

# Optimize RRSP Contribution Strategy Summary

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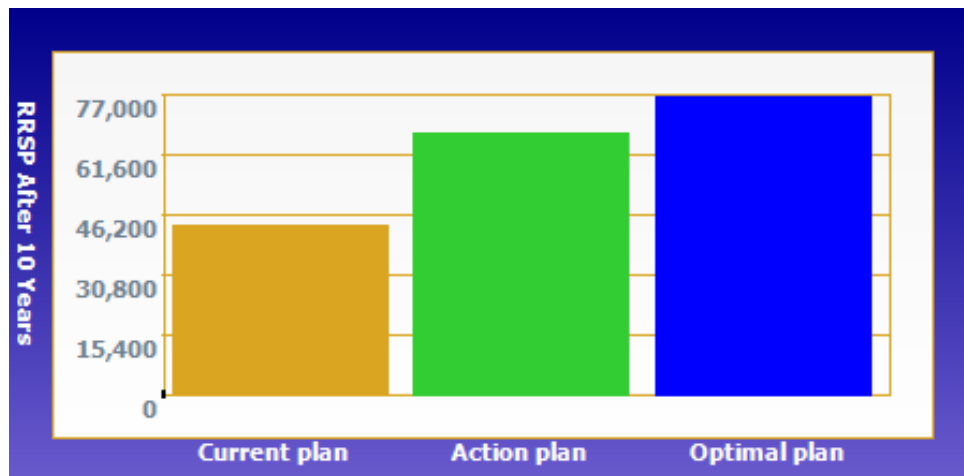
## Assumptions

- \$8,000 to invest now, and \$2,000 per year of long-term investable cashflow
- \$86,000 taxable income, in Ontario for 2005; spousal income of \$0; no children
- \$25,000 of RRSP contribution room; currently reinvest 0% of RRSP refunds
- 7% annual returns; 6% interest rate for RRSP loan; 10-year evaluation period
- Sufficient income taxes have been prepaid with payroll deductions or installments so that RRSP contributions generate tax refunds

## Action Plan

**\$6,810 is temporarily borrowed** and combined with the \$8,000 of available cash to make a **total contribution this year of \$14,810**. This should generate a 43.4% tax refund of \$6,429, which is quickly used to pay down the loan, leaving a long-term **catch-up loan of \$381**.

\$52 per year of the long-term, investable cashflow is used to pay off the loan over 10 years. The remaining investable cashflow of \$1,948 per year, plus the extra cash from reduced clawbacks, could be invested. 80% of this cashflow averaging \$1,948 per year equates to annual **RRSP contributions of \$2,754**. This is most easily achieved by contributing **\$230 per month**, and adjusting taxes withheld by your employer to get refunds invested immediately.



## Projected Benefits

This year's RRSP contribution is \$14,810 instead of \$8,000. After 10 years, the selected **Action Plan** is projected to grow to \$67,186. This is **55% and \$23,816 better** than the current plan, and 12% less than the optimal plan.

\* \* \*

These results are projections only. **Actual results are NOT GUARANTEED, and will vary**, perhaps significantly. While every effort has been made to provide valuable and accurate projections, no individual or company involved in the creation, use, or interpretation of this analysis accepts responsibility for any losses associated with its use.

## Description

Talbot's RRSP Contribution Optimizer determines an individual's optimal RRSP contribution strategy, accounting for different tax brackets, the "hidden tax" of government clawbacks, and most importantly, an investor's behaviour.

### Opportunity

Instead of merely analyzing whether an RRSP "catch-up loan" strategy makes sense, Talbot's RRSP Contribution Optimizer helps significantly increase the value of investors' RRSP plans by:

- determining the best RRSP catch-up loan amount accounting for different tax brackets
- using a more effective RRSP refund strategy
- using a forced savings approach to reduce behavioural risks
- investing additional cashflow produced by reduced clawbacks

With today's low interest rates, ***what is the best amount to contribute to RRSPs this year, using available and borrowed funds, as part of a long-term contribution strategy?***

For most investors, the **optimal RRSP contribution strategy** should be **at least 28-92% better** than their current approach.

## Issues

**RRSPs are under-utilized.** Canadians typically use less than 9% of their available RRSP contribution room. In 2003, 78% of tax filers (18 million Canadians) had unused RRSP contribution room of \$343 billion, with an average unused room of over \$19,000.

**Too many are saving too little.** With a savings rate of near 0%, most investors are not putting a priority on investing for their future.

**Most don't save consistently.** Sadly, few investors "pay themselves first", automatically investing each month. The common "ad hoc" savings approach provides no consistency or confidence in achieving financial goals.

**Investors don't have a plan.** Most investors don't even have a rough financial plan to help them get closer to their retirement goals.

**Interest rates are low.** With interest rates still near 40-year lows, investors should be wondering when it makes sense to borrow to catch up on some of their RRSP room.

**Decreased trust and appreciation.** Corporate scandals, the 2001-2002 bear market, the focus on MERs and commission-based advice have left many investors less trusting and less appreciative of the financial industry.

