The Stan Clark Financial Team's

PERSPECTIVES

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Financial planning

Put your money in a TFSA or an RRSP?

By Sylvia Ellis, Senior Estate Planning Advisor

Since the Tax Free Savings Account (TFSA), was first introduced on January 1, 2009, many people wonder how it compares in attractiveness to a Registered Retirement Savings Account (RRSP). If you can't put money into both a TFSA and an RRSP, which one should you choose?

The two plans are actually meant to be tax-neutral. For people who are being taxed at the same rate now as they will be in retirement, this means the TFSA and RRSP are equally suited.

Let's look at an example that compares the after-tax growth of $5,000 over 20 years:

	TFSA	RRSP
Pre-Tax Income	$5,000	$5,000
Tax (40%)	(2,000)	n/a
Net contribution	$3,000	$5,000
Growth @ 5% for 20 years	$7,960	$13,266
Tax upon withdrawal	n/a	(5,306)
	$7,960	**$7,960**

Basically, the money contributed to a TFSA is taxed up-front, and the funds going into an RRSP are only taxed upon ultimate withdrawal. But the end results are identical.

Many people are inclined to contribute to an RRSP rather than a TFSA because they want the RRSP's tax refund. But Jamie Golombek, managing director of Tax and Estate Planning at CIBC Wealth Management, urges you to remember that "the refund associated with an RRSP contribution should not be considered a windfall but rather the present value of the future tax payment that will have to be made on the ultimate RRSP withdrawal (assuming tax rates are constant)."

Jamie explains that, even if you invest your tax refund in a TFSA (and assuming your TFSA grows at the same rate of return as your RRSP), then the value of your TFSA will equal the amount of future tax payable upon your RRSP withdrawal.

"The growth of the refund is meaningless, because at the end of the day, you end up paying back the refund with interest at the same rate of return that you're earning inside of your RRSP."

What's the key to answering the RRSP versus TFSA question? It helps to try to determine what your tax rate might be in retirement compared to what it is now, or until then. Here are the two situations that can affect your decision today:

1. If the tax rate at the time of withdrawal is lower than at the time of contribution, the RRSP is a better choice.
2. If the tax rate at the time of withdrawal is higher than at the time of contribution, the advantage goes to the TFSA.

When considering your tax rate on withdrawal, you also have to factor in the effect of RRSP withdrawals on benefits such as the Guaranteed Income Supplement or Old Age Security, which might be clawed back because of withdrawals from an RRSP or a Registered Retirement Income Fund (RRIF). Neither would be affected by withdrawals from a TFSA.

TFSAs also have advantages, including greater flexibility and more control – that is, access to capital that allows you to dictate the terms of how you use your money.

So, should it be a TFSA or an RRSP? It depends on your income and tax rates, and how these compare now to retirement. If you would like help determining what is best for you, please do not hesitate to ask us. ■

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