Should You Invest in a TFSA or an RRSP?

Description

Some investors are confused about whether to use tax-free savings accounts (TFSAs) or registered retirement savings plans (RRSPs) to invest for their future. The short answer is that both should be used if possible. However, there's a longer, more detailed answer to the not-so-simple question.

Using TFSAs

TFSAs are great for anyone who's 18 years old or older to save. TFSAs can be used for saving for both short-term and long-term goals. You can withdraw from it anytime without penalty. However, if you use it to save for retirement, you've got to be disciplined to not withdraw from it.

You can open as many TFSA accounts as you want, but there's a contribution limit for each year. If you were 18 years old in 2009 when the program started and you've never contributed to a TFSA, your total contribution limit is $46,500.

This year's contribution limit is $5,500. So if you're 18 with a social insurance number, you can contribute $5,500 in total across any number of your TFSA accounts.

Using RRSPs

The income you earn every year creates more contribution room for your RRSP, and that room accumulates. When you reach a high tax bracket, you can contribute to an RRSP to reduce taxes.

TFSAs or RRSPs?

If you're in a low tax bracket, it makes more sense to save and invest in TFSAs for tax-free growth instead of investing in an RRSP for tax-deferred growth.

You can lower your taxes and potentially lower your tax bracket by investing in RRSPs. Investors in high tax brackets might decide to contribute to RRSPs first to reduce their taxes and tax brackets. After contributing to their RRSPs, they should also consider investing in their TFSAs.

Conclusion: What to invest in?

Since stocks historically deliver higher returns than other investments, it makes sense to dollar-cost average into stocks over time to invest for the long term.

Investors can invest in exchange-traded funds with broad market exposure, such as **SPDR S&P 500 ETF Trust** (NYSEARCA:SPY), or quality individual stocks that have beaten the general market over time, such as **Alimentation Couche-Tard Inc.** (TSX:ATD.B) and **Union Pacific Corporation** (NYSE:UNP). Couche-Tard and Union Pacific delivered annualized returns of 23% and 16%, respectively, over the past decade, while the average market returns per year were 7%.

It's best to buy when equities are relatively cheap, which is usually when they dip at least 15-30% or when the market dips that much. For individual companies, the lower their credit ratings, the bigger the margin of safety that investors should wait for before investing.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:UNP (Union Pacific)

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