Enhance your RRSP potential creatively

Every year, a surprising number of Canadians fail to take maximum advantage of their RRSPs — simply because they can't find the cash to contribute. The result is they lose a valuable tax deduction and, more importantly, an opportunity to build tax-deferred savings for the future.

But this needn't happen. In fact, there are several ways to ensure that you make your maximum allowable RRSP contribution every year.

GOOD REASONS TO BORROW

In these days of high interest rates, it's hard to believe that borrowing can make good financial sense. But it can — and usually does — if you borrow to finance your RRSP contribution.

To illustrate, let's say that the February 29 contribution is just a few weeks away, and that you're entitled to contribute the full $11,500 to your RRSP. But after paying all your Christmas bills, you find that you've only got about $7,000 in cash. Should you borrow the extra $4,500?

Assuming that your bank will give you an RRSP loan at 9%, repayable over 12 months, your total borrowing cost will be about $214. (This is a reasonable assumption, since many financial institutions offer special RRSP loans at or near the prime rate.)

Now consider that if your combined federal-provincial tax rate is 45%, your extra $4,500 contribution will reduce your taxes by $2,025. Add to this the earnings generated by your contribution — assuming a 10% rate of return, that would be $450 — and you'll end up with a total benefit of $2,475 after one year. Subtract the cost of borrowing, and your net gain from borrowing is $2,237.

In fact, if you received a tax rebate from your contribution and used the proceeds to pay down your loan, you'd come out even further ahead, since your borrowing costs would be reduced.

Continuous contributions

Borrowing your RRSP contribution makes sense if you're caught short of cash at the last minute. But there is a better alternative — one that takes the pain out of having to come up with a large lump-sum contribution, and puts more of your money to work sooner.

The idea is very simple. Rather than make one annual contribution to your RRSP, why not contribute smaller amounts throughout the year?

Most financial institutions can arrange to have regular contribution, deducted automatically from your account, so you don't have to think about setting aside the cash. And when everyone else is rushing around at the last minute, you'll have already made your RRSP contribution.

But convenience is only one reason for setting up a continuous contribution (or purchase) plan. A more important benefit is that you'll get a head start on accumulating more savings in your RRSP.

For example, if you contribute $3,000 at the end of each year to an RRSP earning 10%, you'll end up with about $295,000 after 25 years. But if you spread out that contribution over 12 months (at $250 a month), you'll accumulate $331,700 — a difference of nearly $37,000!

NON-CASH ASSETS

Finally, if you have a self-directed RRSP, you can contribute non-cash assets, and receive a tax deduction of their value at the time of transfer. These can include any RRSP eligible securities, such as Canada Savings Bonds, Canadian stocks or debt instruments, so long as their value does not exceed your RRSP contribute limit. Keep in mind, too, that securities transferred to an RRSP are considered to have been sold at their current market value - which may trigger taxable capital gains.

MOST IMPORTANT STRATEGY . . .

These are just a few of the strategies that you can use to reduce your taxes while you generate more savings for your retirement. How you choose to contribute to your RRSP is up to you. The most important thing is to do it now.

This is one of a series of articles on RRSP investment strategies prepared by the **Bank of Montreal.**

Secure your future with an RRSP

One of the best ways to secure your future is to have a registered retirement savings plan, according to CIBC.

"People who have been contributing to an RRSP over the years have a head start on securing their future," said R.G. Albu, manager, Milton branch "And for those people who have never contributed this might be the year to start."

"RRSPs are one of the few remaining tax breaks available to some people. You pay less income tax each year you contribute to an RRSP. Also interest earned in the plan is tax-sheltered, hence you'll pay less taxes, " said Mr. Albu.

"For example, if a person contributed $2,000 a year to an RRSP for 25 years at an investment rate of 10.25 per cent compounded annually, the actual investment would be $50,000. But the retirment nest-egg would amount to over $225,177."

Mr. Albu suggests people should be aware of changes in contribution limits for the 1991 tax year.

The RRSP contribution limit for 1991 is 18% of the prior year's earned income up to maximum of $11,500, less the individual's 1990 pension adjustment. In November, the federal government mailed out new contribution limit statements to people based on their previous year's income.

SOME LIMITATIONS

Individuals with company pension plans may be more limited in their RRSP contributions as a result of the new changes.

"Starting in 1991, people are allowed a lifetime cumulative excess contribution of $8,000 in their RRSP without penalty," explained Mr. Albu. "The new laws also make it possible to save any unused contribution from the 1991 tax year and beyond for up to seven years.

"For example, if you're permitted to contribute $11,500 for 1991, and can only contribute $8,000, you can put the remaining $3,500 in your RRSP in a following year without affecting that year's maximum allowable contribution limit.

"People of retirement age face significant contribution changes. They are no longer able to directly transfer payments from either a Canada Pension Plan or a company pension plan into an RRSP without paying any income tax. Also, these amounts do not constitute earned income," Mr. Albu said. "But they can continue to contribute until December 31 in the year that they turn 71."

"In addition, people can contribute to a spousal RRSP," said Mr. Albu. "A spousal RRSP applies to all married income earners. They can use all or part of their maximum allowable RRSP contribution for a spousal RRSP and deduct it on their own tax return.

"CIBC offers many different kinds of RRSPs to choose from," says Mr. Albu. "Many people prefer to put their RRSP money into a term deposit or a guaranteed investment certificate. Most financial institutions, including CIBC, also offer a range of RRSP-eligible mutual funds."

Anyone who wants to contribute to an RRSP should not wait until the Feb. 29 deadline, Mr. Albu advises.

"Investment accumulating in accounts outside an RRSP is completely taxable," Mr. Albu said. "The sooner people deposit funds into an RRSP, the sooner they start sheltering interest from taxes."

"In fact, people planning to contribute to an RRSP for the 1992 tax year should consider making a deposit right now to gain the benefit of having the interest sheltered for an additional 12 months." Investing money early produces bigger savings as interest will compound sooner.