27% of Canadians Are Making This Huge TFSA and RRSP Mistake

Description

Canadians 18 years old and above can open a Tax-Free Savings Account (TFSA) or Registered Retirement Savings Plan (RRSP) or both to meet financial goals. The RRSP was introduced in 1957, while the TFSA followed in 2009. Either way, users benefit from the power of compounding.

However, based on a **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) survey, about 27% of Canadians don't understand the critical difference between the two. Also, some respondents are unsure of how a TFSA (30%) and RRSP (35%) impact taxes. It's a mistake if users can't comprehend fully how each account could affect overall savings and tax strategies.

Common misconception

The TFSA and RRSP are complementing investment vehicles, so it's beneficial to have both accounts. In TD's survey results, over one in five respondents use their TFSAs to help reduce their taxable income for the following year. Unfortunately, you won't get the desired results that way because the tax incentives are different.

TFSA contributions will earn tax-free money from income-producing assets and offset tax payables, but it won't reduce taxable income. On the other hand, RRSP contributions are tax-deductible. Hence, the plan is more effective in bringing down taxable income.

Build wealth and reduce taxes

Let's dive into the nitty-gritty of creating tax-efficient structures in your TFSA and RRSP. First, you don't derive tax-deduction benefits when you make TFSA contributions. However, TFSAs offer more flexibility than RRSPs. TFSA withdrawals are also not subject to tax.

The tax advantages feature of a TFSA has no expiration date. Unlike the RRSP, you can continue to build wealth on a tax-free basis past 71 years old. Also, withdrawing TFSA funds won't affect income-tested benefits like the RRSP and Registered Retirement Income Fund (RRIF).

The Canada Revenue Agency (CRA) can claw back Old Age Security (OAS), Guaranteed Income Supplement (GIS), and even Employment Insurance (EI) payments when you withdraw from your RRSP or RRIF.

While RRSP contribution limits are typically higher, contributions lower taxable income immediately. Also, the tax benefit is more significant if you belong to a higher income bracket. Moreover, a spousal RRSP allows you to reduce tax liability today and in the future by splitting your income with your partner.

Eligible investments

TFSA and RRSP users can hold bonds (government and corporate), mutual funds, GICs, ETFs, and stocks in their accounts. Since the goal is to build wealth or a substantial nest egg, the advice is to invest in a blue-chip stock like TD. Canada's second-largest bank has been paying dividends for more than 100 years.

At $88.11 per share, the $160.22 billion bank pays a 3.59% dividend and maintains a less than 50% payout ratio. Over the last 48 years, TD's total return is 39,162.95% (13.16% compound annual growth rate. TD's retail products have a composite market share of about 21% in Canada, enough to occupy the top or second market share position.

TD is 166 years old, yet industry experts still regard it as a growth company. Expect the bank to expand further in the U.S. following its acquisition of **Wells Fargo's** Canadian direct equipment finance business this year.

Recommended route

Focus on saving money in a TFSA when your salary is lower. When your earning grows and likely to land you in a higher tax bracket, contribute the maximum to your RRSP to give you a tax deduction upfront.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:TD (The Toronto-Dominion Bank)
2. TSX:TD (The Toronto-Dominion Bank)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Yahoo CA

Category

1. Bank Stocks
2. Dividend Stocks
3. Investing

Date
2025/07/05
Date Created
2021/05/28
Author
cliew