Building family wealth with registered plans

January 2024

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Registered plans can have a big impact on family wealth by providing the equivalent of a tax-free rate of return on your investments. And with some plans, government assistance can boost the effective rate of return.

Registered Retirement Savings Plans (RRSPs)

For most high-income earners, maximizing RRSP contributions is the number one way to save for retirement. For 2024, a maximum contribution of $31,560 can be made provided you are otherwise up to date with your RRSP contributions and had earned income of at least $175,333 ($31,560 divided by 18%) in 2023. Earned income includes (self) employment income as well as rental income. For 2024, you'll want to earn at least $180,500 of earned income to be able to contribute the maximum 2024 RRSP dollar limit of $32,490.

Taxes are deferred on any income and growth while funds are held within the plan and you'll only pay tax when the funds are withdrawn from the RRSP, or from a Registered Retirement Income Fund (RRIF) or prescribed annuity into which you would have transferred the RRSP funds (by the end of the year you turn 71).

Debunking the RRSP myth

Over the years, some have argued that there's no point investing in an RRSP since you pay all the savings back in taxes when you retire anyway. Let's debunk that fairly quickly. 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 as it is in the year of withdrawal, an RRSP provides a completely tax-free rate of return. 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 over the long term, depending on your rate of return, you are often still better off with an RRSP than non-registered investments due to effectively tax-free compounding. For further details, see our report Just do it: The case for tax-free investing.

Example

Morris is in the top Ontario tax bracket of 53.53% and contributes the maximum ($31,560) to his RRSP at the beginning of each year for the next 40 years. Assuming a 5% average rate of return, after 40 years, his RRSP will be worth $4.0 million pre-tax and $1.9 million after-tax.

If instead Morris eschews the RRSP (and the associated tax deduction!) in favour of a non-registered investment, he would only be able to invest $14,666 of after-tax income annually. Using the same 5% rate of return, but taxed annually, at the end of 40 years, his non-registered account will only be worth $973,000 after-tax. The RRSP strategy has doubled Morris' after-tax net worth of his savings even though he's always in the top tax bracket of 53.53%.

Using spousal or partner RRSPs

If you think that, upon retirement, your spouse or partner[1] will have a lower tax rate than you, you should consider contributing to a spousal or partner RRSP. That's an RRSP to which you contribute and you claim a deduction. Your spouse or partner owns the RRSP and pays tax at their lower rate upon withdrawals. Your contributions to a spousal or partner RRSP will not affect the contribution room of your spouse or partner, who will still be able to contribute to their own RRSP.

Unlike pension income splitting, which allows you to split only up to 50% of your RRIF withdrawals after age 65, with a spousal RRSP/RRIF strategy, you could have up to 100% of the RRSP/RRIF withdrawals taxed to your spouse or partner.

RRSPs for business owners

RRSPs also make good financial sense for incorporated business owners and professionals. In our report RRSPs: A smart choice for business owners, we explain why it often makes sense to take sufficient salary or bonus from your corporation to maximize your RRSP contributions, rather than leaving the funds inside the corporation for investment. Similarly, if your family members work in the business, the corporation could also pay them a reasonable salary for their efforts so they could build up RRSP contribution room and contribute to their own plans.

Registered Retirement Income Funds (RRIFs)

When transferring RRSP assets to a RRIF (by age 71), keep in mind that you can use the younger spouse or partner's age on which to base the minimum annual RRIF withdrawals. Also, to enjoy the longest possible tax deferral, you could arrange to have your annual minimum amount paid to you in December each year.

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[1] In this report, spouse refers to someone to whom you are legally married. Partner refers to a common-law partner under the *Income Tax Act*, which means someone who cohabits with you in a conjugal relationship, provided the two of you have cohabited for the past 12 months or are jointly parents of a child.

Finally, if you are planning on retiring outside of Canada and become a non-resident for tax purposes, if you retire to a country that has a tax treaty with Canada, the amount of non-resident tax Canada withholds on RRIF withdrawals may be reduced. Some treaties apply a reduced withholding tax rate for “periodic pension payments,” which may include payments from a RRIF where the total annual withdrawals do not exceed the greater of twice the minimum amount for the year and 10% of the fair market value of the property of the RRIF at the beginning of the year. For example, under the Canada-US Tax Treaty, the tax rate for non-resident withholdings is generally 25% but a reduced rate of 15% applies to periodic pension payments. You should, however, confirm whether the country in which you retire will impose tax on any RRIF withdrawals.

