5 Tips for Using TFSAs and RRSPs

Description

Some Canadians struggle with not knowing which account to save and invest in. Should you prioritize contributing to the Tax-Free Savings Account (TFSA) or the Registered Retirement Savings Plan (RRSP)? Here are some tips that can help you with your investments that are for retirement or otherwise.

All Canadians should invest in TFSAs

You're eligible for opening a TFSA once you turn 18 and have a valid social insurance number. Each year, there's a maximum amount of money that you can contribute into your TFSA. It's called the TFSA limit. The 2022 TFSA limit is $6,000. It means that you can contribute up to $6,000 across multiple TFSAs for tax-free earnings.

For example, you might put $3,000 in a GIC in a TFSA, because GIC produces interest income that are otherwise taxed at your marginal tax rate in a non-registered account. You might then have another TFSA account where you'd contribute the remaining $3,000 to invest long term in stocks and bonds.

If you were eligible for the TFSA since its inception in 2009 and never contributed to an account, you'll have $81,500 of contribution room. Let's say you do have this much TFSA contribution room that you haven't touched. If you invest $81,500 in your TFSA now and contribute $6,000 every year going forward for a 10% return every year, you'll accumulate $3,554,995 in 34 years! Now that'd be a spectacular retirement fund.

TFSA provides flexible tax-free withdrawals

However, you don't necessarily have to use your TFSA for retirement. You can use it to save for any goals because you can withdraw anytime tax free. Your goals may be to buy a car, pay for a down payment for a home, pay for a vacation, etc. You can re-contribute the amount you withdraw as soon as the next calendar year.

When should you contribute to an RRSP?

Canadians can contribute to their RRSPs to earn tax refunds that can be used for contributing to their TFSAs. RRSP contributions reduce your taxable income and, therefore, reduce your income tax for the year. The general advice is to make RRSP contributions when you're in a relatively high-income tax bracket. If you just started working and expect your tax bracket to climb higher, you might save your RRSP room for future years when you can make a contribution and get a bigger tax refund. Generally, it makes sense to make a bit of RRSP contributions every year versus making a big lump sum in a single year.

TFSA and RRSP contributions: Maximize returns

Once you've made TFSA and RRSP contributions, the goal should be to maximize your returns to make use of their tax advantage. To be exact, a TFSA is tax free other than non-withholding taxes automatically deducted from foreign dividends.

In the case of RRSP, withdrawals will be taxed as ordinary income. RRSPs are meant to help you save for retirement. So, when you withdraw from an RRSP (likely turned RRIF) in retirement, you are expected to have lower income than during working years. In other words, RRSP growth is tax deferred.

Some Canadians might end up withdrawing from their RRSP for living expenses in years that they have low or no income. There will be an immediate tax withholding on your withdrawal. The withdrawal is also counted as ordinary income for the year.

TFSA and RRSP contributions: Strategic portfolio allocation

Since interest income is taxed at your marginal tax rate, some Canadians shelter investments, such as bonds and GICs, which pay interest income, in TFSAs or RRSPs. Ultimately, the goal is to maximize your *after-tax* income. In other words, you'd perform tax planning to minimize your income taxes.

To maximize the dollars you keep in your pocket after tax, you'll need to look at your financial position, including your investment portfolio, and make calculations to determine which accounts are best to hold what investments. If it gets to complex, consider consulting a qualified financial advisor.

CATEGORY

1. Investing

PARTNER-FEEDS

1. Business Insider
2. Flipboard
3. Koyfin
4. Msn
5. Newscred

6. Quote Media
7. Sharewise
8. Smart News
9. Yahoo CA

PP NOTIFY USER

1. kayng
2. kduncombe

Category

1. Investing

Date
2025/09/20
Date Created
2022/09/11
Author
kayng