ALASKA HIGHWAY NEWS

Brad Brain: The battle of the heavyweights

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Smart Money

Brad Brain: "For a long time, Registered Retirement Savings Plans were the undisputed champion of financial planning. But Tax Free Savings Accounts are an up and coming contender, and some say deserving of the title. Let's see how these two heavyweights match up."
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For a long time, Registered Retirement Savings Plans were the undisputed champion of financial planning. But Tax Free Savings Accounts are an up and coming contender, and some say deserving of the title. Let's see how these two heavyweights match up.

Registered Retirement Savings Plans offer two big benefits. You will get a tax deduction when you put the money in, and you will have tax sheltered growth as long as the money is in the plan. This is offset by RRSP withdrawals being included in your taxable income.

Tax Free Savings Accounts also offer tax sheltered growth, but now you can access your money tax free too. This is offset by not getting a tax deduction when you contribute money into the TFSA.

Often a comparison between RRSPs and TFSAs will revolve around how a person can withdraw from their TFSA without paying tax. And without question that is a substantial benefit. In addition to the obvious advantage of not adding to your income tax bill, the tax-free withdrawal also means that it won't impact any income-tested government benefits like the Guaranteed Income Supplement and the Old Age Security benefit.

The problem is, if we only look at taxation at the time of withdrawal as the basis for comparison, then it is a rather superficial analysis that can lead to erroneous conclusions.

When money comes out of an RRSP, it is taxable. Nobody likes paying taxes, and the pain that comes from doing so can lead to forgetfulness. People forget that they received a tax deduction when the money went into the RRSP. People forget that they took their tax refund and did something with that money. People forget they didn't pay any tax on the growth of the money. They just remember that they paid tax on the money when it came out.

Folks, I am here to tell you that, for most people, that's not a bad thing. Most people will make more money when they are working then they will after they stop. That means that they are in a higher tax bracket in their working years then they are when they are retired. So what an RRSP gives you is the opportunity to save tax when you are in a higher tax bracket, not pay any tax along the way, then, when you eventually do pay tax, you pay it in a lower tax bracket. Nothing wrong with that.

As for government benefit clawbacks, many of the people that worry about government benefit clawbacks are not really going to be affected by them in the first place. OAS clawbacks are real, but they don't kick in until you have $79,000 income in retirement, and you don't lose your OAS completely unless you are over $128,000. Only about 2% of the Canadian population are affected by OAS clawbacks.

The bottom line is that RRSPs and TFSAs are both great planning tools, but neither is intrinsically superior to the other. Which one is right for you will be determined by your objectives and your personal circumstances, including; what do you want to use the money for, when do you want to use the money, what is your tax bracket now and what do you expect it to be in the future, and what are your RRSP and TFSA contribution limits.

You have until March 1 to make a contribution to your RRSP and still get a tax deduction for 2020. Speak to a Certified Financial Planner to see how to best utilize these fantastic, tax-advantaged plans to help you to reach your financial objectives.

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