**Need for behavioural solutions.** The biggest threat to an individual's financial success is their behaviour, both as a consumer and an investor. The financial industry needs to design, package, and deliver solutions that help investors minimize the natural behavioural risks that stand in the way of financial success.

## Concepts

Investors can significantly increase the value of their RRSPs by understanding and taking advantage of the following opportunities.

### Use a More Effective Savings Approach

Fundamentally, there are three investment or savings approaches: "ad hoc", automatic, and forced. Any of the approaches (or combinations) can be used to "fuel" your investment plan. Each approach has different behavioural risks.

The "**ad hoc**" **savings** approach is where you invest when you have money available, and are in the mood. This approach is most vulnerable to the behavioural risks of procrastinating and reduced savings. If you have money available but are not committed to saving, nothing gets invested. If you are committed to saving but have no money available, nothing gets invested.

The **automatic savings** approach is where you "pay yourself first", by investing on a monthly basis with deposits automatically coming off of your pay cheque or out of your chequing account. The automatic savings approach is much better than ad hoc saving, but plans are still vulnerable to being suspended, reduced, and having RRSP refunds spent.

The **forced savings** approach is where an investment loan is paid off over time. For many people, the most important benefit of a responsible investment loan strategy is the increased commitment and discipline that results from a forced savings approach. As with a mortgage, once you start an investment loan, you are much more likely to continue the payments and fuel your investment plan.

A **forced savings approach** is the most **effective solution** to the **behavioural risks** that reduce most investment plans.

### Use a More Effective RRSP Refund Strategy

While they have many benefits, there are also **behavioural risks of RRSPs**, which are often overlooked. The most significant behavioural risk is that most people **do not invest all of their intended dollars** towards their retirement goal. In addition, most people have the false impression that they have invested more than they really have.

**Example:** Let's pretend that Bob has \$1,000 to invest, and he is in a 50% tax bracket to keep the math simple. Recognize that the \$1,000 is an after-tax amount — dollars that have already been taxed. If Bob puts the \$1,000 in his RRSP, and spends his \$500 tax refund, his net after-tax cost is only \$500. Thus, Bob's after-tax commitment towards his retirement is only \$500, not the \$1,000 after-tax amount that he started with and intended to save for retirement. Unfortunately, Bob's RRSP statement reports that he has \$1,000 in his account, further reinforcing the false belief that he has invested \$1,000 towards his future.

**RRSPs often convert after-tax dollars into before-tax dollars** inside of an RRSP, which when withdrawn are 100% taxable again. In other words, the common approach of investing in RRSPs and **spending the refund reduces the actual amount** intended to be **saved to an amount that is 22-46% less**, depending on your tax bracket. This significantly reduces the potential of RRSPs for those who have not used all of their available contribution room.

Unfortunately, spending RRSP refunds is the first and most common of the five RRSP refund strategies, each representing a different behaviour and level of commitment to retirement savings. Directing RRSP refunds towards your retirement goal and reinvesting the refunds will increase your RRSP by the rate of your tax bracket.

Simply **reinvesting RRSP refunds** is an easy way to **increase RRSP savings by 22-46%**.

"Grossing up" RRSP contributions is even more effective. The fourth refund strategy is to borrow enough to maximize your annual contributions, with the balance of the loan repaid within a year. The final refund strategy is to borrow a larger amount that might take 10 years or more to repay, to "catch up" on some or all of your unused contribution room.

**Five RRSP Refund Strategies**

- Spend refund strategy
- Reinvest refund strategy
- Gross-up refund strategy
- Top-up loan strategy
- Catch-up loan strategy

**Investable dollars equate to a larger amount in an RRSP**

To truly invest all of your dollars intended for savings, you need to use the "gross-up" refund strategy. After-tax dollars equate to a larger before-tax amount inside an RRSP, which we can refer to as the "grossed-up" RRSP amount.

In a 50% tax bracket, \$1,000 can be "grossed up" to an RRSP contribution of \$2,000, as shown below.

Grossed-up RRSP contribution	\$2,000
- 50% tax refund	- \$1,000
	-----
Net Cost	\$1,000

To calculate the grossed-up RRSP amount that equates to the after-tax amount that we have to invest, use the following formula.

$$\text{Grossed-up RRSP amount} = \text{After-tax amount} \div (1 - \text{Tax rate})$$

This formula simply works backwards to determine the maximum amount that we can contribute to an RRSP with the after-tax dollars available to invest, taking full advantage of the tax refund.

To invest all dollars intended for retirement and **increase your RRSP savings by 28-85%, make grossed-up contributions** to your RRSP.

**Notes** for reinvest and gross-up refund strategies

- reinvesting or grossing up refunds is only possible for those who do not maximize their RRSPs each year, and thus have RRSP contribution room available
- actual tax refunds received depend on having already paid the appropriate withholding taxes, either through payroll deductions or quarterly installments if you are self-employed

**How to gross up RRSP contributions**

The easiest way to gross up RRSP contributions and invest all of your intended cashflow is to **"pay yourself first"** and invest the appropriate grossed-up amount every month using pre-authorized withdrawals from your chequing account. Then have your employer adjust your withholding taxes to get your tax refund working for you immediately instead of being spent. To do this, file a *"Request to reduce tax deductions at source"* form, available at <http://www.cra-arc.gc.ca/E/pbg/tf/t1213/t1213-04e.pdf>.

