Make the Most of RRSPs and TFSAs

Saving for retirement is typically the biggest and most important of our long-term goals. Who doesn't want to spend retirement enjoying their preferred lifestyle? Two popular vehicles to help Canadians save for retirement are the Registered Retirement Savings Plan (RRSP) and Tax-Free Savings Account (TFSA). Let's look at the basics of each savings vehicle.

RRSPs

The RRSP generates retirement income to supplement personal savings and company/government pension plans. You may open an RRSP once you begin earning taxable employment-related income. For each calendar year, the maximum contribution is 18% of earned income, to an upper limit set by the federal government. If you don't make your maximum allowable contribution in a given year, you may carry forward unused contribution room to future years.

Your maximum annual limit is reduced if your employer makes contributions for you to a registered pension plan (RPP) or deferred profit-sharing plan (DPSP). Check your income tax return statement for the next year's RRSP contribution limit, and your annual T4 tax slip for how much your employer has contributed to your RPP and DPSP.

RRSP contributions are tax deductible, reducing income tax payable. Investments you may hold in an RRSP are wide ranging, from mutual funds and stocks to bonds, GICs and more. If your investments earn capital gains, dividends or interest, that growth is not taxed until you begin withdrawing assets (you may convert your RRSP to a Registered Retirement Income Fund or annuity no later than December 31 of the year you turn 71). Tax-deferred growth allows you to build wealth more effectively than paying tax on growth as it's earned.

TFSAs

This savings vehicle started in 2009. You may open a TFSA once you turn 18, and contribution limits are set by the federal government rather than being a percentage of earned income. The government occasionally increases the annual contribution limit based on inflation rates.

Similar to RRSPs, a TFSA can hold different investment products, and any growth won't be taxed when earned. In fact, you're never taxed on TFSA withdrawals since you've made contributions using after-tax dollars, while RRSP contributions are made with pre-tax dollars. As with any investment, the value of your holdings may decline. Historically, investments have tended to rise over time, but it's not guaranteed and you'll likely experience periods of volatility where your investments rise and fall based on economic/market conditions.

There's no mandatory age limit to begin TFSA withdrawals, and if you do withdraw some money, you may recontribute this amount later (just not the same calendar year) without penalty or impact on subsequent annual contribution limits.

RRSP or TFSA?

If possible, it's valuable to maximize contributions to both plans. But if you're not in a position to do so, consider your financial situation to help determine the better plan to focus on.

For instance, an RRSP is often suitable if you're in a high tax bracket but expect your income to be lower in retirement. That's because the tax deduction from RRSP contributions and the savings from tax-deferred growth will be relatively high. If you're in a lower tax bracket in retirement, your withdrawals won't attract as much tax as they would have during your higher-income years.

Conversely, if you're in a lower tax bracket and are less impacted by income tax – on a relative basis – than a high-income earner, consider prioritizing TFSA contributions since upfront RRSP tax deductions won't be as advantageous. Also, if you're saving for a large purchase, such as a vehicle, home or vacation, a TFSA helps build your savings on a tax-free basis. When it's time to make your purchase, you can withdraw the funds without tax consequences and will maintain contribution room for future years.

Benefit from professional advice

Deciding which savings plan to prioritize and what investments to put into your plan(s) can be difficult. Both plans are effective at helping you save for retirement and generate the income you'll need. Your advisor can help create a retirement savings strategy that reflects your preferences and financial circumstances.

Contact us today if you're ready to start investing for your financial future.