Global Asset Management

PLANNING FOR YOUR FUTURE

RRSPs vs TFSAs

Learn the basics

What is an RRSP?

A Registered Retirement Savings Plan (RRSP) is an account designed to help Canadians plan for their future. Your RRSP is an investment portfolio, meaning it can hold a variety of investments like mutual funds, ETFs, guaranteed investment certificates (GICs), bonds and equities.

Essentially, by “registering” your retirement savings plan you’re entering into a contract with the government: you put money away for retirement and they provide some perks. And those perks are what make RRSPs special.

What’s in it for me?

Anything you contribute to your RRSP is not taxed until you withdraw funds at retirement, which means more money down the road. Say you make $50,000 this year and put $5,000 of that in your RRSP account. This contribution can be deducted directly from your income so that only $45,000 is considered taxable by the government.

Another benefit is that any investment gains you make within the RRSP are able to grow tax-deferred until you withdraw money from the account. When interest and earnings on investments are not taxed, you gain more, leading to more money for you to spend in retirement. When you do begin to withdraw money from your RRSP, you’ll most likely be retired and earning much less than when you were working, and will therefore be in a lower tax bracket.

The details

Since an RRSP is a registered plan, there are rules around how much you can invest and for how long. First, you can contribute to your RRSP until December 31 of the year you turn 71, then you have to convert it to another vehicle, such as a RRIF. Second, there is a maximum you can contribute. The amount changes from year to year. For 2018, the total amount that can be contributed is the lesser of $26,230 or 18% of your earned income the previous tax year (plus any unused RRSP deductions from previous years). In 2019, the limit will be bumped to $26,500.

What is a TFSA?

The Tax-Free Savings Account (TFSA) was introduced in 2009 to encourage people to save for retirement. You're eligible to start contributing as soon as you turn 18.

What's in it for me?

This account can hold a basket of investment products – GIC's, mutual funds, ETFs, stocks, bonds, etc. And even though the money you put into your TFSA is 'after-tax income,' the gains you make from the investments inside are tax free. There's good news on the withdrawal side too. You can withdraw money from your TFSA at any time and withdrawals are not taxed.

The details

Maximum annual contributions can change each year, so for 2019 you can put in up to $6000, but check back next year to keep on top of the limits. Any unused contribution room can be carried forward to future years, and if you do decide to withdraw money, the withdrawal amount is added back to how much you can contribute the next year. The fact that the money you take out of your TFSA isn't considered income is even more important for retirees. Why does this matter? It means you can take money out without it affecting other benefits (like Old Age Security) that are based on income.

What's the difference between a TFSA and RRSP?

They're both investment accounts with tax advantages but there are important distinctions between the two:

TFSA

- Contributions are not deductible from income
- Growth within your account will be tax free
- When you contribute to a TFSA, you have already paid tax on the money you deposit
- With a TFSA, there is no tax on any money you take out (including any interest, dividends or capital gains earned)
- TFSAs have no age limits and can be appealing for seniors who don't need the money immediately – you're not required to make withdrawals as with a RRIF
- Can be used for short-term goals, such as saving for a house or a car, and long-term goals like retirement

RRSP

- Contributions are deductible and reduce your income for tax purposes
- Income earned in your RRSP is not taxed until it is withdrawn. Capital growth is tax sheltered and so the total value may grow more quickly
- Money you withdraw from an RRSP is added to your income and taxed accordingly
- You can contribute to an RRSP until December 31 of the year you turn 71, then you have to convert it to another vehicle, such as a RRIF

Talk to your financial advisor to find out which account type is right for you based on your individual goals and needs.

Disclosure