Just before the RRSP contribution deadline, you can **immediately increase your RRSP contribution by 28-85% by using a temporary "gross-up" loan.**

**Example:** In a 50% tax bracket with \$1,000 to invest, Bob could borrow an extra \$1,000 to "gross up" his RRSP contribution to \$2,000. This will produce a 50% tax refund of \$1,000, which completely and almost immediately repays the \$1,000 loan. Using this temporary gross-up loan, Bob is able to double the amount contributed to his RRSP, relative to the common approach of spending the refund.

Gross-up amounts for different tax rates are shown below, as well as the initial contributions resulting from spending and reinvesting RRSP refunds.

RRSP Contribution from \$1,000 After-Tax			
Refund Strategy	25% Tax	40% Tax	50% Tax
Spend Refund	\$1,000	\$1,000	\$1,000
Reinvest Refund	\$1,250	\$1,400	\$1,500
Gross-Up Refund	\$1,333	\$1,667	\$2,000

Many people set up monthly "pay yourself first" RRSP plans. It is important to note that unless your current monthly contribution is grossed up to the right amount as shown in the table, having your employer withhold less tax does not increase your RRSP at all. Simply reducing your withholding taxes amounts to getting your RRSP refund back a little bit each pay period instead of all at once when you file your taxes.

To calculate the exact RRSP gross-up amount for any tax rate, use the "Calculate RRSP Gross-up" option on the Analyses menu.

## Reduce the Behavioural Risks of Investing

The **biggest threat to your financial success** is you, specifically **your behaviour** as an investor and consumer. Improving returns from 6% to 8% is not nearly as important as increasing your annual savings from \$2,000 to \$10,000, especially if you are getting close to retirement. Some of the investing behavioural risks include:

- continuing bad financial habits
- procrastinating
- suspending or reducing savings
- spending RRSP refunds
- not estimating (or underestimating) the savings needed
- not having a goal and a plan

These behavioural risks exist because most of us prefer to do what is easy, instead of doing something that might not be fun or takes discipline.

**Most investors can minimize behavioural risks by combining forced and automatic savings approaches.**

Investors should first use a forced savings approach by borrowing and investing an amount that can easily be handled emotionally and financially, with all remaining cashflow invested using an automatic "pay yourself first" approach into RRSPs with larger grossed-up contributions.

Committing to pay off an RRSP catch-up loan is an effective solution to the behavioural risks of not investing available cashflow or spending RRSP refunds instead of contributing a larger grossed-up amount.

**Less disciplined investors might be better off with a larger-than-optimal catch-up loan**, because once started, you have no choice but to make the loan payments. Making a one-time decision to commit to paying off a larger RRSP loan reduces the risk that the some of the remaining cashflow might not end up invested and grossed up.

Note that Talbot's RRSP Contribution Optimizer addresses all of the behavioural risks except properly estimating how much savings are needed, which should be done once the RRSP contribution plan is on track.

## Invest Additional Cashflow Produced by Reduced Clawbacks

Many government support programs, like the Canada Child Tax Benefit (CCTB), are reduced or "clawed back" as your taxable income rises. Thus, clawbacks are effectively a "hidden tax" that reduce the total amount that you get to keep. Any strategy that reduces a clawback results in receiving higher government benefits.

**Opportunity.** RRSP contributions reduce your taxable income, and thus reduce clawbacks and increase government benefits. This means that contributing to RRSPs not only reduces taxes, but can also "pay you" by increasing the government benefits you receive from programs that are clawed back. This extra cashflow from reduced clawbacks can be grossed up to add more fuel to your retirement savings.

**Example:** For families with 2 or more children under 18, the 2004 clawback rate on the Canada Child Tax Benefit is 4% for those with a family income over \$35,000. In this case, a couple in the middle 31% tax bracket who contributes \$1,000 to an RRSP, saves \$310 in taxes and increases their CCTB by \$40. Thus the total benefit is \$350, or 35% of their contribution, not just 31% tax savings. The CCTB is not all clawed back until family income is over \$95,400 for two kids, and \$127,700 for three children.

For lower-income families, the "hidden tax" or clawback rate on the CCTB is 12-33%, which can be higher than the visible tax rate of about 22%. In these situations, the total immediate benefit from an RRSP contribution could be 34-55%, which could be higher than the benefit for those in the top tax bracket. Clearly, contributing to RRSPs is a great way for these families to increase CCTB benefits, save taxes, and save for their future.

When comparing financial strategies, it is critical to focus on the net amount that you keep, after losses due to taxes and clawbacks. More important than Marginal Tax Rates, are what we might call **Marginal Loss Rates**, which define what portion of the next dollar earned would be lost to all taxes and clawbacks.

