Maximize Savings

RRSP, tax-free savings account or both?

BY DAVID SHUBS

David Shubs is an Investment Advisor and Associate Portfolio Manager at CIBC Wood Gundy. His views do not necessarily reflect those of CIBC World Market Inc. He can be reached at david.shubs@cibc.ca.

The majority of people are familiar with a Registered Retirement Savings Plan (RRSP). The Tax-Free Savings Account (TFSA) was announced in the 2008 budget and has left many people still scratching their heads. How is it used? Does it replace the RRSP? Which should I contribute to?

The TFSA can play an important role in your financial and tax planning. It can be used alone or in conjunction with an RRSP, non-registered account, trust, corporate pensions, etc.

The TFSA is an account that allows every Canadian adult over the age of 18 to invest $5,000 (inflation adjusted) per year. The funds in the TFSA can be invested in the same manner as the RRSP – stocks, bonds, cash, etc. Similar to an RRSP, investment gains are compounded on a tax-free basis within the account. Although there are no income tax deductions for TFSA contributions, a TFSA does have benefits that an RRSP does not.

> **The tax-free savings account can play an important role in your financial planning.**

There are NO taxes on any funds withdrawn from a TFSA.

TFSAs are an all-purpose savings vehicle. You can take money out and then put it back again with no penalties.

Withdrawn money does not count as income when taking it out in retirement. This means that OAS payments are not affected by any withdrawals. A TFSA has no minimum withdrawals, ever.

With an RRSP, you contribute during your working years and receive a tax reduction for these contributions based on your marginal tax rate. The investments in the RRSP grow tax-free until you decide to withdraw some or all of your RRSP assets. At that time, the proceeds will be taxed at your current marginal rate.

If your tax rate at the time of withdrawal is greater than the tax rate when you contributed, the benefits of the RRSP may be somewhat muted.

If your tax rate is the same at the time of withdrawal, the tax deduction received upon contribution will correspond to the taxes payable upon withdrawal.

If your marginal tax rate is lower at the time of withdrawal, there will be an tax benefit in addition to the tax-free compounding

If you were looking to maximize both accounts, depending on the amount of money you have to invest and your tax rate, you may be able to invest in your RRSP and take the tax refund and fund your TFSA.

Should your refund not be the full $5,000, you could be left not maximizing your TFSA. **OHB**

PHOTO: ISTOCKPHOTO.COM/CALVIO