"Apply even some of this book's teachings and you'll owe it's author a debt of gratitude. And that's smart debt!"

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THE SMART DEBT COACH

$1,000 BENEFIT GUARANTEED OR MONEY BACK

Secrets of the Rich to Increase *Your* Wealth and Security

Talbot Stevens

Free Sample Chapter

I hope you find these ideas valuable, and encourage you to ACT on any concept that should increase your wealth and security.

Cheers,

Talbot Stevens, *The Smart Debt Coach*

Contents

Don’t Put Dry Pasta in Your RRSP

“Gross Up RRSP Contributions 25 to 85 Percent”

I couldn’t wait to get to the game the next week, and I had to admit it wasn’t all about watching my son play. I didn’t want to take advantage of Bruce’s goodwill and knowledge, but … okay, I did want to take advantage of Bruce’s goodwill and knowledge.

After we were settled in our spots and pleasantries had been exchanged, I launched in.

“Last week, you talked about ramping up our RRSP contributions,” I reminded him. “I might not know much about money, but I know that there’s no investment that earns 25 percent returns, let alone 85 percent.”

“Wow, that didn’t take long,” Bruce chuckled. “First of all, there *are* investment strategies that can temporarily produce annual returns higher than 85 percent. These are too often only used by the wealthy. But, as we saw with Trump, the ‘higher-return, higher-risk’ strategies can lose a lot of money just as fast as they can make it.

“Secondly, there is a simple way that millions of Canadians *can* get returns of 25 percent or more, and yes – guaranteed. But that’s not what I’m talking about.”

Kim was intrigued. “What do you mean then?”

“A key concept that’s overlooked by most investors is that when you’re saving for retirement, you should **never put dry pasta in your RRSP**.” Bruce smiled as an ‘Are-you-nuts?’ expression formed on my face.

Mercifully, Michelle stepped in. “What does pasta have to do with RRSPs?”

“She does most of the cooking in the family,” I explained.

“Dry pasta illustrates a fundamental understanding that’s important when investing in general, and introduces one of the behavioural risks of RRSPs,” our hockey-dad advisor explained. “Have you ever noticed that when you cook pasta, it expands to be much larger than it was when it was dry?”

"Of course," Michelle nodded. "As it soaks up water, it can become twice as big after it's cooked."

"And if you let it dry out, what happens?"

"It returns to its original size," Michelle dutifully replied.

"Dollars you earn are a lot like pasta. You're paid with dollars that haven't been taxed yet. Before-tax dollars are like larger, wet, cooked pasta. But after federal and provincial income taxes suck all the water out, you're left with after-tax dollars – smaller, dry pasta.

"One of the secrets of the rich is that they **always think about the impact of taxes, and the big difference between before-tax dollars and after-tax dollars**."

"What does that have to do with RRSPs?" I inquired.

"**If you don't put the equivalent, before-tax amount in your RRSP, you end up unknowingly investing less than you start with, less than you intended, and less than you need to**," Bruce contended.

"Let me try to illustrate the behavioural issue and the opportunity to significantly increase your retirement funds. Let's say that Joe here is in a 40 percent tax bracket, and has $3,000 to add to his retirement savings. If he chooses the conventional route and puts the three grand in his RRSP, this should produce a tax refund of …?"

"Forty percent of the amount he contributed," Kim obliged, "or $1,200."

"Correct. In addition to the real benefit of tax-deferred investment growth, contributions to an RRSP produce a tax deduction that reduces your taxable income. For the majority of Canadians who have already prepaid income taxes through their employer, this means that after filing income taxes, they'll receive a tax refund. Unfortunately, I think too many Canadians actually use RRSPs more for the immediate benefit of saving taxes than as a tax-efficient way to save for retirement.

"Whatever the motivation, if Joe contributes $3,000 to an RRSP, he'll get back 40 percent or $1,200, as Kim said. So far, so good. But what do most Canadians do with their RRSP refunds?" Bruce posed with a raised eyebrow.

"I can't speak for others," I replied, "but the years that we did contribute, we typically put the refund towards a winter vacation down south."

