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Should I use a TFSA, an RRSP, or both?

Adapted from an article by Manulife Financial

Low income

A TFSA can be an ideal savings vehicle if you're in a low-income tax bracket. RRSPs may not be well suited to low-income Canadians. The RRSP tax savings are rather small and you may be in a higher tax bracket when you make withdrawals. You may also want to consider that TFSA withdrawals don't impact income tested benefits and credits, such as child tax benefits and credits, Old Age Security, or Guaranteed Income Supplement.

If you now find yourself in a lower tax bracket, such as when on maternity leave, and made RRSP contributions in the past, you may want to consider withdrawing from your RRSP to make a TFSA contribution. Your tax cost on the withdrawal is likely to be much lower at that point that later on when you need it for retirement. However, remember that funds withdrawn from your RRSP can't be re-contributed later.

Middle income

One strategy would be to contribute to your TFSA now and accumulate RRSP room to be used later when in a higher tax bracket to optimize the tax benefits. At this level it's more of a judgement call.

Another option here is to contribute to an RSP now, but no use the tax deduction. You have the option to 'bank' the tax deduction, saving it for a later year when your income leaves you at a higher tax level, and the deduction therefore has more value.

High income

This is a situation where you may want to maximize both your RRSP and TFSA contributions. In fact, the tax savings or refund received from the RRSP contribution could be used to fund the TFSA.

Which option is better with a Home Buyers Plan?

If you're saving for a down payment on a house, a TFSA might be a better option than saving in an RRSP and withdrawing under the Home Buyers Plan (HBP) for several reasons:

- You have the flexibility to recontribute the TFSA withdrawal without time limits. If HBP repayments aren't made on time, the annual repayment amount is added into your income and any missed repayment amount means the RRSP room is lost forever.
- There's no restriction on how much you can withdraw from your TFSA, while the HBP restricts you to $35,000 from each of your RRSP and your spouse's RRSP. Alternatively, you could each

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contribute to a TFSA and then withdraw double the amount, plus any investment earnings tax free and with no required repayments.

- There are no conditions on TFSA withdrawals, whereas the HBP requires you to be a first-time home buyer.

Similar logic could be applied to the Lifelong Learning Plan (LLP). By using a TFSA to save and fund continuing education, contributors can gain increased withdrawal flexibility while eliminating any enrollment requirements or repayment conditions.

Whether to save in a TFSA, RRSP, or both depends on your savings needs, your eligibility for income tested benefits, and your current and expected future financial situation and income level.

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