**Clawbacks included in analysis.** Talbot's RRSP Contribution Optimizer currently only accounts for the clawback of the CCTB program, which affects all parents with children under 18. Clawbacks of government programs affecting seniors (Guaranteed Income Supplement, Old Age Security, age credit) are not included because building a retirement plan using RRSPs is primarily an issue for those under the age of 65.

## Account for Different Tax Brackets

The tax savings benefit of RRSPs depends on your tax bracket. By contributing to an RRSP, you reduce your taxable income by the amount of the contribution, and thus reduce income taxes. However, **if you make a large RRSP contribution, you could reduce your taxable income to a lower tax bracket**, and further contributions will produce reduced tax savings.

**Example:** Let's assume that Kim's income is \$74,000 and income tax rates are 30% for income below \$70,000, and 40% for income above \$70,000. If Kim contributes \$4,000 or less to an RRSP, her tax savings will be 40% for every dollar contributed. Additional contributions will only produce tax savings of 30%.

Accounting for different tax brackets can help maximize your RRSP tax refunds.

Talbot's RRSP Contribution Optimizer determines the best amount to contribute to an RRSP, accounting for the current tax brackets in your province, your income, and the "hidden tax" of clawbacks.

Note that in most provinces, federal and provincial income taxes are calculated separately, with slightly different tax bracket boundaries.

## Your Optimal RRSP Contribution Strategy

Determining the optimal RRSP contribution strategy consists of finding what portion of your investable cashflow is best used for payments on a catch-up loan (using a forced savings approach), and what portion should be grossed up (using a "pay-yourself-first" automatic savings approach). Additional cashflow resulting from reduced clawbacks is also grossed up for extra contributions.



In some cases, it is best to borrow to catch up on RRSPs as much as possible this year. In other cases, your RRSP value is maximized by borrowing to contribute less than you could, or perhaps none at all.

The optimal contribution strategy is a **theoretical best** that **assumes perfect 100% discipline**, which is unrealistic for most investors.

## Reducing behavioural risk

**You do not benefit from a plan that is not acted on and followed through to completion.** Financial success is not determined by what you know, or plan. It is determined by what you *do*.

For a catch-up loan that is well within one's financial and emotional capacity, the risk that the forced savings portion of the plan doesn't get completed is near zero. Thus, the behavioural risk of the plan is reflected by the portion of the cashflow that is used for automatic savings and not "forced" to be saved.

Since most investors typically spend their RRSP refunds, it might not be realistic to assume a 100% discipline level where *all* of the remaining cashflow is invested.

Investors will **benefit most by defining an Action Plan that minimizes behavioural risks, realistically accounting for their own discipline level.**

For investors with less-than-perfect discipline, it might be best to commit to a larger-than-optimal RRSP catch-up loan to increase the forced savings portion of the plan. Those less comfortable with investment loans might prefer using a smaller-than-optimal portion of their cashflow for forced savings.

## Action Plan Considerations

In addition to the mathematical analysis of what combination of catch-up loan and grossing up optimizes the value of your RRSP, there are other factors that should be considered when defining your Action Plan.

The **optimal RRSP contribution strategy** is the theoretical best, and **assumes perfect discipline**. The biggest threats to financial success are **behavioural risks**, and these factors are often more important than an analysis which projects results based on parameters that are often unknowable.

## Forced savings more effective than automatic savings

For many people, the most important benefit of a responsible investment loan strategy is the increased discipline that results from a forced savings approach. Like with a mortgage, once you start an investment loan, you are much more likely to continue the payments and fuel your investment plan than with "ad hoc" or automatic "pay yourself first" savings approaches that are easily suspended or reduced.

**Less disciplined investors might be better off with a larger-than-optimal catch-up loan**, because once started, you have no choice but to make the loan payments. This reduces the risk that all of the remaining cashflow might not be invested using grossed-up contributions.

Catch-up loans are an effective solution to the behavioural risks of not investing available cashflow or spending RRSP refunds instead of contributing a larger grossed-up amount.

## Current markets

If the current investment markets are lower than normal, choosing a larger-than-optimal catch-up loan allows you to "buy low" with a greater amount, which can boost returns.

If you are confident that markets are overvalued, you might use a smaller portion of your total contribution room now and catch up more when markets are lower and "on sale".

Low interest rates make it easier to borrow more to catch up on RRSPs, but make sure you can easily handle the payments with higher interest rates and income disruptions.

## Other factors

**Emotional risk.** Some people are not comfortable borrowing to invest, and might become stressed if they borrowed to invest more and those investments temporarily dropped in value. If you are new to borrowing to invest, a smaller catch-up loan might be safer.



**Flexibility.** Not committing to loan payments leaves you with the flexibility to use future cashflow for other opportunities or emergencies. On the other hand, not committing to a forced savings plan by paying off an investment loan leaves you vulnerable to the behavioural risk of not investing and grossing up all of your investable cashflow.

## More Cases

These additional cases provide a deeper understanding of the analysis possibilities for different scenarios.

