Here's what you need to know about RRSPs and TFSAs

A common question that is often asked when talking about saving is "should I be using a Registered Retirement Savings Plan (RRSP) or Tax-Free Savings Account (TFSA)?"

When deciding this, you have to take into consideration many factors such as tax rates and time horizon of objective to name a few. To first understand how we make that choice, we must understand the differences between the two types of accounts.

Registered Retirement Savings Plan (RRSP) – These accounts would be typically considered for retirement savings, and are funded with pre-tax dollars. You are able to contribute based on 18% of your "earned income" or a maximum of $26,230 for 2018. As most people's income will drop in retirement, you have the benefit of getting a deduction at a higher tax rate when you contribute and paying a lower tax rate when you take it out in the future. Any money taken out of an RRSP is included at income and taxed at your marginal tax rate, and you do not get the contribution room back. If you do not contribute to your RRSP the room will continue to accumulate and can be used in future years before you turn 71. You may also borrow from RRSP's for a down payment on your first home, or to go back to school.

Tax-Free Savings Account (TFSA) – This account has more flexibility surrounding how it can be used. As of 2019 the total TFSA contribution limit is $63,500. Each year you are allowed to contribute a specific amount. In 2019 the amount was $6,000. When funding the TFSA you use after-tax dollars, but any of the growth is not taxed and when it is taken out there are no tax consequences. When you take money out of a TFSA you get the contribution room back the following calendar year.

What are my savings for? A new car, a vacation, retirement?
If you are saving for a shorter term goal such as new car or vacation, a TFSA would be the best solution as you have the flexibility to withdraw funds without any tax consequences. With the ability to have tax free growth and no tax consequences upon withdrawal this can make it an idea account to save for shorter term goals such as a new car, home renovation, or vacation.

When looking from a tax perspective, a question to ask would be "do I believe I will be in a higher tax bracket or a lower tax bracket when I retire". If the answer is a higher tax bracket, the TFSA is the best option. If the answer is a lower tax bracket, the RRSP is the best option.

When making this choice it is always best to speak with a financial advisor as most people have multiple financial goals and professional advice will help to prioritize where your money should go.

RRSP vs. TFSA

	RRSP	TFSA
Need earned income to contribute	✓	✗
Tax deductible contributions	✓	✗
Earnings are sheltered while in plan	✓	✓
Tax free withdrawals	✗	✓
Age limit for making contributions	✓	✗