Tax Free Savings Accounts (TFSAs)

TFSAs for family members

Canadian residents start accruing contribution room once they turn 18 and unused room is carried forward indefinitely to future years. This creates an excellent opportunity for intergenerational, tax-free wealth transfer by gifting funds to family members to make their own TFSA contributions if they don’t have enough money to do so themselves. Figure 1 shows us, by year of birth, how much cumulative TFSA room an individual may have if they have been a Canadian resident for all years and haven’t ever contributed to a TFSA.

Figure 1: TFSA dollar limits

Age	Birth year	Year age 18 was reached	Dollar limit when age 18 was reached	Cumulative dollar limit[2]
18	2006	2024	$7,000	$7,000
19	2005	2023	$6,500	$13,500
20	2004	2022	$6,000	$19,500
21	2003	2021	$6,000	$25,500
22	2002	2020	$6,000	$31,500
23	2001	2019	$6,000	$37,500
24	2000	2018	$5,500	$43,000
25	1999	2017	$5,500	$48,500
26	1998	2016	$5,500	$54,000
27	1997	2015	$10,000	$64,000
28	1996	2014	$5,500	$69,500
29	1995	2013	$5,500	$75,000
30	1994	2012	$5,000	$80,000
31	1993	2011	$5,000	$85,000
32	1992	2010	$5,000	$90,000
33	1991	2009	$5,000	$95,000
34+	Before 1991	Before 2009	$0	$95,000

[2] This assumes that you have been a resident of Canada since the later of 2009 or the year you reached 18 years of age.

Although contributions made to a TFSA are not tax deductible, no tax is payable on income and growth or on withdrawals, as long as the TFSA rules are followed. The 2024 TFSA dollar limit is $7,000 and unused TFSA contribution room carries forward indefinitely from year to year. If you are at least 30 years old in 2024, and have been a resident of Canada since 2009 but never contributed to a TFSA, you could contribute $95,000 in 2024. If you continue to contribute $7,000 annually in the future, after 40 years you would have about $1.5 million, assuming an annual 5% rate of return.

Example

Samantha, who is in the highest tax bracket in B.C. (53.50%), has six adult grandchildren, ages 17, 18, 20, 22, 26 and 30, none of whom have opened up a TFSA. From Figure 1, we can see the amounts that Samantha could gift funds to five of her six grandchildren to help them fund their own TFSAs. To fully catch-up, she would have to gift a total of $192,000. After 2024, Samantha could gift $7,000 to each grandchild to make their annual TFSA contributions. With a 5% rate of return on investments, the total contributions of $1,032,000 for her six grandchildren would grow to almost $1.9 million over the following 20 years. This means there is almost $900,000 of earnings that otherwise would have been taxed in Samantha's hands at her top tax rate.

TFSAs for business owners

TFSAs are also a good financial choice for business owners. Unlike RRSPs, you don't need earned income to contribute to a TFSA; therefore, your corporation could pay you just enough salary or dividends so you'd have enough money, after personal tax, to contribute to a TFSA. This is explored in detail in the report TFSAs for business owners… a smart choice, which concluded that you should consider withdrawing sufficient corporate funds annually to maximize your TFSA contributions, rather than leaving the funds inside the corporation for investment.

Registered Education Savings Plans (RESPs)

An RESP allows you to save for your child or grandchild's future post-secondary education by contributing up to $50,000 per child or grandchild. Canada Education Savings Grants (CESGs), which are provided by the Government of Canada, are equal to 20% of total annual contributions, generally up to a maximum of $500 per year per child who is under 18 years of age, with a lifetime limit of $7,200 per child, can be paid into an RESP.

Tax is deferred on investment income earned within an RESP. When RESP earnings and CESGs are paid out for post-secondary education purposes, they are included in income of the beneficiary, who may pay little or no tax if they claim the recently enhanced Basic Personal Amount ($15,705 in 2024) along with tuition credits to reduce, or in some cases, eliminate all tax from the RESP withdrawals.

Building family wealth through RESPs

The best way to maximize CESGs may be as follows: for each child or grandchild, contribute $16,500 in the year of birth and an additional $2,500 annually for the following 13 years, with $1,000 in year 15. By doing so, you would have maximized the $7,200 of CESGs (which are limited to 20% or $500 annually) and maximized the $50,000 contribution.

