TD Asset Management

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Client Strategies

Registered Retirement Savings Plan (RRSP) or Tax-Free Savings Account (TFSA)

Two tax-efficient programs that encourage saving for the future

In 1957, the Registered Retirement Savings Plan (RRSP) program was established to encourage Canadians to save and build wealth for their retirement. In January 2009, 52 years later, the federal government introduced an additional incentive to save for the future—the Tax-Free Savings Account (TFSA). From a wealth-accumulation perspective, both an RRSP and a TFSA uphold the general idea that the more money you can set aside, the more you'll have to invest and potentially grow your savings. Both of these programs offer a number of tax advantages compared to a non-registered account, but they also contain some differences. Ultimately, however, the goal of both programs is to help you get the most mileage out of your money.

TFSA highlights

A TFSA can be a flexible account for any type of investor, but how you use a TFSA will depend on your specific needs and objectives. Here is how a TFSA works:

As of January 1, 2013, Canadian residents aged 18[1] or older can contribute up to $5,500 annually to a TFSA. This is an increase from the annual contribution limit of $5,000 for 2009 through 2012 and reflects indexation to inflation.

- Since 2013, Canadian residents age 18 or older can contribute up to $5,500 annually to a TFSA.[1] The annual TFSA contribution limit for 2009 to 2012 was $5,000.
- Unused TFSA contribution room can be carried forward to future years.
- Contributions are not tax-deductible but withdrawals are tax-free.
- Full amount of withdrawals can be put back into the TFSA in future years.
- Investment income earned in a TFSA is tax-free.
- Neither income earned within a TFSA nor withdrawals from a TFSA affect eligibility for federal income-tested benefits and credits, such as Old Age Security (OAS), the Guaranteed Income Supplement (GIS), and the Canada Child Tax Benefit.
- Legislation does not permit a spousal TFSA or a joint TFSA; however, funds can be given to a spouse or common-law partner for them to invest in their own TFSA.
- TFSA assets can generally be transferred to a spouse or common-law partner upon death.

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Client Strategies

Wide range of qualified investments

Generally, the types of investments allowed in an RRSP will also be permitted within a TFSA. These include mutual funds, stocks, guaranteed investment certificates (GICs), and bonds. You can also hold cash in a TFSA before investing it.

Investors can make "in-kind" contributions to a TFSA, as long as the asset is a qualified investment. The Canadian Income Tax Act rules that apply to in-kind contributions from a non-registered account to an RRSP also apply to a TFSA. That is, you will be deemed to have disposed of your investment for its fair market value (FMV) at the time you make your in-kind contribution from a non-registered account to your TFSA. If the FMV is more than the cost you paid for your investment, you will have to report the capital gain in your income tax return. However, if the cost is more than the FMV, the resulting capital loss cannot be claimed.

TD Mutual Funds

If you're planning to invest in mutual funds in your TFSA, then TD Mutual Funds may be the right choice for you. TD Mutual Funds has a solid reputation of delivering long-term investment performance as well as offering a diversified lineup of investment options to suit many investor preferences. Moreover, you can conveniently and affordably invest in TD Mutual Funds by setting up a pre-authorized chequing plan (PAC) for as little as $25 a month. Using PACs to make regular contributions allows you to "pay yourself first," a strategy that many financial experts recommend to help you achieve your investment goals.

Differences between an RRSP and a TFSA

Since its inception, the goal of an RRSP has been to help Canadians accrue after-tax income to finance their retirement. While a TFSA can also be used to save for long-term needs, the two savings vehicles have important differences:

