Dispelling the Myths - #2: Everyone Should Have An RRSP (And Why The RDSP Is Different!)

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It's nearing the end of RRSP season, financial institutions are running ads and the media is showing its usual enthusiastic interest in RRSPs. It's only normal, right? Everyone should be opening and contributing to their RRSP? At the risk of being struck down, I suggest that this is, in fact, not true for everyone.

Since I was a poor, young student, I recall being bombarded with pro-RRSP messages:

- Some frightening: "If you don't save, you'll have nothing to retire on. You can't count on Old Age Security or Canada Pension Plan – when the bubble of the baby boomers hit's they will crash. You're on your own. If you are poor when you are old you'll only have yourself to blame."
- Some enticing: "With the power of compounded interest, if you save just a little bit every month, when it comes time to retire you will be rich."
- Some engaging: "Your future is a shared responsibility. Your government bears some responsibility but not all the responsibility for you. You have a role to play too."

I am not arguing that any of these messages is necessarily wrong but for some people, if you do the math, it is not in their interest to save in an RRSP.

Who are the people who should NOT be contributing to RRSPs?

By and large, people who will have low incomes all of their lives: people like the 2 million Canadians whose income is below $19,000 per year.

Let's take an example (all in today's dollars).

Bill is 25, lives in British Columbia and has a full-time job (35 hours per week) earning the minimum wage of $8.00 per hour and qualifies for the disability amount (Disability Tax Credit). Because Bill's income is low ($14,560), there is no tax benefit. The RRSP tax deduction is worth nothing because Bill doesn't pay any taxes. In BC, his basic tax credit is $11,000 and the disability amount is $7,058.

Bill works for the next 40 years, contributing $50 per month ($600/year) to an RRSP. He also contributes about $60 per month ($720) to Canada Pension Plan (CPP).

Bill retires at 65 years of age. At that point his RRSP will be valued at about $77,000 (with an annual return of 5%). A 20 year annuity (at 5% return) will provide him with about $488/month ($5,862 per year).

Because Bill's income will be low, he will qualify for the Guaranteed Income Supplement of $506/month (on top of his Old Age Security). His $488/month of RRSP income, however, will reduce his Guaranteed Income Supplement by $244/month (50% of this RRSP income).

In short, his contributions will gain him no tax advantage but will reduce his Guaranteed Income Supplement by 50%.

What should Bill do?

Bill has four choices:

- Make no contributions
- Contribute to an RRSP
- Contribute to a Tax Free Savings Account (TFSA)
- Contribute to an RDSP

To assist, we've compared Bill's resulting income at 65 years, depending on his choice, in the table below.

	No Contributions	**$600/year to an RRSP**	**$600/year to a TFSA**	**$600/year to a RDSP**
Old Age Security	$524	$524	$524	$524
Canada Pension Plan	$312	$312	$312	$312
RRSP Income	-	$489	-	-
TFSA Income	-	-	$489	-
RDSP Income	-	-	-	$1,936
Guaranteed Income Supplement	$506	$261	$506	$506
Total monthly income at 65 years	**$1,342**	**$1,586**	**$1,830**	**$3,278**

(Note: We've calculated income/growth on investments at 5%. For income from all three registered plans we've done an annuity calculation for 20 years with an estimated income of 5%. We've made no considerations for inflation.)

As you can see, Bill will have a higher income at 65 if he contributes to an RRSP than if he doesn't. But remember, he is losing 50% of his savings as a result of having his Guaranteed Income Supplement reduced by 50% of his taxable income.

Contributing to a Tax Free Savings Account (TFSA) is a better option, as money coming out of the TFSA is not taxable and therefore does not reduce Guaranteed Income Supplement payments.

People who are in receipt of provincial disability benefits, however, cannot save in RRSPs or TFSAs because they are not exempt assets and once a person's asset limit is exceeded their benefits will be cut off. People on disability benefits in Alberta and Northwest Territories may be able to use RRSPs and TFSAs because of the higher asset limits for benefits in these provinces.

The best option by far is to contribute to a Registered Disability Savings Plan. The RDSP comes out on top in this calculation for two reasons: the very generous federal government contributions (Canada Disability Savings Grant and Bond) and the fact that income from an RDSP is only partially taxable, taxable in the hands of the beneficiary and does not affect Guaranteed Income Supplement payments.

RDSP resource centre

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