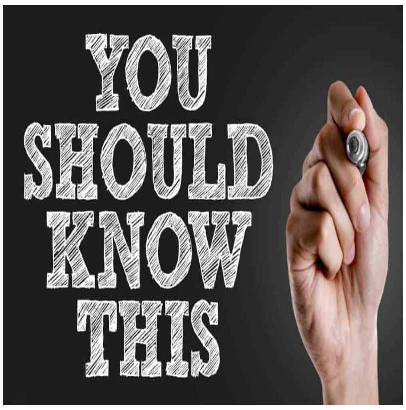

CRA: 1 Little-Known Way Your RRSP Is Taxed Less Than Your TFSA

Description

The Tax-Free Savings Account (TFSA) and Registered Retirement Savings Plan (RRSP) are tax-sheltered accounts in Canada. Both investment vehicles are supposed to provide the utmost tax benefits to account holders.

Each account has investing rules, although there's a striking commonality. The eligible investments in a TFSA are also permitted in an RRSP. Thus, you can hold cash, bonds, exchange-traded funds (ETFs), mutual funds, guaranteed investment certificates (GICs), and stocks in either account.

The Canada Account Agency (CRA) allows foreign investments, but there's a catch. While Canada's Income Tax Act no longer imposes limits on investments from abroad, users should be aware of the tax implications. U.S.-based dividends paid to a TFSA, in particular, are subject to a 15% withholding tax.

However, if you were to invest in foreign assets, hold them in your RRSP. A special tax treaty between Canada and the U.S. has existed since 2005 that grants tax exemptions for investments held in an RRSP but not in a TFSA.

Special tax exemption

Users can include foreign stocks in their TFSAs or RRSPs, provided the publicly listed company belongs to the CRA's designated stock exchanges. Most Canadians would invest on American stock exchanges besides the local bourse to further diversify. Canada and the U.S. established a tax treaty that covers Canadian pension plans, including the RRSP.

The agreement between the two countries stipulates that investments in U.S. entities held in an RRSP are tax-free. Unfortunately, this tax exemption doesn't apply to a TFSA. The U.S. deems it not the equivalent of a pension plan. Dividends earned from the U.S. and paid to a TFSA are subject to a 15% tax.

If you're an RRSP user, your dividend portfolio could have 100% foreign content. The same goes for the Registered Retirement Income Fund (RRIF) users. Furthermore, RRSP or RRIF users can mix local and foreign securities to maximize returns and minimize risk.

Value for money

National Bank of Canada (TSX:NA) doesn't belong to the elite Big Five banks, but it's an equally attractive option for long-term dividend investors. The stock's performance in the COVID year is proof it can hold a candle to its bigger industry peers.

Thus far in 2021, National Bank has outperformed the TSX (+20.69% versus +7.30%). If you were to invest today, the share price is $85.76, while the dividend yield is 3.31%. The dividend payments are safe considering the 49.82% payout ratio.

Over the last two decades, National Bank shares' total return is 1,284.99% (14.03% CAGR). Even market analysts are bullish on Canada's sixth-largest bank. They forecast the price to hit $98 (+14.2%) in the next 12 months. The growth estimate in the next five years is 8.84% per annum.

The balance sheet of this $28.88 billion bank is well balanced, and the credit quality is strong. TFSA or RRSP investors get value for money plus a resilient business model that can endure economic downturns.

Taxing decision

Whether you're a TFSA or RRSP user, you must determine which of two provides more tax-savings benefit. You don't pay tax at all on TFSA withdrawals. The RRSP offers tax-free money growth today, but the CRA taxes fund withdrawals in the future. If you can properly manage your accounts, you can reduce your tax burden significantly.

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1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. TSX:NA (National Bank of Canada)

PARTNER-FEEDS

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Date
2025/08/14
Date Created
2021/04/02
Author
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