- **Tax deductibility** - RRSP contributions are tax deductible and reduce your income for tax purposes. In contrast, TFSA contributions are not tax deductible.
- **Contribution limits** - You may be able to contribute more to an RRSP—up to 18 percent of your previous year's earned income or to an annual RRSP dollar limit ($23,820 for 2013) adjusted for certain amounts (e.g., pension adjustment, past service pension adjustment, and pension adjustment reversal). In 2013, the annual TFSA dollar limit is $5,500. In future years, the annual TFSA dollar limit will be indexed to the inflation rate in $500 increments. This means that the annual TFSA dollar limit could increase in some years but not every year depending on the inflation rate. However, your unused contribution room in either program may be carried forward to subsequent years. RRSP withdrawals (excluding the Home Buyers' and the Lifelong Learning Plans) are added to your taxable income and are subject to tax at your marginal tax rate at the time of withdrawal. TFSA withdrawals, on the other hand, are not counted as income and are tax-free. You can take out as much as you like at any time for any reason.[2] Unlike an RRSP, your TFSA withdrawal will be added to your contribution room in the following calendar year(s).
- **Withdrawals** - RRSP withdrawals could reduce amounts you receive from federal income-tested benefits and tax credits such as the OAS, the GIS, and the Canada Child Tax Benefit. TFSA withdrawals do not impact these government benefits.
- **Spousal contributions** - Attribution rules apply to spousal RRSPs (i.e. total contributions made to your personal and spousal RRSP must not exceed your personal contribution limit), but they do not apply to TFSAs. Although you cannot directly contribute to your spouse's TFSA as you can with a spousal RSP, you can give your spouse money to contribute to his or her own TFSA without affecting your personal TFSA contribution room.
- **Maturity date** - An RRSP must be collapsed by December 31st of the year in which you turn 71. A TFSA has no plan maturity.

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Using the accounts exclusively or together

The answer to whether it may be better for you to contribute to an RRSP or to a TFSA, will depend on a number of factors, including whether you will need to access your money on a short-term basis or your expected tax rate at the time of contribution and at the time of withdrawal (i.e. during retirement). For example, if your income level and corresponding tax rate are unlikely to change between now and retirement, a TFSA may be a sensible choice due to its flexibility and because you won't lose any tax-savings benefits should you need to access your cash along the way. If you're in a higher-tax bracket now but expect to be in a lower tax bracket in retirement, it may be a good idea to contribute to an RRSP first as the contributions could produce favourable tax benefits now while deferring taxation on your investments to the future. Any extra savings could then be allocated to a TFSA. If you're just beginning your career, you may not be earning much at present. However, if you foresee your income rising down the road, you could start off with a TFSA now and then contribute to a RRSP later on when you're in a higher tax bracket—this strategy would allow you to reap an RRSP tax deduction in the year you make the contribution and would create additional TFSA contribution room (in the following year). Your advisor has the expertise and advice to help you determine whether an RRSP, a TFSA, or the two together can fit into your financial picture.

More Information

When it comes to financial planning, tax-efficient savings vehicles like an RRSP and a TFSA are viable options that could help support your lifelong goals and investment needs. For more information on the TFSA program, please visit www.tfsa.gc.ca, which also includes a calculator to help you estimate TFSA savings amounts.

Given the different tax characteristics of an RRSP (tax deferred), a TFSA (tax-free), and a non-registered account (taxable), you may want to review the types of investments you may hold in these accounts to ensure your overall investment portfolio is structured in the most tax efficient manner.

For more information, talk to your financial advisor today.

[1]Individuals must be the age of maturity to open a TFSA with select financial institutions. In certain provinces and territories, the age of majority is 19, which may delay the opening of a TFSA. However, the accumulation of contribution room will start at age 18. [2]Some restrictions may apply, depending on the investments chosen. Source: Canada Revenue Agency, 2013. The statements contained herein are based on material believed to be reliable. Where such statements are based in whole or in part on information provided by third parties, they are not guaranteed to be accurate or complete. The article does not provide individual financial, legal, tax or investment advice and is for information purposes only. Particular investment or trading strategies should be evaluated relative to each individual's objectives and risk tolerance. TD Asset Management Inc. ("TDAM"), The Toronto-Dominion Bank and its affiliates and related entities are not liable for any errors or omissions in the information or for any loss or damage suffered. Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus, which contains detailed investment information, before investing. Mutual funds are not covered by the Canada Deposit Insurance Corporation or by any other government deposit insurer and are not guaranteed or insured. Their values change frequently and past performance may not be repeated.. TD Mutual Funds are managed by TD Asset Management Inc., a wholly owned subsidiary of The Toronto-Dominion Bank and are available through authorized dealers.

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