Should You Contribute to Your TFSA or RRSP in 2022?

Description

The Tax-Free Savings Account (TFSA) and Registered Retirement Savings Plan (RRSP) are both excellent tools to help you save money. Ideally, you should contribute to both your TFSA and RRSP. However, we have other obligations, and resources are limited. So, Canadians should prioritize the tax-advantaged account to contribute to first.

In any case, using the TFSA or RRSP as a savings tool is not the best mindset to have. Savings accounts earning interest aren't earning much these days because of low interest rates. Therefore, if you plan to park your money for a long time, consider investing in stocks that can provide stable returns no matter what happens in the economy.

One blue-chip stock even new investors can consider today is **Enbridge** (TSX:ENB)(NYSE:ENB). The Canadian Dividend Aristocrat is perfect for current income and predictable returns. As the leading energy infrastructure company in North America, it generates stable cash flow. Additionally, it maintains a sustainable payout ratio. Its yield is close to 7% today! So, by holding the dividend stock, investors are pretty much guaranteed a 7% return.

The stock trades at a 10% discount from the analyst's 12-month price consensus price target. In the last couple of years, ENB stock has increased its dividend by about 3% per year. Projecting this growth rate into the near future and ignoring any valuation expansion potential, investors should get long-term returns of at least 10% per year over the next five years.

An investment in solid dividend stocks like Enbridge will mostly likely beat low interest-earning investments in the long run.

Contribute to your TFSA

All Canadians eligible for a TFSA should maximize their contributions for tax-free growth, especially if you're in a low tax bracket. Consider saving your RRSP room for future years when you're in a higher tax bracket.

Some investors believe it makes more sense to earn interest income in their TFSAs, because interest income is taxed at the marginal tax rate. At the end of the day, it depends on your investment portfolio mix. Think of how much tax you’re saving and ultimately how much money you’re keeping in your pocket.

The best five-year GIC rate is 2.7% right now. For example, if you live in British Columbia and earn more than $50,197 and less than or equal to $86,141, a $6,000 GIC earning a 2.7% interest rate generates annual interest income of $162 and is taxed $45.68 this year on this income. The same investment earning a 7% dividend yield generates income of $420 a year and is taxed $6.85 this year on this income. Half of the booked capital gains on the stock are taxed at your marginal tax rate, which has an effective tax rate that’s half of the tax rate for interest income. The scenario should be similar no matter where you live in Canada.

On an initial look, it seems logical to hold GICs in the TFSA and ENB stock in the taxable account for Canadians who own both GICs and ENB stock for income. However, holding solely solid stocks in the TFSA (and zero interest-earning investments) would lead to faster growth of the TFSA. Consequently, if you can stomach the risk, it would be a good idea to invest in quality stocks.

Contribute to your RRSP

If you’re in a high tax bracket, you should contribute to your RRSP first, which can significantly lower your income tax for this year. You can use the refunds to invest and even contribute to your TFSA.

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