### Impact of Key Parameters

The Analysis Summary graphically summarizes the "mathematically best" catch-up loan amount for this year, and thus the optimal balance of forced and automatic savings, ignoring behavioural factors. Let's explore how key parameters affect the optimal RRSP contribution strategy, assuming we have perfect 100% discipline.

### Default Assumptions

Let's use the following default assumptions, from our original Case Study of Tom and Anne Smith.

- Cash available to contribute now: \$2,000
- Annual investable cashflow: \$2,000
- Available RRSP contribution room: \$25,000
- Taxable income: \$86,000
- Spouse's taxable income: \$0
- Children's ages: 3, 5
- Interest rate for RRSP catch-up loan: 6.0%
- Annual return: 7.0%
- Evaluation period (years): 10
- Portion of RRSP refunds reinvested: 0%

### Risk Tolerance

The most critical factors in analyzing the merits of any forced savings strategy (borrowing to invest) are the investment returns and the interest rate on the loan. It is important to not use aggressive assumptions or the analysis will present misleading conclusions and unrealistic expectations.

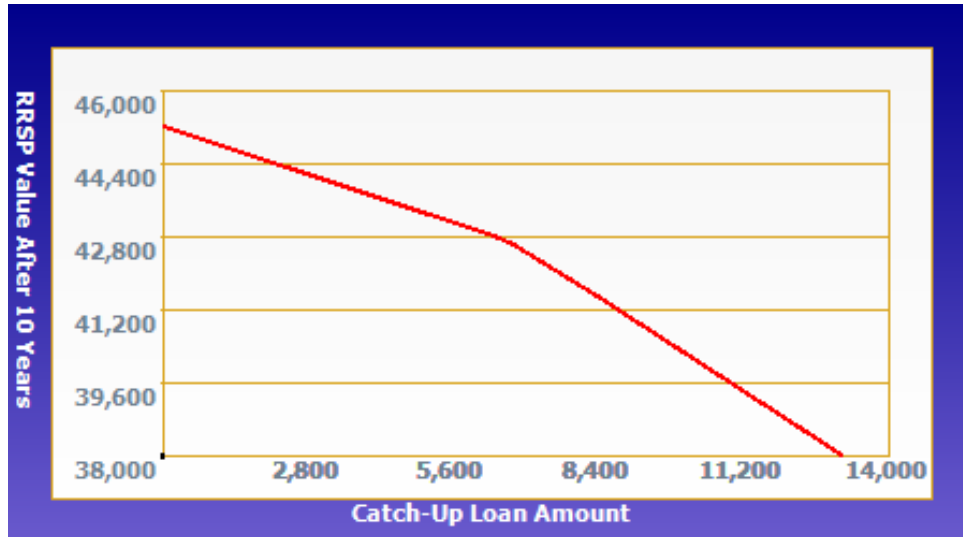
Investors have little control over the RRSP loan rate. The prime interest rate in Canada has averaged about 7.4% over the last 66 years.

The investor's risk tolerance will determine the types of investments held in RRSPs and thus the investment returns. If they are conservative, fixed-income investors, they will generally experience lower returns. If they are comfortable with more aggressive, equity-based investments, on average they should end up with higher returns.

The following charts show results for the default case, with a 6% loan rate, and returns that are lower, the same, and higher.

## Lower Returns

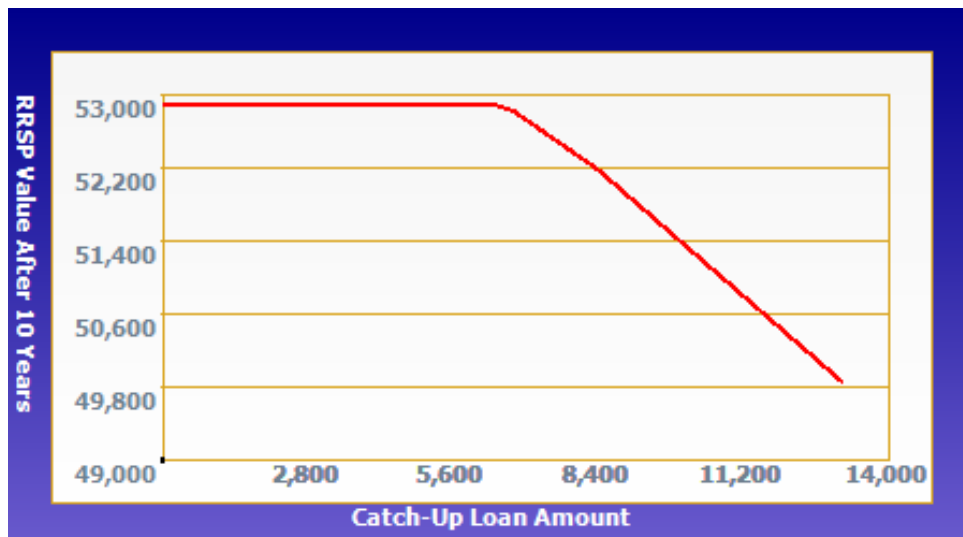
### Optimal RRSP Catch-up Loan Amount 3% Returns, 6% Loan Rate



**Notes:** Mathematically, if returns are sufficiently lower than the loan rate, investors should not borrow to catch-up on RRSPs. However, this results in 100% behavioural risk, since none of the savings are forced or "locked in", and refunds are vulnerable to being spent.

