


Should University Students Contribute to an RRSP?

By FT (<https://milliondollarjourney.com/author/ft>) | July 27, 2010 | 26  (<https://milliondollarjourney.com/should-university-students-contribute-to-an-rrsp.htm#comments>)

Linda, a University student, is on the financial ball and considering starting her RRSP contributions (<https://milliondollarjourney.com/rrsp-deadline-march-1.htm>) but is wondering if it's the best choice. Here is the question:

I am going into my 3rd year of university and just started a well paying summer job. I have been hearing about RRSPs since high school and the value of starting it early. As this is my first job I have not reported income before this year. I already have a TFSA so perhaps it is simpler just to put my earnings there. It would be beneficial putting it in the TFSA if I needed to make a withdrawal, right? (because then there would be no penalties for withdrawing my money)

Are there any benefits for a student like me to start a RRSP at this stage? I couldn't find much information targeted to my scenario, but I guess I am just an early and avid business student.

To start, RRSP contribution room is based on 18% of the previous year earned income + any unused contribution room from previous years. In this case, Linda states that she has never reported income before, thus I'm going to assume that she hasn't built up any RRSP contribution room yet. However, even if she does have RRSP room available, should she contribute?

To me, it doesn't make a lot of sense to contribute to an RRSP at this stage of her life as her income is low, thus the tax refund would be low. The goal of the RRSP is to contribute during high income working years and withdrawing during lower income retirement years. The higher the tax bracket, the greater the advantage of the RRSP and the opposite is true.

If Linda is dead-set on using the RRSP, then I would suggest contributing but carry forward the tax deduction (<https://milliondollarjourney.com/rrsp-tip-carry-forward-your-rrsp-tax-deduction.htm>) for future higher income years. This way, she gets to take advantage of the tax deferral of the investment gain within RRSP, let her investments compound without tax drag, and look forward to large tax refunds in the future.

One issue with putting all your savings within an RRSP are the withdrawal penalties. Although Linda may be in a low tax bracket, thus withdrawals would face minimal tax, there is still the RRSP withholding tax (<https://milliondollarjourney.com/should-i-withdraw-from-rrsps-to-pay-credit-card-debt.htm>) upon withdrawal. In other words, upon withdrawing the first \$5,000, 10% would be withheld and a greater percentage as the withdrawal amount increases.

To avoid the RRSP problems in this case, the Tax Free Savings Account (<https://milliondollarjourney.com/federal-budget-2008-tax-free-savings-account-tfssa.htm>) (TFSA) provides an ideal location to store savings. While the deposits do not get a tax deduction, the withdrawals are not taxable or penalized in any way. The icing on the cake is that most gains within the account are not taxable. As Linda is a student, I'll assume that she may need liquidity to pay for her studies in the upcoming semester, so I would suggest to continue putting cash in her TFSA.

Did you contribute to an RRSP as a student?