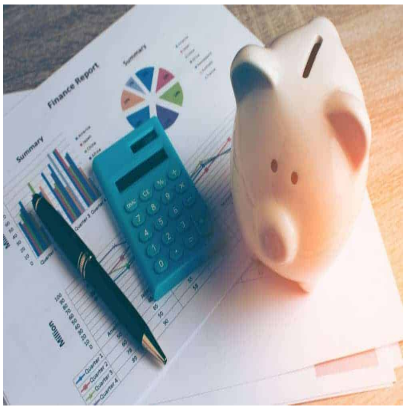

TFSA vs. RRSP: Which Is the Better Option?

Description

A recent poll found that up to one-third of Canadians didn't know the difference between an RRSP and a TFSA, which is a concerning figure since making the wrong decision could have significant tax consequences. While you may have done the research and decided to invest in a blue-chip stock like **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), knowing where to put that investment is just as an important decision to make.

Both types of accounts have their advantages and disadvantages, and so it really comes down to some key questions that you should be asking yourself.

Why it all might come down to the income you're making today

Since the main advantage of an RRSP is deferring taxes, you'll want to ask yourself how long you think you'll be working and whether you'll be making more in your retirement years than you are now. The danger is that people that contribute to an RRSP today that are in a low tax bracket aren't going to be saving much in the way of taxes by deferring that taxable income later down the road.

TD, for example, can generate a lot of dividends for your portfolio, as the stock pays 3.5% annually, and over the years it has regularly increased its payouts. And in an RRSP, you won't have to pay on the wealth you build until you actually start withdrawing funds from your account, at which point they will become taxable. So, while you may have avoided the taxes in the year you contributed and gotten a tax credit, if you're generating an income when you pull the funds out, you could be in a higher tax bracket, which could negate any benefits from putting the investment into an RRSP.

With a TFSA, however, you are contributing after-tax dollars to your account, so if you're holding TD stock in there, you won't have to worry about paying taxes later on those gains and dividends. And it's not only dividends, but any capital appreciation will also be shielded from the tax man, which is very important for a stock like TD, which has grown more than 300% over the past 10 years.

Going forward, there's still lots of potential growth available to TD, as it continues to show strong returns in the U.S., and the bank stock will also benefit from both economies doing well, as that will lead to more mortgages and other fees. TD isn't even a big growth stock, and yet it has generated significant returns for investors over the long term. If you were to invest into a stock with more growth potential, then there could be even more income at stake, and that's why knowing which account to put the investment in is a crucial decision for investors.

Bottom line

There are many factors for investors to consider, but at a high level the most important one you should be asking is whether you'll be making more when you draw the funds out versus when you contribute them. That's a good starting point for any type of analysis, and while it won't take every possible factor into consideration, it'll get you started on the right path and asking the right questions.

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2. Investing

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