"Or paid off Christmas purchases," Michelle added.

"Like you two, my experience is that most Canadians spend their RRSP refunds," said Bruce. "In fact, I know some people who *mentally* spend their refunds before they even make their RRSP contribution!"

"If everyone spends their RRSP refunds, then what's the problem?"

"If Joe contributes three thousand to his RRSP, and – like most – spends the refund, how much did he put towards his retirement?" Bruce tested.

"Three thousand," we all replied in unison.

"But here's the critical point that's easy to overlook. Did he invest three thousand *before-tax* dollars, or *after-tax* dollars?"

After a pause, I replied, "Before tax. RRSPs are all before-tax dollars that will be taxed later, when I withdraw them."

"Correct!" Bruce said encouragingly. "So if Joe spends the $1,200 refund, how much money did he really put towards his retirement … after tax?"

After some hesitation, Michelle replied, "Only $1,800. But I'm confused. The contribution receipt and the investment transaction both indicate a $3,000 contribution."

"That's true. It's easy to be misled into thinking that if you start with $3,000 and put it into an RRSP, you've invested all of the money you started with and intended for retirement. **One of the behavioural risks of RRSPs is that by spending the refund, you end up converting after-tax dollars to less valuable before-tax dollars**, probably without realizing it.

"Since generally **we only get to spend or save after-tax dollars**, Joe started out with $3,000 of after-tax money to invest – smaller, dry pasta. But if he contributes it to an RRSP and spends the $1,200 refund, he ends up investing only $1,800 after tax. That's his net, after-refund contribution to his retirement."

There was a pause as we digested the message.

"I never realized that," I confessed. "Does this mean RRSPs aren't as good as we thought?"

"No, RRSPs are as good as they've always been," Bruce countered. "But a better understanding of how they work and the behavioural issues can make a big difference.

"The good news is that more people are recognizing the importance of what happens to RRSP refunds. Some illustrations of RRSPs now also show what you could end up with when the refunds are reinvested back into the RRSP.

"If Joe reinvested his $1,200 refund, his total RRSP contribution would be $4,200 – a 40 percent improvement over the typical approach. But I want to emphasize that while this is much better than spending them, reinvesting the refunds means putting partially cooked pasta in your RRSP. It still does not invest the initial, after-tax amount that you started with."

"What do you mean?"

"To add the amount that Joe started with and intended to go towards his retirement, he needs to invest the same amount of *after-tax* dollars in his RRSP.

"Joe, if you had $5,000 in your RRSP and withdrew it, how much would you have left after taxes?"

"I'd lose 40 percent to taxes, so I'd have $3,000 after tax."

I swear I saw a light go on over Kim's head. "So for Joe, $3,000 to invest equates to $5,000 in an RRSP. In other words, three thousand after tax equates to five thousand before tax. But how does he turn three thousand into a five thousand dollar RRSP contribution?"

"That's where the 'Gross Up' strategy comes in," Bruce answered. "It's the second 'can't-lose' good debt concept, and most investors can benefit from it. **The Gross Up strategy converts the after-tax amount available to invest into the equivalent, before-tax amount in your RRSP**.

"One way Joe can do that is to temporarily borrow the difference between the amount he has to invest and the equivalent, before-tax RRSP amount. In this case, he needs to borrow $2,000 to Gross Up his 3,000 after-tax dollars to the equivalent $5,000 amount in his RRSP.

"A few weeks after filing his tax return, Joe will get a refund for 40 percent of his $5,000 RRSP contribution. The $2,000 refund is enough to completely, and almost immediately, pay off his temporary Gross Up loan. If we ignore the few dollars in interest, the Gross Up loan allows

Joe to turn his $3,000 to invest into a $5,000 RRSP contribution. This means he ends up with 67 percent more fuel in his retirement vehicle.

"So **each after-tax dollar you have to invest equates to a much larger before-tax dollar in an RRSP – 25 to 85 percent more, depending on your tax bracket**.

