TFSA vs RRSP:

What's Your Best Bet When it Comes to Your Income Tax Return?

By Charlene Birdsall, CPA, CMA, CIM, CFP, National Bank Financial – Wealth Management

Over the years, I have tried to instill the power of saving to all my clients. But the big question is, where to put the savings?

There are many options as to where to deposit savings, such as a savings bank account, chequing account, tax free savings account (TFSA), first home savings account (FHSA), or a registered retirement savings account (RRSP). For 2024, the new contribution limit for the TFSA is $7,000 (total $95,000), for the FHSA, it is $8,000 (total $16,000 if the account was opened in 2023), and for the RRSP is $31,560 or 18 per cent of prior year's earned income. Each of these savings vehicles are suitable depending on personal financial goals and circumstances, which would – of course – influence the choice.

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Two clients, different needs

Two of my clients – Daniel and Gwen (not their real names and who don't know each other) – both asked what to do with their income tax return this year.

Let's begin with Daniel. He was in his early thirties, earned $45,000 last year, had some debts but has a manageable plan to pay them off slowly, and has always been diligent about saving.

Daniel had a simple yet clear financial goal in mind – wanting to build an emergency fund and save enough for a down payment on a sailboat. He had taken a few mechanical courses and sailing lessons for many years as he wanted to eventually travel the world in his own sailboat. He knew it would be costly, but he was prepared by learning how to sail and knowing how to fix the craft – all he needed were the funds for his purchase. He also believed in the power of compound interest and wanted to make the most of his income tax return.

For Daniel, I recommended the TFSA to be the most suitable option. Here's why:

- **Liquidity:** The TFSA is incredibly flexible. Contributions made to a TFSA can be withdrawn at any time, for any reason, without incurring taxes or penalties. This was vital for Daniel as he needed easy access to his TFSA fund in case of an emergency.
- **Short-Term Goals:** Daniel's main financial objective was to save for a down payment on a sailboat and he planned to purchase a sailboat within the next five to seven years. By contributing his tax return to a TFSA, he could watch his money grow tax-free while also keeping it accessible for when he needed to use it.
- **Tax Benefits:** Daniel wasn't in a high-income tax bracket, so the immediate tax deduction that comes with RRSP contributions wouldn't provide as much benefit to him as it would someone in a higher tax bracket. The tax-free growth within the TFSA, however, would be more advantageous in his case.

Now, let's turn our attention to Gwen. She earned a

substantially higher income of $130,000 per year, was in was in her mid-forties, and had been saving diligently for her retirement. Gwen was a frugal spender and had enough built up as an emergency fund. She had already contributed to her RRSP over the years, but she was also considering her options for her tax return. Gwen had long-term financial goals and was focused on retirement planning.

For her, I recommended the RRSP was the more appropriate choice, and here's why:

- **Tax Deductions:** Gwen's higher income placed her in a high tax bracket. Contributing to her RRSP would provide her with immediate tax deductions and reduce her taxable income for the year. This meant that she could potentially receive a larger tax refund, further boosting her retirement savings.
- **Retirement Planning:** Gwen was looking ahead to her retirement, which was a little over a decade away. She wanted to maximize her savings in a tax-efficient way. RRSPs are specifically designed for retirement savings and can provide her with tax-advantaged way to grow her investments.
- **Long-Term Growth:** The RRSP allowed Gwen to invest her tax return in various assets like stocks, bonds, and mutual funds, which had the potential for significant long-term growth. The power of tax-deferred compounding over time would work in her favour.

In summary, the recommendations made for Daniel and Gwen were based on their individual financial goals and circumstances. Daniel chose to contribute his tax return to a TFSA because of its liquidity and suitability for his short-term objectives, while Gwen opted to put her tax return into a RRSP due to the immediate tax deductions and its alignment with her long-term retirement plans.

Ultimately the right choice depends on your individual situation, and it's essential to consult with a financial advisor to make the most informed decisions. Daniel and Gwen's stories serves as a reminder that there is no one-size-fits-all approached to financial planning and the best path forward is one that aligned with our specific goals and aspirations. ◗

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