSP contributions. It is important, first, to understand them so that they can be used to each taxpayer's advantage and, second, to reflect on why the Federal Government has made these changes.

First, the RRSP contribution for 1991 is based on 18% of your 1990 earned income minus the 1990 PA (pension adjustment in Box 52 of your 1990 T4s, for members of pension plans). Earned income is the total of salaries, commissions, net business income, net rental income, certain royalties, alimony payments received, S.U.P. income, and research grants ... less business losses, rental losses, and alimony payments made.

People earning more than $40,000 will be able to contribute more to build a bigger nest egg. People earning less, who may actually see their contribution limit go down, should do everything possible to contribute up to their limit. It may be a long time into the future before they realize the wisdom of making that decision.

This means that most people except those on commission or with business or professional income know right now how much they can contribute to their RRSP for 1991. If you have not been able to save to make the maximum contribution in the past, it will be just as hard or harder in the future.

Second, our government is trying to tell us that they are not going to be able to fund a satisfactory retirement income in the future, so they are encouraging Canadians to increase their retirement savings. The fact that they are allowing contributions to increase by $1,000 per year until 1995 and by the rate of inflation thereafter means that the government knows that inflation is going to be with us for a long time. The government is also allowing taxpayers if they miss making the full RRSP contribution in any given year to carry forward the unused contribution, (with certain restrictions) for up to seven years.

One of the most dangerous aspects of this carry forward provision is simply that it will tempt people to defer RRSP contributions unnecessarily. Readers of this column will realize the pitfall

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of procrastination unless there is a very good reason. The overriding fact of saving for retirement is the critical importane of time and the "magic of compounding rate of return" in building retirement savings.

These new rules will allow most Canadian taxpayers to plan RRSP contributions right now.

The cornerstone of financial planning is to "save a part of what you earn" or to "pay yourself first" and many financial writers agree that 10% of your gross earnings is the minimum target wise people should save to achieve financial independence. Previously we have discussed the fact that the assets most Canadians have at retirement are their house, car, insurance policy and pension plan ... and these are things that have been acquired by systematic deductions from the paycheck.

Why not plan to maximize retirement savings and the financial independence that goes with it the same way?

The easiest way to do this is to arrange a pre-authorized cheque into your RRSP each month. And the way that we think is best is to do this in a mutual fund. Over the long term, equity mutual funds have provided a better return than most other investments. The main reason for choosing a mutual fund is that it offers professional management of your money. You can choose from many types of funds, from conservative money market or T-Bill funds, to bond funds, real estate funds, balanced funds or equity funds.

A comparison of a 10% investment with an actual mutual fund using regular monthly savings versus a Dec. 31 contribution each year for the last 23 years shows two things. First, the mutual fund had achieved a return that was 170% of the value of the 10% investment and, second, the monthly saving option in either investment resulted in a 4% to 5% greater value after 23 years than annual contributions. What wasn't shown was that it probably was a whole lot easier to save monthly than to wait until the last minute and hopefully have all the money at hand.

Why not calculate your maximum allowable contribution for 1991, divide it by 12 and start your RRSP saving the easy way?

For a free booklet on RRSPs by installment and charts comparing an actual mutual fund with a 10% investment, by monthly and annual contributions, over the last 23 years, contact Peter C. Masson M.B.A., Regal Capital Planners Ltd., 10 Fagan Drive, Georgetown, Ontario or phone 877-7216.

Paul J. Rockel is the author of the best seller "Why I Invest in Mutual Funds" and President of Regal Capital Planners Ltd.

Cashing RRSP costly source of extra money

MONEYCARE

By Rick Bates, CA

Many people are losing their jobs during this recession. If it happens to you and you are tempted to dip into your registered retirement savings plans, the best advice is not to do it. Sometimes there are alternate sources of money.

The cost of withdrawing RRSP funds is very high. Suppose you are 40 and withdraw $5,000 to tide you over until you have a job.

If you left that money in the RRSP, and it earned 12 per cent a year, it would grow to $85,000 by the time you are 65. Even if you then withdrew it as a lump sum and paid tax in the highest tax, you would still have more than $40,000.

That is what you would forgo. In addition, the $5,000 withdrawn is subject to tax of about $1,400, assuming you will be in a lower tax bracket next year.

The big advantage of an RRSP is less that it saves you tax, but that it defers tax on the money contributed and on the income earned in the fund.

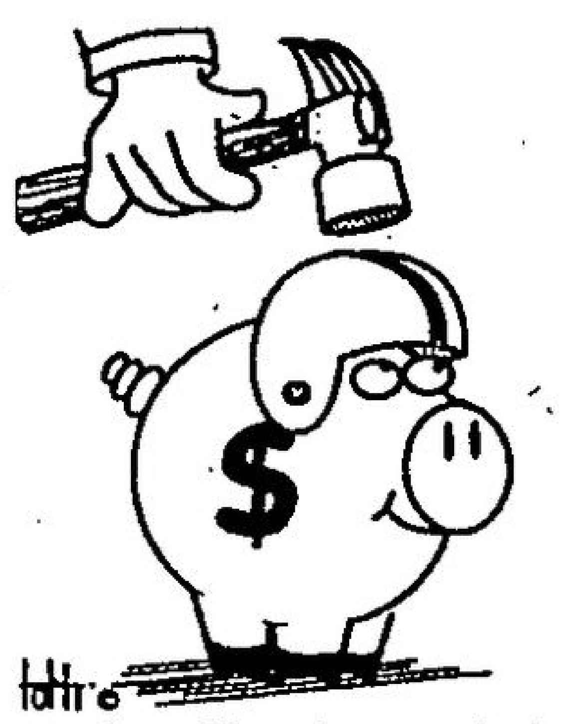
Rather than dipping into an RRSP, consider:

• If you do not intend to return to work, you can choose to annuitize all or part of your RRSPs and begin receiving income from a life annuity. Providing you are 60 or more when you do this, you are entitled to a 17 per cent tax credit on the first $1,000 a year of annuity income.

• If you are in danger of defaulting on your mortgage, but you have RRSPs worth at least as much as the mortgage, you can employ your RRSP funds without withdrawing money.

This is done by having your self-administered RRSP hold the mortgage. You would be able to do this only if your mortgage is coming due and you could pay it off without penalty. The mortgage, to be held in your RRSP, must be insured. There are also the usual fees involved in setting up any mortgage.

In addition, a mortgage held by your RRSP must be at a normal market rate, so there is no advan-



tage there. The advantage is that you would be able to extend the amortization period to 25 years, and thus reduce monthly payments.

Before choosing either of these alternative strategies, it would be wise to talk with a financial adviser.

For CA's advice on TV – see Your Wealth, available on broadcast channels in Ontario and on satellite across Canada, or Money in the Bank, on your community cable channel.

Moneycare is general financial advice by Canada's chartered accountants. Rick Bates is a professor at the University of Guelph.

Correction

A picture featured on Page 2 in last weekend's Herald Outlook featuring the release of a red-tailed hawk incorrectly named Park School as sponsors of the release. It was actually Harrison Public School that worked hard to raise money to help save the hawk's life. The Herald regrets the error.