## Same Returns

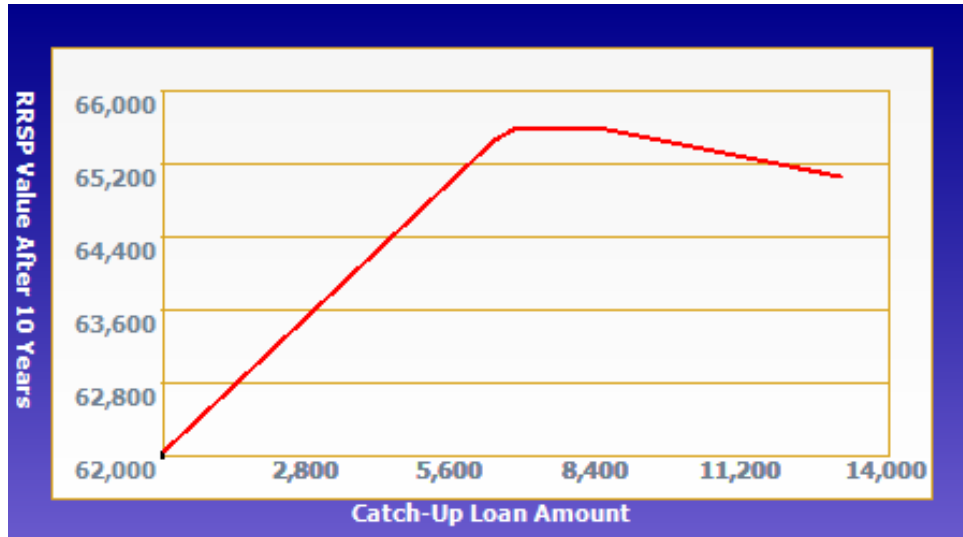
### Optimal RRSP Catch-up Loan Amount 6% Returns, 6% Loan Rate



**Notes:** While the taxable income stays in the same tax bracket, there is no difference between using a catch-up loan strategy and investing all equivalent (grossed-up) dollars monthly, as indicated by the horizontal part of the line. Dropping into a lower tax bracket decreases the benefit of additional borrowing to catch up.

## Higher Returns

### Optimal RRSP Catch-up Loan Amount 9% Returns, 6% Loan Rate



**Notes:** As expected, borrowing more to invest is better, but borrowing to catch up the maximum is not best if the drop in tax brackets is large enough. With 10% returns, catching up as much as possible is best.

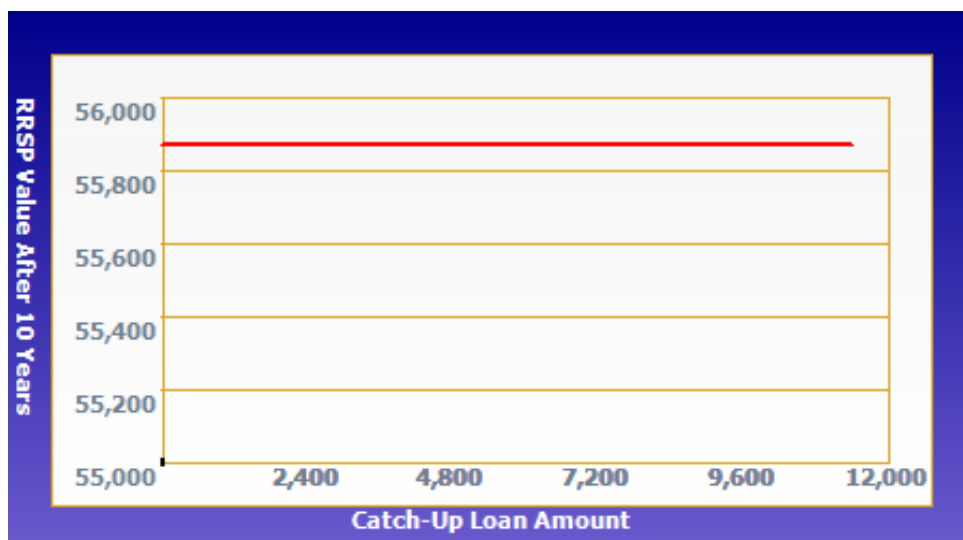
## Income

Investor income determines the tax bracket or brackets involved in the analysis.

### High Incomes

At very high income levels, the tax rate is the highest and does not change. This means there might be no bends in the Analysis Summary chart, as shown below.

