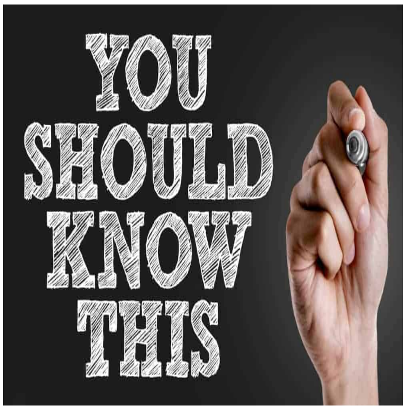

TFSA 101: How to Use it With Your RRSP

Description

The Tax-Free Savings Account (TFSA) has been around since 2009, offering Canadian investors a tax-free way of making investments and saving cash. But what most Canadians may not remember is that when the TFSA was introduced, it was meant as another way to save for your retirement.

Why would you use the TFSA when you have access to the Registered Retirement Savings Plan (RRSP)? It's a good question, and one I hope to answer today. I'll also discuss how you can use the two together to save the most you can for retirement.

What the RRSP offers

Your RRSP certainly does have advantages. Every year, every single dollar you put into your RRSP comes off of your income tax. That means you're only paying tax on everything you earned, minus your RRSP contribution. This can bring you down to an entirely different tax bracket, and it's something I would recommend to every investor.

However, let's say you need the cash immediately. There are very few ways that you can take out cash from your RRSP before retirement. And if you do, there's usually a timeline when you have to re-contribute that cash back into your RRSP. Furthermore, each year, there is a contribution limit, and that's based on your income. You get that from your notice of assessment, and it's definitely something you should pay attention to, because there are penalties if you go overboard.

What the TFSA offers

In comparison, the TFSA offers Canadian investors a way to put cash aside with the ability to take it out at any time, tax free. Don't get me wrong; there are certainly rules to this as well. As you probably already know, each year, the government applies a contribution limit.

If you were 18 years old in 2009, your contribution limit is at $81,500 today. But let's say you turned 18 this year; in that case, you only have $6,000 of contribution room. Furthermore, you really need to be careful when you're taking out cash. Any cash that comes out of your TFSA cannot be re-contributed until the next year. It can get pretty complicated, so make sure you're speaking with your financial advisor before simply taking cash out.

Using them together

Here is what I would recommend if you are an investor wanting to put money in both your TFSA and RRSP, which you absolutely should — especially if you're looking to save for retirement. Each year, I would try to max out your TFSA contributions room as soon as you can. Invest in strong companies, exchange-traded funds, and other stable stocks, then let it grow throughout the year.

Next, when you receive your notice of assessment look at your contribution limit for your RRSP and see what would bring you down to the next tax bracket on your income tax. Then try to reach that amount and take out the cash from your TFSA to help top you up. By doing this, you will save potentially thousands in taxes, and you will have had the added benefit of seeing your savings grow in your TFSA while waiting to invest in your RRSP.

Make it safe

If you're going to do this, make sure you're investing in strong, stable companies. What I would recommend is **Canadian Utilities** (TSX:CU). It's a Dividend King with over 50 years of consecutive dividend growth. You can lock in a 4.37% dividend yield and use the passive income to reinvest and add to your savings whether it's in your RRSP or your TFSA. By doing all this together, on a regular and consistent basis, you will create a larger retirement portfolio that only grows larger year after year.

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