THE VALUE OF FINANCIAL ADVICE SERIES: → doesn't like RRSPs but…

35 year-old Ted, has decided he wants to retire as early as possible, no later than age 55. He has a good job as an Electrician, a trade in high demand with plenty of opportunities to work overtime. The overtime pay he earns occasionally results in some pretty stiff tax deductions on his pay-cheque, Ted hates paying tax.

Ted also doesn't like the idea of Registered Retirement Savings Plans (RRSP). He considers them inefficient because:

- He feels he will lose access to his cash once it is invested.
- Withdrawals are taxed as ordinary income, even though they can be made up of dividends and capital gains.
- Withdrawals could affect his income-tested government benefits.

Ted prefers, instead, to invest his surplus cash in a non-registered account. He meets with Betty (professional financial advisor) to validate his strategy.

Betty explains that Ted may be overlooking some opportunities by excluding the RRSP from his investment portfolio. She explains that Ted's first point is untrue, he retains full access to his invested cash, although he will be taxed on any withdrawals as the original investment is made with untaxed money. She also touches on a couple of programmes that allow for withdrawals without taxation (home buyer's plan and life long learning plan).

Betty points out an RRSP advantage that Ted has not fully considered…the impact that tax sheltered growth has on the size of the account. She works through the following example to demonstrate the potential of this concept.

<u>EXISTING RETIREMENT FUNDING PLAN</u>

Ted's current age:	35 years
Retirement age:	55 years
Difference:	20 years
Non-registered account current value:	$240,000
Annual contribution:	$11,500
After tax rate of return:	5.056% (Ted will pay tax on the growth of his investments in the non-reg. account)
Future value of non-registered account:	**$1,026,135.21**
Ignoring tax on growth during income phase, this would provide income stream from age 55 to 90 of:	**$51,305/year**

Now, let's look at what would happen if Ted used an RRSP in place of the non-registered plan above:

<u>REVISED RETIREMENT FUNDING PLAN (RRSP)</u>

Ted's current age:	35 years
Retirement age:	55 years
Difference:	20 years
RRSP current value:	$240,000
Annual contribution:	$11,500
Tax return re-invested:	$5,500 (average based on tax return generated by previous year contribution)
Untaxed rate of return:	6.4% (FPSC L/T growth rate for Canadian equities)
Future value of RRSP:	**$1,482,856.73 (taxable on withdrawal)**
This pool of assets would provide an after-tax income stream from age 55 to 90 of:	**$53,232/year ($74,140.38/year gross)**

CONCLUSIONS:

- Under the RRSP plan, Ted receives a higher rate of return since the growth is not subject to tax until withdrawal.
- Additional growth is made possible by re-investing the tax return arising from annual RRSP contributions. **NOTE:** This analysis focuses only on tax sheltered growth and ignores the real value that occurs from paying less tax at the time of contribution.
- RRSP assets are protected from creditors including claims arising from lawsuits or bankruptcy.

- By using an RRSP to grow his assets in place of the non-registered plan, Ted will be able to enjoy an enhanced retirement income stream. During the 35-year retirement time frame, this adds up to a total of **$67,445 more!**