RRSPs & TFSAs - What's the Difference ?

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Tax Free Savings Accounts (TFSAs) were introduced in 2009 and they seem to be struggling to catch on. Registered Retirement Savings Plans (RRSPs), however, have been around for over fifty years and attract billions of dollars of deposits each year. If you are serious about saving for your future, it is important to know the differences between the two.

While RRSPs and TFSAs seem to be very similar on the surface, they are really apples and kumquats apart. The only similarity is that, within limitations, earnings inside either plan are allowed to grow without current taxation.

Deposits - Contribution limits to an RRSP are based on a percentage of income of the preceding year to an annual maximum, plus any unused contribution room, minus a pension adjustment. So, the maximum contribution for 2012, ignoring unused room and pension adjustments, is 18% of 2011 income to a maximum of $22,970. Any contributions made to an RRSP are deductible from income for the tax year you choose.

There are no income requirements to make a deposit to a TFSA because deposits cannot be deducted from income. The limit is currently $5,000 per year and any unused portion of this limit can be carried forward and used in another year.

Withdrawals - RRSPs are a tax-postponed savings plan. When withdrawals are made, they are fully taxable in the year they are received at whatever the tax rate is for the plan holder.

Income arrangements from an RRSP must be made before the end of the year in which the plan holder turns age 71. There are also minimum amounts that must be withdrawn each year and these minimums increase each year.

TFSAs are a truly tax-free plan for saving money. Withdrawals are not taxed and actually get added back to contribution room. For example, John contributed $5,000 each year since 2009. He has no contribution room left. He makes a withdrawal of $6,000 for his dream vacation in 2012. This means that in 2013 he can contribute $11,000 to his TFSA.

You can keep a TFSA for as long as you want. Unlike RRSPs, you will not be forced to take an income or withdraw funds from your TFSA at a certain age.

Government Benefits - Because income from an RRSP shows up on a tax return, it may affect government benefits such as Old Age Security (OAS). Withdrawals from a TFSA are fully tax free and will not cause a reduction in OAS benefits. For some, this means they may qualify for the Guaranteed Income Supplement (GIS) even though they are receiving an income from their TFSA.

RRSPs and TSFAs are different animals. They each have distinct features and benefits that will affect people in different ways. Both of these tax preferred plans can play a role in your future.

Questions about RRSPs & TFSAs strategies?

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