Should I contribute to a TFSA, RRSP, or both?

With the availability of Tax-Free Savings Accounts (TFSAs), does it still make sense to contribute to a Registered Retirement Savings Plan (RRSP)? Determining which plan, or combination of plans, is best depends on your personal situation and your objectives.

The tax assistance provided by a TFSA is, in many ways, the opposite of that provided through RRSPs:

- RRSP contributions are tax-deductible, with both the contributions and the investment earnings taxable upon withdrawal. Withdrawals are included in income and affect eligibility for federal income-tested benefits and tax credits
- TFSA contributions are made from after-tax income, with both the contributions and the investment earnings exempt from tax upon withdrawal. Withdrawals will not affect eligibility for federal income-tested benefits and tax credits

Generally, an RRSP is used for saving for retirement, while a TFSA can be used for both saving for retirement and other shorter-term needs. Because TFSA withdrawals are added back to your available TFSA contribution room in the following calendar year, there is very little downside to using TFSA savings for mid-sized to large purchases.

If you are in a low tax bracket, saving in a TFSA may be more advantageous than saving in an RRSP, since TFSA withdrawals have no impact on federal income-tested benefits and tax credits such as child tax benefits and Old Age Security. If you are in a high tax bracket, you will probably consider using both types of plan. RRSPs may be a better option if your tax rate at the time you contribute is higher than when you withdraw your savings. You'll benefit from a tax deduction when you make your contribution and withdrawals will be taxed at your lower future rate. If the reverse is true, a TFSA can provide better results.

Whether to save in a TFSA, an RRSP or both may depend on your savings needs, your eligibility for income-tested benefits and your current and expected future financial situation and income level. Anyone saving outside an RRSP should consider contributing to a TFSA first.

Talk to your advisor

Your advisor can help you determine the amount you need to save to achieve your goals and the most appropriate investments for your risk tolerance. He or she can also help you take advantage of the tax-advantaged investment strategies that are available to Canadian investors of all ages.

Comparison of savings options

	Non-registered	RRSP	TFSA
Annual contribution limit	Unlimited	Yes – based on earned income	Yes – no earnings requirement
Legislated minimum age to contribute	No	No	Yes – age 18
Legislated maximum age to contribute	No	Yes – end of year you turn age 71	No
Carry-forward of unused room	n/a	Yes	Yes
Tax-deductible contribution	No	Yes	No
Monthly penalty on excess contributions	n/a	Yes – on excess at month end	Yes – on highest excess during month[1]
Tax-deferred/tax-free investment growth	No	Yes – tax-deferred	Yes – tax-free
Taxable on withdrawal	Taxable disposition	Fully taxable	Tax-free – except for growth after death if spouse not successor holder
Withdrawals added to contribution room	n/a	No	Yes – but not until the following calendar year[2]
Withdrawals impact federal income-tested benefits and tax credits	Yes	Yes	No
Interest deductible on loan to invest	Yes	No	No
Available for use as collateral for a loan[3]	Yes	No	Yes
Tax-deferred/tax-free transfer to spouse[4] on death	Yes	Yes	Yes – if successor holder or value at date of death
Tax-deferred/tax-free transfer to second generation on death	No	No – fully taxable unless financially dependent	Yes – investment income after date of death is taxable
Loss denied on transfer-in-kind to plan	Yes	Yes	Yes

[1] Any income attributed to deliberate over-contributions will be taxed at 100 per cent.

[2] The withdrawal of amounts in respect of deliberate over-contributions, prohibited investments, non-qualified investments, asset transfer transactions and income related to those amounts does not create additional TFSA contribution room.

[3] You should be fully aware of the risks and benefits associated with investment loans since losses as well as gains may be magnified.

[4] Includes a spouse or common-law partner as defined by the *Income Tax Act* (Canada).

Solutions

Garry Forde
Indepth Planning Corp.
202 2286 Mccallum Rd.
Abbotsford, BC, V2S 3P4
604-859-1658
advisor@indepthplan.com

strong reliable trustworthy forward-thinking

Manulife Investments

For your future™

TMK1442E 12/12