Strategies for how to contribute to an RRSP after receiving a sizable inheritance

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Canadians who have significant unused RRSP contribution room and received a healthy inheritance can make a supersized contribution one year and start to benefit from tax-sheltered investment growth, but spread the income tax deductions over multiple years.

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Many millennial and some Generation Z Canadians have accrued tens of thousands of dollars of unused registered retirement savings plan contribution room from early in their careers. As some begin to receive inheritances amid the great wealth transfer, registered retirement savings plans (RRSPs) can be an ideal place to invest some of their newfound wealth while benefitting from income tax deductions.

Canadians accrue 18 per cent of their earned income from the previous year in RRSP contribution room every year, up to the year's maximum contribution limit. For 2024, the maximum annual contribution is $31,560, and in 2025 it's $32,490. Unused contribution room carries forward and is added to the annual contribution limit.

Canadians' median RRSP contribution was $3,910 in 2022, according to Statistics Canada data released in April, 2024. RRSP contributions declined across all age groups in 2022, with tax filers aged 25 to 44 showing the biggest change. The agency doesn't release information on unused contribution room.

Kurt Rosentreter, portfolio manager at Manulife Wealth Inc. in Toronto, says he often works with millennial clients who've recently received an inheritance. Whether to make contributions to their RRSP, tax-free savings account (TFSA) or tax-free first-home savings account depends on the client's financial goals, annual income and marginal tax bracket.

For those with higher incomes and large carry-forward room, an RRSP becomes a consideration, he says, and a smart way to bring taxable income down.

Mark McGrath, certified financial planner and associate portfolio manager with PWL Capital Inc. in Squamish, B.C., says that while the question of contributing inheritance funds to an RRSP or TFSA largely comes down to tax bracket calculations, clients should also consider the TFSA's flexibility.

"You can withdraw at any time, for any reason, and you don't lose that contribution room," he says of TFSAs. "With RRSPs that's not the case."

There's also uncertainty associated with RRSPs because there's no guarantee of what someone's tax bracket will be decades in the future. Contributing to an RRSP later at a higher tax bracket could be more beneficial.

Tina Tehranchian, certified financial planner and senior wealth advisor at Assante Capital Management Ltd. in Toronto, says clients who have significant unused RRSP contribution room can make a supersized contribution in one year and start to benefit from tax-sheltered investment growth, but spread the income tax deductions over multiple years.

This strategy works particularly well for clients expecting growth in their income or a jump to a new tax bracket in the next couple of years, such as a client who's about to sell an asset and incur capital gains, or who's expecting a raise. Using deductions from the inheritance can offset the higher income.

The problem with receiving an inheritance and contributing to an RRSP gradually every year is "you'll have to invest it somewhere in the meantime," Ms. Tehranchian says. If that's a non-registered account, it means incurring capital gains when transferring investments to the RRSP.

"If you put it all in the RRSP right away, you get the benefit of tax sheltering, providing you have the room."

Mr. McGrath also favours making a larger contribution and spreading the tax refunds over several years, noting that claiming most or all of the deduction in one year would have diminishing returns.

But he says the biggest consideration for people spreading out their tax deductions is the impact of the time value of money – the theory that "a tax refund five years from now is worth less than a tax refund today," because a larger tax refund in the present day could be reinvested in the market and experience compound growth over multiple years.

However, he acknowledges it can become "a pretty convoluted calculation" as it's based on expected returns that may not come to pass.

Mr. Rosentreter says making a major contribution is the ideal approach, but a client who doesn't have enough unused RRSP contribution room could spread contributions over several years to get similar tax savings benefits.

"That will slowly build up your RRSP for the purposes of getting some tax deduction, the purpose of driving toward the retirement goal, of building up some money for the homebuyers plan if real estate is in your future as well," he says.

Clients who max out their RRSP room and have a strong marriage or common-law relationship could also consider contributing additional inheritance funds to a spousal RRSP for their partner, Mr. Rosentreter says. "You build wealth in their name and get the tax deduction," he says.

But he acknowledges that would have implications in the event of a marriage breakdown. Canadian family law generally treats inheritances as exempt from the division of assets, although the growth in value of those assets throughout the marriage is subject to equalization. But when inheritance funds are commingled with joint assets, they become family property to be divided equally at the time of a divorce.