### Optimal RRSP Catch-up Loan Amount \$160,000 Income, 6% Returns, 6% Loan Rate

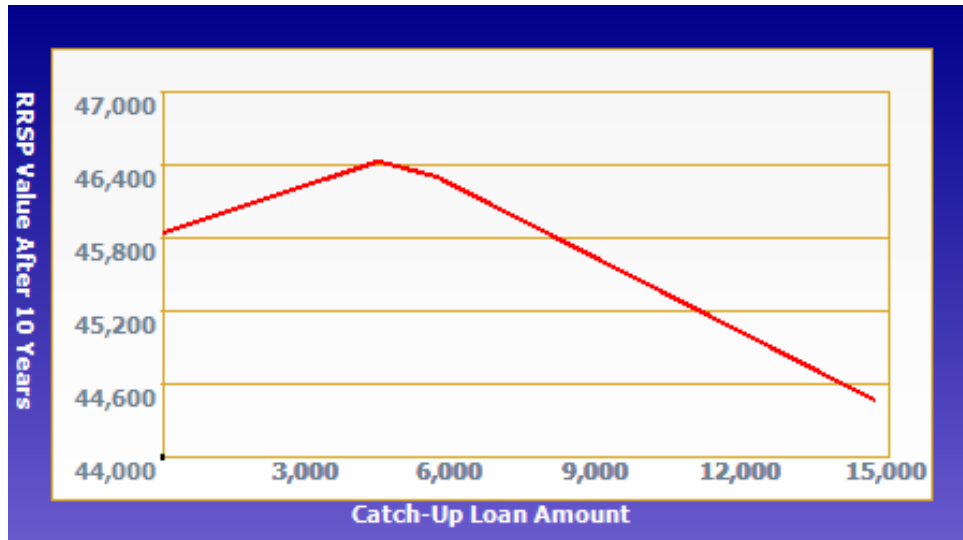


**Notes:** While the taxable income stays in the same tax bracket, there is no mathematical difference between using a catch-up loan strategy and investing all equivalent (grossed-up) dollars monthly. However, the behavioural risk is 100% when there are no forced savings.

## Middle Incomes

At middle income levels, large RRSP contributions can cross one or more tax bracket boundaries. Since the interest expense on borrowing for RRSPs is not tax deductible, dropping into a lower tax bracket changes the benefit of borrowing to catch up relative to monthly savings, resulting in one or more bends in the Analysis Summary chart (red line).

### Optimal RRSP Catch-up Loan Amount \$45,000 Income, 6% Returns, 7% Loan Rate

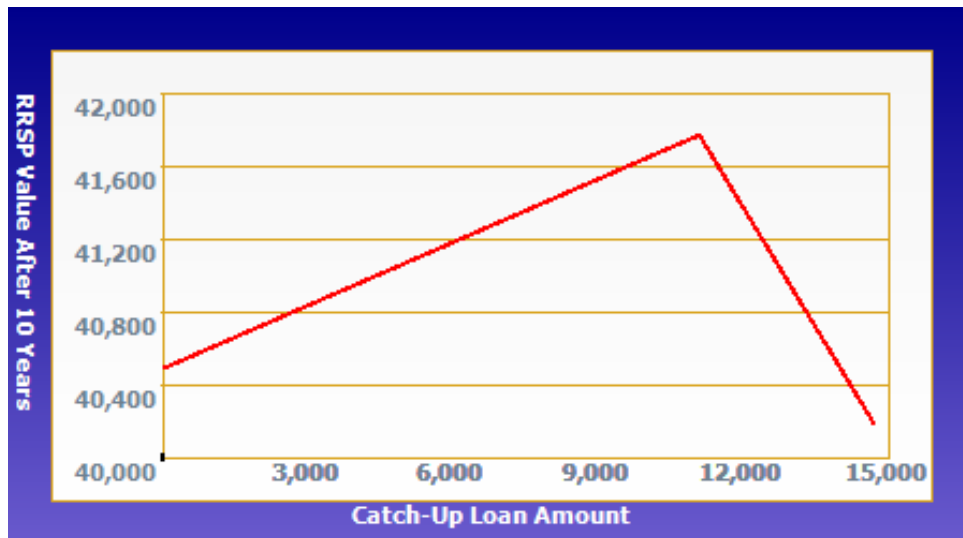


**Notes:** All forced savings is worse than all automatic savings (catch-up loan of \$0), which is not as good as using a small catch-up loan.

## Low Incomes

At lower incomes, it is possible to contribute enough to RRSPs to reduce the taxable income to the basic personal tax exemption where no income tax is payable. The analysis allows contributions beyond this level, but the benefits of contributing past this point (while paying non-deductible interest) drop very quickly.

## Optimal RRSP Catch-up Loan Amount \$25,000 Income, 6% Returns, 7% Loan Rate



**Notes:** The benefits of catch-up loans over ~\$11,000 drop quickly, because the contributions are large enough to reduce the taxable income below the basic tax exemption, producing no additional tax deductions.

### Cashflow

If there is not enough investable cashflow to make payments on a catch-up loan, the optimal contribution strategy is to gross up the available cash as much as possible. See the 'Calculate RRSP Gross Up' option on the Analyses menu.

If there is lots of unused RRSP room, cashflow will be the key factor that limits the maximum catch-up loan that could be considered.

