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A Fresh Look at RRSPs vs. TFSAs

The Tax-Free Savings Account (TFSA) contribution limit has increased to $7,000 (from $6,500) for 2024. This new limit means that a taxpayer who has never contributed to a TFSA and has been eligible for one since its inception will have a cumulative contribution room of $95,000. TFSAs are now a serious portfolio and investment planning alternative to making RRSP contributions. So, which is better you ask? Well, it depends…

If you are a Canadian with significant assets and savings, then maximizing your TFSA makes sense as a retirement income planning strategy. The income from it during your retirement years is non-taxable and will not trigger any Old Age Security claw back which in 2024 starts at $90,997 (up from $86,912 in 2023)[1].

The TFSA is also useful for Canadians over 55 who receive an inheritance and have already maximized their RRSP and\or their company pensions and are looking for another tax sheltering investment vehicle. Starting or topping up a TFSA with a windfall is a smart planning tactic. All interest income (with GIC rates now commonly above 3%-4%) compounds tax-free and is tax-free upon withdrawal from the TFSA.

TFSAs are now starting to get big enough, with contribution room of $95,000 plus growth over the past few years that your Advisor can now put together a proper investment portfolio for growth or income. That was hard to do with a single $5,000 contribution at the program's inception.

At the other end of the demographic spectrum, if you are a Millennial or are a Canadian earning gross income of $65,000 or less per year then a TFSA may be a better choice for you. At that income level, your average tax rate or savings, depending on your province will be about 15% taking into account the Personal Exemption of $15,075 for 2024 for those with net income of $173,205 in 2024[2].

In this situation, the taxes saved on the growth of your TFSA over time may far outweigh the few dollars of taxes saved by contributing to an RRSP at this stage of your life. You can also use the Carry-Forward provisions to accumulate your RRSP contribution room for future years when your marginal income tax rate is high enough to warrant contributing to an RRSP.

While both vehicles are useful for accumulating assets for future retirement income, an RRSP is still usually the best option for Canadians earning higher than average incomes of $80,000 or more. The tax savings can be significant – in the 35% or more range which makes saving for retirement easier.

RRSP contributions are deductible from earned incomes while TFSA contributions are made with tax paid capital. A contribution of $10,000 can cost you about $6,500 or less in an RRSP while a $10,000 TFSA contribution will require pre-tax capital amount of something between $10,000 and $15,000 (at the top marginal tax rate of about 54% in Ontario). If you are a high-income earner, an RRSP contribution of $10,000 has a lower capital cost than depositing the same $10,000 into a TFSA.

Given the tax savings on an RRSP contribution and considering that taxes need to be deducted from a TFSA contribution, and using similar rates of return, an RRSP will create more total capital over longer periods of time (30-40 years) than a TFSA. The reason is that more capital is put to work immediately in an RRSP than for a similar contribution level for a TFSA. So, what is best for your situation? It depends on a number of variables and each situation is unique.

Call us today to review your financial situation [1] to help you determine the best strategic approach to choosing an RRSP vs. a TFSA or both.

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1. CanPension.ca: CPP and OAS Payment Increase 2024 [2]
2. Advisor.ca: Essential tax numbers: updated for 2024 [3]

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