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RRSP vs TFSA's

The biggest question at the beginning of each year, is which to contribute to?

Does it really matter? Are there certain rules?

Well, both are great vehicles, but they apply most effectively in different situations.

Here's my quick break-down of when to invest in each.

TFSA: This vehicle gives NO tax breaks upon contribution, but provides tax-free growth forever, if you invest for that long. It is great for both short-term objectives, and long-term savings because of the flexibility. If you have high income, then it's not going to reduce your taxes for the current year. That's the biggest difference.

The 1 item to be careful of is foreign property in a TFSA, for example US stocks, or US ETF's. If you are required to file a US tax return, then you may need to include income from the TFSA, as it is not recognized in the Canada-US tax treaty. Since no Canadian institution offers tax receipts, that makes this a difficult task to manage.

RRSP: Most people understand the benefits here, but the biggest benefit for the RRSP (Registered Retirement Savings Plan) is the instant tax break that is achieved for that tax year. It's one of the few opportunities for this. Of course, RRSP's were created to be an incentive to save for retirement. The idea is that once you stop working your income will be lower. Therefore, you contribute in the high-income years and get a substantial tax break, and defer the tax until retirement, when your tax rate is expected to be lower. Of course, you get the many years of tax deferral as well, which is a great benefit to many. The downside is when you do withdraw the funds, you pay tax on every dollar, just like income.

So, in low income years, the RRSP doesn't provide much benefit, other than reducing the tax even lower. But in that situation, if there's limited money for savings, I would often lean towards the TFSA.

There are 2 other scenarios that can benefit some and enhance the benefits of the RRSP. These are 2 withdrawal programs that give you access to the funds on a tax-free basis, when you qualify and the intent is to pay them back at a later date. The first is the Lifetime Learning Program, a program that offers up to $20,000 to someone attending post-secondary school. The second is the Home Buyer's Plan. This plan allows you to withdraw up to $25,000 towards a down payment on a home. Of course, to qualify, there are a number of rules to follow, but these programs do provide some additional incentive to consider contributing to an RRSP.

As in all situations, when investing, consider your timeline, and investing priorities. That will guide you to determine the best vehicle and the best investment.