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RRSP or TFSA?

Is it better to contribute to a Registered Retirement Savings Plan (RRSP) or a Tax-Free Savings Account (TFSA)? As one does not replace the other, the best solution is to contribute to both. However, each option has its pros and cons, depending on your age and personal financial situation.

What is the difference between an RRSP and a TFSA?

These two savings vehicles meet different needs:

- An RRSP is a long-term savings vehicle intended for **retirement**.
- A TFSA is a complementary tool to help you save for short-term **goals** (e.g., travel, education, renovations). TFSAs can also be useful in saving for retirement as they do not affect the amount of government benefits you receive, unlike RRSPs.

RRSP contributions can be deducted from your taxable income, whereas TFSA contributions are made with income that has already been taxed. Therefore, they aren't tax deductible.

That having been said, if you withdraw funds from an RRSP, they will be included in your taxable income and taxed at the rate based on your current income, which is not the case with a TFSA.

Which one should you choose?

As with any financial portfolio, diversification should be a key aspect of your retirement savings plans. Essentially, RRSPs and TFSAs enable you to **build tax-sheltered savings**.

Your financial advisor can help you determine which one would be more advantageous in your situation. However, we've gathered a few rules of thumb for you below.

If your tax rate is higher now than it will be at retirement, an RRSP is likely the better option. However, if you think that your retirement income will be higher than your current income, you're better off with a TFSA.

“RRSPs offer two key advantages, but the biggest one is the tax savings,” explained Jean-Philippe Bernard from National Bank Financial – Wealth Management. “RRSPs allow you to defer taxes on your investment income, while your contributions allow you to reduce your tax burden every year.”

Do you expect to receive a significant pension? Your government benefits (e.g., Old Age Security and the Guaranteed Income Supplement) may be reduced as your pension income is considered in their calculations. Unlike with TFSAs, RRSP withdrawals are considered income. Therefore, a TFSA may be more advantageous as it enables you to better manage your total taxable income.

If you are nearing retirement age, you must also take into account that at age 71, all RRSPs must be converted to Registered Retirement Income Funds (RRIFs), which will impact your taxes. This is not the case with TFSAs, which have no age limit, so you can contribute to them throughout your life. “In the case of RRSPs, your funds are tax-deferred, but the tax rate will likely be lower when you are 65 or 70 as your income is probably going to be lower,” added Jean-Philippe Bernard. “As for TFSAs, you have already paid taxes on the funds invested, so you will not be taxed on them again when you withdraw them.”

When it comes to estate planning, there are also major differences between the two vehicles from a tax standpoint. Both savings vehicles allow you to designate a beneficiary. However, all amounts invested in an RRSP will be taxed upon your death (unless an eligible rollover is applied), while TFSA earnings cease to be tax-exempt after death.

How to make contributions

The amount that you can contribute to your RRSP is based on your "earned income" from the previous year as well as any pension contributions made by you or your employer. The amount is provided on your income tax notice of assessement (mailed to you or available at ***MyAccount***). There are annual limits and any usused contribution room from previous years can be carrier forward.*

As for TFSAs, the maximum annual contribution may vary from year to year ($6,000 in 2019). You will find the allowable TFSA contribution room from previous years on the Canada Revenue Agency’s web site. Any unused contribution room, starting in 2009, can be carried forward indefinitely.

* See the calculation **here.**

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