

ALL THOSE RRSP ABSTAINERS JUST MAY HAVE BEEN RIGHT!

Garth Turner column - January 8, 2001

According to the latest Royal Bank survey, only about half of Canadians eligible to make an RRSP contribution this year will actually pony up some cash - about \$4,000, on average. To date, those people who have a registered retirement plan (again, about half of us) have accumulated an average of less than \$50,000 in it. If this is the only source of retirement income most people have to look forward to, they're cooked.

But this is not another column telling you to mend your broken ways and start loading up on RRSPs. In fact, this is aimed at those folks who have for years been socking money away for their retirements, and now have substantial amounts built up inside their RRSPs. For them I have this message: STOP!

From an investment point of view, one of the most significant things that has happened in years took place on October 18, 2000, when Finance Minister Paul Martin axed the capital gains tax rate. Now any money you make on investments like stocks or mutual funds (but not interest) receives the most favorable tax treatment. In fact, half the gain is completely tax-free, while the other half is taxed at your own personal rate.

So, since the highest tax rate in Canada is just around 50% (in B.C.), that means the maximum capital gains tax rate you would face would be half of 50%, or just 25%. Now, let's go back to those RRSPs, for a comparison.

If you are a good beaver who has amassed most of your net worth inside your RRSP, come retirement time, with an income of \$60,000 per year, you will be taxed at the rate of 50% on money coming out of your RRSP or RRIF. However, if you had your wealth outside an RRSP, and took income in the form of capital gains on your investments, the tax rate would be half of that, just 25%.

So, on the surface, it now makes real sense to have a two-pronged approach to retirement planning: (1) Make RRSP contributions regularly to reduce your taxable income, and also to build capital more quickly in this tax-free environment. Also, if you have any assets that bear interest, then make sure they live inside your RRSP. (2) At the same time, don't throw everything into the registered plan. Now you should also be building a non-registered portfolio of quality mutual funds and stocks that will yield long-term capital gains.

In fact, for some people, it now makes supreme sense to be transferring money out of their RRSPs and into non-registered plans - especially because you can do this without paying any income tax.

How could that be? Aren't all RRSP withdrawals (except for buying a home or going to school) completely taxable?

Well, here's a plan for partially collapsing an RRSP and incurring no tax. Go and borrow some money and invest it in assets with the potential for a capital gain. Let's say you got an investment loan of \$100,000, with an interest rate of 8%, which would mean \$8,000 a year in interest-only payments.

Now take \$8,000 a year out of your RRSP. That \$8,000 coming from your plan must be added to your taxable income in the same year. But the \$8,000 in interest on your investment loan is completely deductible from your taxable income - so the two cancel each other out, and you pay absolutely no tax.

To recap: You will have reduced your RRSP by \$8,000 and paid no tax on that withdrawal. But at the same time you have \$100,000 invested in assets outside your RRSP which will yield capital gains, eventually taxable at half the rate of your registered ones. Hey, this is not for everyone, because you are also taking on long-term debt that you have to feel comfortable with, and your stocks and mutual funds may vary wildly in value from month-to-month. If you can't sleep at night thinking about that, don't do this.

But if you can't sleep either, thinking about giving over half your RRSPs to the feds, well, why not?

Watch Garth Turner's Investment Television, Sundays on Global. Garth's latest book and CD is the "2001 Retirement Guide."