A TFSA can be an excellent complement to an RRSP

Tax-Free Savings Accounts (TFSA) represent a unique way for Canadians to save money and pay less tax. They allow every Canadian resident age 18 and older with a Social Insurance Number to contribute. The annual limit for 2013 has been raised to $5,500.

Key features

- Investments grow tax-free while inside the account.
- Withdrawals can be made at any time for any purpose and are not subject to tax.
- Unused contribution room can be carried forward indefinitely to future years.
- Withdrawals can be recontributed in future years.
- TFSAs can hold many of the same investments as an RRSP, including all Fidelity mutual funds.

The TFSA and RRSP are both important tax-advantaged savings plans sponsored by the Government of Canada. Generally, one is not better than the other; they work together to give Canadians valuable tax benefits. TFSAs are flexible enough to help Canadians save for both short-term objectives, such as major purchases, and long-term goals. Whereas, RRSPs are long-term plans that are designed for retirement saving.

A TFSA can be an excellent complement to an RRSP and may be used to maximize retirement income when RRSP contribution limits have been reached.

The TFSA or RRSP decision

- Choose an RRSP when pre-retirement income is expected to be higher than retirement income. Income during retirement may benefit from a lower income tax rate.
- Choose either a TFSA or an RRSP when pre-retirement income is anticipated to be equal to retirement income. Income tax rates may be equal before and during retirement, so there is no advantage to one over the other.
- Choose a TFSA when pre-retirement income is expected to be lower than retirement income. Income during retirement may be withdrawn tax free from a TFSA.

A TFSA compared to an RRSP

The major difference between a TFSA and an RRSP is the treatment of contributions and withdrawals for tax purposes. RRSP contributions are tax-deductible, but withdrawals are taxed as earned income. On the other hand, TFSA contributions are not tax deductible, but withdrawals and the earnings and growth on investments are completely tax free.

Furthermore, TFSA withdrawals have no effect on an individual's eligibility for federal income-tested benefits and credits, unlike RRSP withdrawals, which are included as income for the purposes of calculating benefits. This may be particularly important to seniors who receive Old Age Security and the Guaranteed Income Supplement.

	TFSA	RRSP
Tax-deductible contributions?	No	Yes
Tax on withdrawals?	No	Taxed as earned income
Withdrawals increase contribution room?	Yes	No
What are the contribution limits?	$5,500, regardless of income level (2013)[1]	18% of earned income to a maximum of $22,970 (2012)
Accumulate unused room?	Yes	Yes
Need for conversion?	No	Yes, to a RRIF or life annuity by age 71
Do income attribution rules apply?	No	Generally no, but may apply to withdrawals from a spousal RRSP

Contribution room formula

TFSA contribution limit

$5,500 per year (inflation adjusted) regardless of income[1]

+

Available TFSA contribution room

RRSP contribution limit

18% of prior year's income to the annual maximum contribution limit

+

Unused RRSP deduction room

For more information on Tax-Free Savings Accounts, contact your advisor.

1. TFSA contribution limits from 2009 to 2012 were $5,000 per year. For 2013 the limit was raised to $5,500.

Read a fund's prospectus and consult your advisor before investing. Mutual funds are not guaranteed; their values change frequently and past performance may not be repeated. Investors will pay management fees and expenses, may pay commissions or trailing commissions and may experience a gain or loss.

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