In defence of RRSPs: Dispelling common myths

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For over 60 years, the Registered Retirement Savings Plan (RRSP) has been available to build savings for retirement.[1] In recent years, these plans seem to be falling out of favour, with fewer Canadians contributing to RRSPs and a significant number of pre-retirees withdrawing funds from these plans. This report looks at this surprising trend and debunks some of the myths that may be keeping Canadians from saving in an RRSP.

The role of RRSPs in retirement funding

When it comes to retirement planning, how much Canadians need to save is a touchy subject. While some Canadians may spend less in retirement due to a reduction in work-related and other expenses, like paying down their mortgage, others find that retirement expenses stay the same or may even increase, perhaps due to increased costs for entertainment, hobbies, or health expenses.

1 The RRSP was introduced in 1957. Funds from an RRSP can also be used for a first-time home purchase under the federal Home Buyers' Plan (available since 1992) and for education under the Lifelong Learning Plan (available since 1999).

Government plans may be a primary source of retirement funds for many Canadians. In 2024, the maximum annual Canada Pension Plan (CPP) retirement benefit starting at age 65 is $16,375; however, payment depends on contributions to the plan and the average The average annual amount paid for a new retirement pension (at age 65) in July 2024 was $9,780, far less than the full amount. maximum annual Old Age Security (OAS) pension starting at age 65 is $8,618 ($9,480 for recipients ages 75 and over) and, for low-income individuals, the Guaranteed Income Supplement (GIS) may add a non-taxable benefit of up to $12,872 annually.[2] When combined, the maximum total standard amount of these benefits is slightly more than $37,800 per individual or $75,600 per couple, before tax. As noted, however, many retirees receive significantly less than the maximum.

Private pension plans may be another source of funds for your retirement; however, less than 4 in 10 Canadian employees are members in these plans.[3] Consequently, private pensions may add little or no value for many employees, and self-employed individuals generally have no private pensions at all.

Another possible source of retirement funds may be from gifts or windfalls; however, these are generally not reliable sources of funding.

Given these realities, you may find that you need to draw on personal savings to supplement your pension income in retirement. RRSPs, along with their newer cousin, the Tax Free Savings Account (TFSA), were specifically designed to help you with your retirement savings goal.

Saving with RRSPs

You can claim a deduction on your income tax return for RRSP contributions up to 18% of your “earned income” for the prior year to a maximum of $31,560 for 2024 ($32,490 for 2025), minus any pension adjustment, plus any unused contribution room from prior years. Contributions in excess of this amount could be subject to penalties and interest.

You generally will pay tax on funds you withdraw from an RRSP[4] at federal / provincial combined marginal tax rates that range from about 20% to 54%, depending on your level of income and province or territory of residence.

Trends in RRSP savings

The C.D. Howe Institute said that Canadians “appear to have diverted a significant portion of new savings away from RRSPs and into TFSAs since their introduction in 2009” and “about four out of 10 dollars of TFSA contributions since 2009 (net of withdrawals) might have been at the expense of unmade RRSP contributions.[5] In a September 2023 memo, they also said that "annual median contributions into TFSAs already outstrip RRSPs"[6], with over $6.6 billion in TFSA contributions versus $5.1 billion in RRSP contributions in 2021.[7]

Worse yet, Canadians may be jeopardizing their retirement savings by withdrawing funds from both RRSPs and TFSAs during prime earning periods. The C.D. Howe Institute report further said, “Among those 45 to 59 years old, there are no material differences between TFSA and RRSP withdrawal rates – withdrawals account for about 30 percent of contributions for both,”[8] meaning that for every $3 contributed to RRSPs and TFSAs, Canadians withdrew about $1 from these plans.

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2 As of November 2024.

3 In 2021, 38.0% of employees were members of a registered pension plan (RPP) and defined benefit plans accounted for two-thirds of employees with an RPP. Source: Pension plans in Canada, as of January 1, 2022, Statistics Canada..

4 You will not pay tax on funds withdrawn under the Home Buyers’ Plan or Lifelong Learning Plan if you meet repayment requirements.

5 TFSAs: Time for a Tune-Up, C.D. Howe Institute, Alexandre Laurin, December 19, 2019.

6 RRSP or TFSA? Canadians Need Help to Make the Call, Colin Busby, C.D. Howe Institute, September 2023.

7 Statistics Canada. Table 98-10-0085-01 Household contributions to registered savings accounts: Canada, provinces and territories, census metropolitan areas and census agglomerations with parts.