"To get the full benefit of RRSPs and build the retirement funds needed, you obviously should never put dry pasta in your RRSP. But you shouldn't put partially cooked pasta in your RRSP either. It's not as filling. In Joe's 40 percent tax bracket, $3,000 of dry pasta equates to $5,000 of cooked pasta – not $3,000 or even $4,200. As an investor, you should **only put fully cooked pasta in your RRSP**!"

"Sounds like I should leave all pasta preparation to someone who knows what they're doing," I looked appreciatively at Michelle.

"How far your retirement vehicle takes you through retirement depends on how efficient the vehicle is, and how much fuel you put in it," Bruce continued.

"In fact, **if you don't invest the equivalent, before-tax amount in RRSPs, you could be better off not using RRSPs at all to save for retirement**," Bruce emphasized. "It's not hard to see how $1,800 of fuel in a tax-efficient vehicle like RRSPs might not go as far as $3,000 of fuel in a less efficient vehicle."

"Wow," Kim let out a low whistle. "I keep reading about how far behind most Canadians are in their retirement savings. We're living longer and longer, and you never know what the economy will be like in the future. Really, every investor should be doing this."

"So don't put dry pasta in your RRSP," I said, pleased with myself and the metaphor. "It's too bad we can't Gross Up after-tax dollars by simply boiling them in water, like cooking pasta!"

"For those who contribute monthly," Bruce added, "another way to get the equivalent amount in your RRSP is to Gross Up your monthly savings by the appropriate amount. Then you reduce your withholding taxes with your employer to account for the RRSP contribution so you don't get a tax refund."

"How does someone know what the equivalent, before-tax amount is?" I asked.

"If you're curious and want to figure it out on your own, **there's a free Gross Up calculator on my website**," Bruce responded. "But I take care of this for my clients and do the paperwork to adjust the withholding taxes. That way, they don't even need a temporary Gross Up loan, and they can get their money invested as soon as it's available."

"That sounds even better," Michelle enthused.

"What about someone who maximizes their RRSP contributions each year?" Kim inquired. "Aren't they already grossing up, so this wouldn't apply to them?"

"Great question. Since they've taken full advantage of RRSPs and can't contribute more, it'd be reasonable to think that they couldn't benefit from these ideas. But let's think it through.

"Let's say that because Joe's got an amazing pension at work, he only has $3,000 of RRSP contribution room available. If Joe puts his $3,000 into his RRSP and spends the $1,200 refund, again, how much has he really invested for his retirement – after tax?"

"It's the same. Only $1,800," Kim responded.

"So the pasta message highlighting the difference between after-tax and before-tax dollars and the behavioural issue about what happens to RRSP refunds, still applies. If someone spends their RRSP refund – whether they have more RRSP room or not – they convert after-tax dollars to before-tax dollars and end up investing less than they started with."

"So if they don't have any more contribution room, what are they supposed to do?"

"If the priority for the initial money was to fund retirement, then the refund should also be invested," Bruce offered.

"Or used to pay down debts," Kim added.

"That's another productive alternative," Bruce agreed.

Naturally, I had another question. "So now that we know how to gross up our RRSP contributions by 25 to 85 percent, how do we get the money to grow at 25 percent a year – guaranteed? It's tough to get ahead with interest rates so low."

“But it doesn’t have to be,” Bruce promised. “Coffee, anyone?

More Information

Speaking

As a speaker, Talbot loves to share effective financial and behavioural strategies to help Canadians create their own financial freedom.

Volume Discounts

Significant discounts are available on bulk purchases of Talbot's books *The Smart Debt Coach*, and *Financial Freedom Without Sacrifice*.

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The ***Leverage Professional* software** projects the net gain or loss from borrowing to invest for your personal situation. The 30-day FREE trial is enough for individual needs. Financial advisors use it to ensure clients understand potential outcomes.

To help avoid putting dry pasta in your RRSP, a free **Gross Up calculator** determines the equivalent, before-tax amount to contribute to your RRSP.

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Talbot also has training and strategies to help financial advisors increase business in a client-first way. In addition to the ***"Help a Friend"* campaign**, a personalized PDF, or **p-Book** format, allows easy digital distribution of book content licensed and branded to an individual advisor. It includes subsets of the book for bite-sized communication of single strategies.

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