### Discipline Level

On the Define Action Plan page, the Discipline Level parameter at the top reflects the portion of the remaining non-loan *after-tax* cashflow that will actually get invested. It does not affect the forced savings part of the plan. Since most investors spend their RRSP refunds, it is unrealistic to assume a 100% discipline level, indicating that 100% of the cashflow left for automatic monthly savings is invested with grossed-up RRSP deposits.

The table lists discipline levels when RRSP refunds are spent or reinvested.

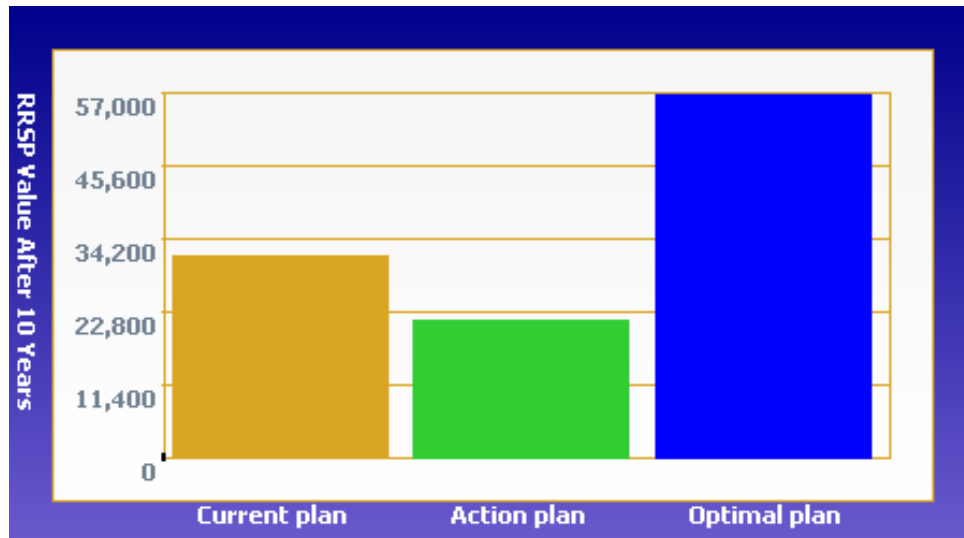
Discipline Levels When Spend or Reinvest Refunds		
Tax Bracket	Spend Refunds	Reinvest Refunds
25%	75%	94%
40%	60%	84%
50%	50%	75%

**Example:** In a 40% tax bracket, reinvesting 100% of refunds into RRSPs *each* year reflects a discipline level of 84%.

## Low Discipline Levels

If the Action Plan is all or mostly automatic savings, and the Discipline Level is low enough, it is possible to produce a plan that is worse than the Current Plan, as shown below.

### Action Plan vs. Current and Optimal Plans \$0 Catch-Up Loan, 30% Discipline Level



**Notes:** Here, the Action Plan is 32% lower than the Current Plan. One solution is to be more disciplined with the monthly savings and invest the remaining cashflow using equivalent, grossed-up contributions a higher percentage of the time.

This is generally not as effective as "locking in" a higher level of commitment by using a (larger) catch-up loan. Even with the same 30% Discipline Level, simply changing to an \$8,000 catch-up loan instead of \$0 produces an Action Plan that is 29% better than the Current Plan.

## High Discipline Levels

For perfectly disciplined investors, behaviour is not a factor and the optimal contribution plan is indicated by the Analysis Summary. The Define Action Plan page can be skipped.

## No Catch-Up Loan Necessary

If the available RRSP contribution room is not significantly more than the cash available to invest, a long-term catch-up loan might not be necessary to use all available RRSP contribution room. In this situation, the optimal contribution strategy is to gross up as much as possible.

**Example:** With the default inputs, and RRSP room of \$2,500, the \$2,000 of cash to invest is more than enough to use all of the available contribution room. Set these inputs and click the Next button to see how.

## Accounting for Clawbacks

The Fast Track mode does not include the impact of clawbacks in the analysis. You must use the Basic Details or Advanced Details modes. Marginal Clawback Rates are shown on the Marginal Loss Rates page, under the Analysis section in the navigation menus.

Contributing to RRSPs reduces taxable income, which also reduces the clawback of Canada Child Tax Benefit (CCTB) payments, for those with children. This results in additional cashflow that would not otherwise exist, which can be invested (in RRSPs to reduce next year's clawbacks and generate additional cash to invest).



## **Low-Income Families**

The clawback rate on CCTB payments for low-income families can be almost 33% (with 3 kids), not including provincial programs. This "hidden tax" is higher than the tax rate, and has a big impact on the optimal RRSP contribution strategy. In this case, borrowing for RRSPs just for one year can produce "free" government money via significant reduced clawbacks, even after accounting for the interest expense.

Long-term RRSP loans are probably not realistic, due to lack of cashflow.

## **Middle-Income Families**

When combined family income exceeds ~\$36,000, the CCTB clawback drops to 4% for two or more children. Cash from reduced clawbacks is minor, but still adds up if invested over the long term.