8 Op. cit.

Debunking the myths: Why saving in an RRSP still makes sense

Canadians cite various reasons why they do not save in RRSPs. Let's look at some of the myths and show why RRSPs are, for many individuals, the best way to save for retirement.

Myth 1: There's no point investing in an RRSP since you pay all the savings back in taxes when you retire anyway

While this is a fairly popular myth, it is completely inaccurate.

Although you do pay tax on RRSP withdrawals, don't forget that you also got a tax deduction upon contribution. If your tax rate is the same in the year of contribution that it is in the year of withdrawal, an RRSP provides a completely tax-free rate of return.[9]

If your tax rate is lower in the year of withdrawal, you'll get an even better after-tax rate of return on your RRSP investment. In fact, even if your tax rate is higher in the year of withdrawal, we've demonstrated that in most cases, you are still better off with an RRSP than non-registered investments due to effectively tax-free compounding.[10]

Figure 1 provides an example showing the after-tax amount from an RRSP, TFSA or non-registered investments after one year, assuming that you would start with $3,000 of income, perhaps from (self-)employment or rental income, have a 33.33% tax rate, and your investments grow at 5% over the course of the year.

If you invest in an RRSP, you would not pay tax on your income, so you would have the full $3,000 to invest. With a TFSA or non-registered account, you would pay tax of $1,000 ($3,000 times 33.33%), leaving $2,000 to invest.

Growth of 5% would increase the value of your investments by $150 ($3,000 times 5%) in your RRSP, or $100 ($2,000 times 5%) in your TFSA or non-registered account.

Figure 1 — RRSP vs. TFSA vs. Non-Registered Investments, Constant tax rate

Description	RRSP	TFSA	Non-registered investments
Pre-tax income	$3,000	$3,000	$3,000
Tax (33.33%)	n/a [11]	(1,000)	(1,000)
Total amount invested, January 1	$3,000	$2,000	$2,000
Growth (5%)	150	100	100
Total pre-tax, December 31	$3,150	$2,100	$2,100
Tax (33.33% / 16.67%[12])	(1,050)	n/a [13]	(17)
Net after-tax proceeds	**$2,100**	**$2,100**	**$2,083**

9 The equivalent of a tax-free rate of return is earned in an RRSP when tax rates are the same constant at the time of contribution and withdrawal.

10 For further details, see our report, Just Do It: The Case for Tax-free Investing.

11 No tax is owing on this income since the RRSP deduction offsets it completely.

12 Assuming that the individual had under $250,000 of capital gains that year such that only 50% of capital gains are included in taxable income. Gains over $250,000 would be subject to the new 66.7% inclusion rate, and thus the taxes would be higher. For additional information, see the CIBC report Capital gains tax planning.

13 No taxes are payable on TFSA withdrawals.

When you withdraw funds from your RRSP, you would pay tax of $1,050 (33.33% on the full $3,150 withdrawn from the RRSP), leaving you with $2,100. When you withdraw funds from your TFSA, you would pay no tax, so you would have $2,100. When you withdraw funds from your non-registered investments, you would pay tax of $17, yielding $2,083.

The non-registered investments leave you with the least amount, since you would pay tax on your $100 of investment income. Notice that investing in your RRSP or TFSA both leave you with the exact same amount of $2,100, meaning your RRSP provides the equivalent of a tax-free rate of return.

Myth 2: It's better to invest in a TFSA than in an RRSP

An RRSP is generally a better choice than a TFSA if you expect to have a lower tax rate in retirement. This is particularly likely if you are a baby boomer in your peak earning years and expect lower income when you are no longer working.

It is true that a TFSA may be a better choice than an RRSP in some cases, such as if you expect a higher tax rate upon withdrawal or will face recovery tax of OAS or GIS benefits (see our report Blinded by the "refund"). Even so, you may not be able to save enough in a TFSA alone and may also need to save in an RRSP.[14]

Myth 3: It's better to pay off debt

Paying off high-interest debt may certainly make sense; however, the decision to pay down debt, at the expense of retirement savings, is often an emotional one that isn't driven by the numbers. When interest rates are low, neglecting your long-term savings in favour of debt repayment may result in sacrificing the quality of your retirement.[15]

Myth 4: I don't have enough money to save in an RRSP

You don't have to make a huge investment in an RRSP. Making modest contributions on a regular basis can really add up. Suppose you were to invest just $100 each month in an RRSP from ages 30 to 65 and could obtain a rate of return of 5% on your investments. In 35 years, you would build up over $114,000 in your RRSP to use for your retirement. Your savings could provide over $9,100 of pre-tax income annually for 20 years to top up your retirement income.

