

RRSP vs TFSA: find the right balance

Most Canadians can benefit from having a registered retirement savings plan (RRSP) and a tax-free savings account (TFSA) — both are great tax-sheltered savings vehicles.

The key difference is whether you pay taxes now or later.

RRSP contributions are tax deductible, so they generate a tax credit. But withdrawals are taxed as income. TFSA contributions are made with after-tax dollars, so withdrawals are not subject to taxation. Depending on how you invest, a TFSA could be ideal for an emergency fund, as a complement to your retirement savings, or for saving for a vacation or other shorter-term big-ticket item.

Your circumstances and goals will determine how you allocate your resources. As you formulate your strategy for your RRSP and TFSA, here are a few scenarios to consider:

You believe your tax bracket in retirement will be lower than it is currently.

RRSP contributions give you a tax break now, and your withdrawals in retirement may be taxed at a lower rate. Most people live on a lower income during their retirement, which means that your withdrawals will likely be taxed at a lower rate.

You have a generous pension plan or expect to enjoy a comfortable retirement lifestyle.

TFSA contributions can provide tax-free income in retirement. By comparison, withdrawals from an RRSP (and from a registered retirement income fund) are taxable and, combined with other income sources, could push your taxable income high enough to trigger a clawback of your Old Age Security (OAS) pension.

You're in a low tax bracket now but expect to earn more in the future.

If you direct savings to a TFSA now, you can save your RRSP contribution room to use later, when you're in a higher tax bracket and your contributions may generate a larger tax refund.

RRSP or TFSA? Which account is right for you?

Very possibly both. Both RRSPs and TFSAs have tax advantages, and both can be used to help you invest for the future, according to your own financial situation and needs.

An RRSP gives you more of a tax break. When you make an RRSP contribution, you defer paying taxes on that income until you retire, when you'll likely be taxed at a lower rate. And your RRSP savings are able to grow tax-free until the money is withdrawn. TFSAs have the advantage if you already have significant RRSP assets, have maximized your RRSP contributions, or if you're planning to withdraw the money in the shorter term.

Ready to gain the tax advantages of an RRSP or TFSA? Talk to your advisor to learn more.

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