Registered Disability Savings Plans (RDSPs)

RDSPs are designed to help to build long-term savings for individuals with disabilities. You can contribute up to $200,000 on behalf of a beneficiary who qualifies for the disability tax credit (DTC). There is no tax on earnings or growth while in the plan. When disability assistance payments are made to the beneficiary, based on a pro-rated formula, original contributions are not taxed, but earnings, growth and government assistance, discussed below, are included in income of the beneficiary.

In addition to the power of tax-deferred compounding, Canada Disability Savings Grants (CDSGs), with a lifetime maximum of $70,000 per beneficiary, and Canada Disability Savings Bonds (CDSBs) with a lifetime maximum of $20,000 per beneficiary, may be received from the Government of Canada up until the end of the year in which the beneficiary turns 49. The availability and amount of the CDSG and CDSB is dependent on "family income." Once a beneficiary turns 19, the beneficiary's own family income, rather than the income of a parent or guardian, is used.

Example

Kanesha, a high-income earner, opens up an RDSP for her child Jamal who is ten years old, has a disability and is entitled to the DTC. She contributes $166,000 in 2024, and $1,000 per year for the next 8 years to maximize the CDSG, which is limited to $1,000 annually since Kanesha's family income is used in the determination of the grants. Once Jamal reaches 19 years of age, and the CDSG and CDSB is based on his personal family income, this example assumes family income is below the thresholds required to receive the maximum CDSG and CDSB. Annual contributions are increased to $1,500 (yielding annual CDSGs of $3,500) for 17 years and $500 (yielding annual CDSGs of $1,500) in the following year, until the maximum CDSGs of $70,000 are received. The RDSP will also receive $1,000 of CDSBs annually for 20 years once Jamal is at least 19 years old.

By Jamal's age 36, the $200,000 in maximum contributions will have been made and the RDSP will have received $70,000 of CDSGs. By Jamal's age 38, the RDSP will also have received $20,000 of CDSBs. Assuming a growth rate of 5% tax-deferred compounding, the RDSP will be worth $2.6 million at the end of the year when Jamal is 59.

Minimum required RDSP withdrawals must begin the following year and any CDSGs, CDSBs, and income and growth withdrawn (in excess of the $200,000 in contributions) will be taxed in Jamal's hands.

First Home Savings Accounts (FHSA)

The FHSA gives prospective first-time home buyers the ability to save up to $40,000 on a tax-free basis towards the purchase of a first home in Canada. Like an RRSP, contributions to an FHSA will be tax-deductible and withdrawals to purchase a first home, including withdrawals of any investment income or growth earned in the account, will be non-taxable, just like TFSAs.

To open an FHSA, you must be a resident of Canada and at least 18 years of age. In addition, you must be a first-time home buyer, meaning that you and/or your spouse or common-law partner have not owned a home in which you lived as your principal residence at any time during the part of the calendar year before the account is opened or at any time in the preceding four calendar years. If you make a qualifying withdrawal to buy a home, the FHSA can remain open until the end of the following year; otherwise, the FHSA can remain open for up to 15 years or until the end of the year when you turn 71 years old, whichever comes first. Any funds left in the FHSA that are not used to buy a qualifying home before closing the FHSA can be transferred on a tax-free basis to an RRSP or RRIF, or will be included in income. Once the 15-year period has ended, you are not permitted to open another FHSA in your lifetime.

Example

Mei has a 30% marginal tax rate and contributes $8,000 to an FHSA at the beginning of each year for 5 years. She contributes the annual tax savings of $2,400 ($8,000 times 30%) to her TFSA and her investments earn a 5% annual rate of return. After 10 years, Mei could withdraw over $74,000 from her FHSA and TFSA for downpayment on a qualifying home. If Mei can also withdraw the maximum allowed of $35,000 from the Home Buyers' Plan, she would have almost $110,000 to use towards a qualifying first home purchase.

Building family wealth with FHSAs

If you have children or grandchildren that are not yet homeowners, consider gifting each of them up to $8,000 each year to fund their own FHSAs. Family members may also save on taxes by claiming deduction for their contributions to their FHSAs. By gifting a total of $40,000 to each eligible family member and having each of them use their respective the tax savings to invest in TFSAs, you could help family members accumulate tens of thousands of extra dollars towards a first home purchase.

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