

## Yes, it is possible to have too much in your RRSP

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My wife Carolyn told me this week that I had shocked her in more than just a couple of ways. I don't know what all the hubub was about. What happened, you ask? A few things. First, I got up at 5:30 a.m. every day this week and worked out for an hour. Next, I changed more diapers in a five-day stretch than she did this week (I admit, this was quite amazing). I also gave her a foot massage -- on two occasions. Practically miracles - - all three feats.

What really pushed her over the edge into the realm of amazement, however, was my comment that I think she and I should scale back our RRSP contributions. That's right, at the pace we're going, we'll end up with far too much in our registered retirement savings plans in retirement.

I can hear the murmurs of the crowd already: "Too much in an RRSP -- is that possible?" I believe it is.

Hold it. I'm not abandoning my belief in RRSPs. I believe that having enough in your RRSP is a good thing. Having more than you need to comfortably support yourself in retirement, however, doesn't make sense. And why not?

Simple. Every dollar that comes out of your RRSP is fully taxable. With the capital gains inclusion rate now at 50 per cent, you can create a pretty tax-efficient portfolio outside your RRSP as well.

I have met a growing number of Canadians who have too much inside their RRSPs. Some are taking advantage of a strategy called the "**RRSP meltdown**." While the idea can be controversial, I believe there is a place for it in some situations. Let's look at the strategy. RRSP excess Jack is a gentleman who is 55 and plans to retire at 65, just 10 years from now. He expects to live to about age 90 and wants to plan for an income in retirement until that age -- a 25-year retirement period.

Jack wants a retirement income of \$50,000 annually (in today's dollars) beginning at age 65. By the way, that \$50,000 annually will equal \$67,195 in the year Jack reaches age 65, assuming a 3-per-cent inflation rate.

The bottom line is that Jack will need \$950,000 in his RRSP at age 65 to provide him with the income he needs in retirement (assuming an 8-per-cent annual return and 3-per-cent inflation annually).

Here's the issue: Jack already has \$600,000 in his RRSP today. Do the math. That \$600,000 will turn into about \$1,295,000 by the time Jack reaches age 65 -- even if he doesn't make another RRSP contribution (assuming an 8-per-cent annual return).

Do you follow? Jack will have about \$1.3-million in his RRSP at age 65, but only needs about \$950,000. He'll have nearly \$350,000 too much in his RRSP at age 65 even without further contributions. RRSP meltdown - What if there were a way for Jack to remove some of the excess assets in his RRSP without any negative tax implications? Would it make sense? Arguably, it would -- particularly when he could then invest those assets outside of his RRSP in a manner that would result in more in his hands after taxes later.

Jack has done that very thing. Here's how: Jack borrowed \$150,000 at 8-per-cent interest and invested the money in high-quality, conservative equity mutual funds. Jack makes interest-only payments on the loan, and the \$12,000 of interest cost annually is deductible on his tax return. Jack then withdraws \$12,000 from his RRSP annually. The interest deduction offsets the taxable RRSP withdrawal so that he is effectively not taxed on the RRSP withdrawal.

What has Jack really accomplished here? He has managed to convert some of his registered money (in his RRSP) into non-registered money on a tax-free basis. The funds invested outside of his RRSP are invested for long-term growth. Capital gains are ideal, because any gains realized after Oct. 17, 2000, will be just 50 per cent taxable as a result of the recent mini-budget presented by Finance Minister Paul Martin.

Okay, there have got to be some drawbacks here to the RRSP meltdown, right? Right. Consider these: Borrowing to invest has to make sense for you -- but it's not for everyone. This is the most important issue when deciding whether or not to use the strategy.

The capital gains inclusion rate could be increased in the future, making non-registered investments less tax-efficient. You can't turn around and re-contribute the money you've withdrawn from the RRSP; the contribution room is lost forever (but you may not care). Because leveraged investing is such a significant part of the RRSP meltdown, I'll devote my next column to this issue.

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