It's easy to set up an automatic savings plan to make regular contributions. Your employer may offer this option, and may even make matching contributions on your behalf, with the added benefit that there will be no tax withheld on the earnings that are contributed.

Myth 5: I don't need an RRSP because I'll have other sources of funds for retirement

You may have assets such as non-registered savings, equity in your home or rental properties that could be a source of retirement funds; however, you may not have considered exactly how you might use these assets in retirement or whether they would provide enough to fund your expenses.

It's important to have a formal and detailed plan that describes the lifestyle you want and how much it will cost, along with any income or other funds that may be used to support you in retirement. Your financial advisor can help you determine what expenses you might expect and the amount of income that you may receive from government or private pensions and your existing assets. If you project a shortfall of funds to cover your expenses, you may need to build additional personal investments to fill the retirement funding gap. For many Canadians, the RRSP should be top on the list for retirement savings.

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14 The TFSA dollar limit is only $7,000 in 2024 and 2025, while the RRSP dollar limit is $31,560 in 2024 and $32,490 in 2025.

15 For factors to consider when deciding whether to pay down debt or save for retirement, see the CIBC report Mortgages or Margaritas: Is paying down debt putting your retirement at risk?

Myth 6: If I save too much in an RRSP or RRIF, there will be a large tax bill when I die

The tax rules require the fair market value of your RRSP or Registered Retirement Income Fund (RRIF) as of the date of death to be included in income on your terminal tax return, with tax payable at your marginal tax rate for the year.

There are exceptions, however, which may allow a tax-deferred rollover to certain beneficiaries. The income inclusion can be deferred if the RRSP or RRIF is left to your surviving spouse or common-law partner. If certain steps are taken, including that your spouse or common-law partner puts the proceeds into his or her own RRSP or RRIF, tax will be payable by your surviving spouse or common-law partner at his or her marginal tax rate in the year in which funds are withdrawn from his or her RRSP or RRIF.

Alternatively, an RRSP or RRIF may be left to your financially dependent child or grandchild and used to purchase a registered annuity that must end by the time your child or grandchild reaches age 18. The benefit of doing this is to spread the tax on the RRSP or RRIF proceeds over several years, allowing the child or grandchild to take advantage of personal tax credits as well as graduated marginal tax rates each year until the age of 18.

If the financially dependent child or grandchild (of any age) was dependent on you because of physical or mental disability, then the RRSP or RRIF proceeds can instead be rolled over to his or her own RRSP and effectively only taxed when withdrawn.

While these tax-free rollover options may be available whether you designate eligible family members as beneficiaries in your will or in the RRSP or RRIF contract itself,[16] the latter option may avoid provincial probate fees (where applicable).

As another option, proceeds of your RRSP or RRIF upon your death may be transferred to the Registered Disability Savings Plan (RDSP) of your financially dependent child or grandchild who qualifies for the disability tax credit, if the RDSP holder and beneficiary consent.

It’s important to know about, and plan for, any available rollovers during your lifetime to maximize tax deferral that may be available upon your death. You should consider designating beneficiaries for your RRSP or RRIF, making sure beneficiary designations in your RRSP or RRIF documents are consistent with beneficiaries named in your will, and ensure that designations are kept up-to-date.

Another strategy that may reduce income taxes on your RRSP or RRIF at death is to take annual withdrawals from your plan during your lifetime in years when your income is in low tax brackets, to increase the income that will be taxed at low rates . For example, in 2024 and 2025, income up to almost $60,000 is taxed at the lowest federal rate of 15%. Provincial or territorial taxes would also apply.

Conclusion

If you are like many Canadians, you will need to supplement your retirement income with personal savings and an RRSP may be the best choice to build your retirement fund. Don’t let unfounded myths keep you from maximizing your RRSP savings opportunity!

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[16] In Quebec, an RRSP must qualify as an annuity to take advantage of a valid beneficiary designation.