Assante®
WEALTH MANAGEMENT

Tax-Free Savings Accounts

Case Study – TFSA vs. RRSP

The situation:

Dave, age 52 and divorced, is reviewing his retirement plans as his employer has offered him $10,000 a year to invest in an RRSP or TFSA.

Dave intends to retire at 67, and anticipates his retirement income including maximum Canada Pension Plan (CPP) and Old Age Security (OAS) to be $75,000 annually before tax. Given his projected expenditures, Dave figures he will need another $8,500 after tax when he retires.

Dave is also concerned about the clawback of government benefits, especially his OAS, and is wondering whether to contribute the funds to his RRSP or TFSA.

What are the tax implications?

- Treatment of contributions for tax purposes: A TFSA contribution is made with after-tax dollars while an RRSP contribution is likely made with pre-tax dollars, given employers' withholding tax exemption provisions.
- Treatment of redemptions for tax purposes: A withdrawal from a RRIF is considered taxable income while a withdrawal from a TFSA is not considered taxable income.

Government retirement benefits*

Canada Pension Plan (CPP) – maximum $1,093 per month, or $13,110 annually.

Old Age Security (OAS) – maximum $571 per month, or $6,846 annually; individuals with net income above $73,756 must repay part or all of the OAS.

** All figures are for 2016. For complete details on clawbacks and income levels see: http://www.servicecanada.gc.ca/eng/services/pensions/infocard/janmar16.shtml.*

The challenge:

To provide the most effective way for Dave to continue accumulating retirement savings and to determine the most tax-efficient way to generate an additional $8,500 in retirement income with the least impact on his future government retirement benefits.

Dave needs to:

- Decide whether to contribute the $10,000 to his RRSP or his TFSA.
- Be mindful of the threshold levels for government clawbacks when he retires.

The strategy:

Dave will be in a lower tax bracket when he retires so it makes sense for him to continue saving in his RRSP. However, he must keep in mind that his estimated retirement needs are in excess of the government's threshold for OAS clawback. For every dollar of taxable income he earns over $73,756, his OAS benefits will be reduced by 15 cents. For example, an additional $10,000 in income will reduce his OAS benefit by $1,500.

Dave has two options:

- Invest $5,359 (equivalent to $10,000 before taxes) in his TFSA; or
- Invest $10,000 in his RRSP.

Here is the fair market value comparison of contributions to Dave's TFSA versus his RRSP, assuming a 5% rate of return on his investment:

Age	TFSA			
	Opening Balance	Contribution	5.00% Return	Closing Balance
52	-	$5,359	$268	$5,627
53	$5,627	$5,359	$549	$11,535
▼	▼	▼	▼	▼
65	$99,670	$5,359	$5,251	$110,281
66	$110,281	$5,359	$5,782	$121,421

Age	RRSP/RRIF			
	Opening Balance	Contribution	5.00% Return	Closing Balance
52	-	$10,000	$500	$10,500
53	$10,500	$10,000	$1,025	$21,525
▼	▼	▼	▼	▼
65	$185,986	$10,000	$9,799	$205,786
66	$205,786	$10,000	$10,789	$226,575

The result:

After 15 years, Dave's TFSA has grown to $121,421. Upon retiring at age 67, Dave begins taking CPP and OAS and reports other retirement income. He also withdraws $8,500 from his TFSA. Because TFSA withdrawals do not affect taxable income, Dave's OAS will not be clawed back any further.

If Dave instead chose to contribute the $10,000 annually to his RRSP, the contributions would have grown to $226,575 – roughly $105,154 greater than the TFSA option. Each year, Dave would need to withdraw $14,810 from his RRIF in order to generate $8,500 in after-tax income. In addition, due to the extra RRIF income, his OAS clawback would increase by $2,221 to $2,408 annually. Over 23 years, the additional OAS clawbacks associated from the RRSP/RRIF option would be $51,083.

By choosing to contribute to his TFSA instead of an RRSP, Dave saves $6,311, which includes $4,090 in income taxes and a reduced OAS clawback of $2,221 each year. Over 23 years, the total savings would be $145,153.

Age	TFSA			
	Opening Balance	5.00% Return	Withdrawal	Closing Balance
67	$121,421	6,071	8,500	$118,993
68	$118,993	5,950	8,500	$116,442
▼	▼	▼	▼	▼
87	$41,107	2,055	8,500	$34,662
88	$34,662	1,733	8,500	$27,895
89	$27,895	1,395	8,500	$20,790
90	$20,790	1,040	8,500	$13,329

Age	RRSP/RRIF			
	Opening Balance	5.00% Return	Withdrawal	Closing Balance
67	$226,575	11,329	14,810	$223,094
68	$223,094	11,155	14,810	$219,438
▼	▼	▼	▼	▼
87	$111,464	5,573	14,810	$102,227
88	$102,227	5,111	14,810	$92,528
89	$92,528	4,626	14,810	$82,345
90	$82,345	4,117	14,810	$71,652

Assuming Dave passes away at the age of 90, what is the impact to his estate when collapsing his TFSA versus his RRIF?

The TFSA would be brought into Dave's estate as a tax-free receipt with no tax impact. The proceeds of his RRIF, on the other hand, would be reported as income and be subject to income tax on his final tax return. Assuming Dave's marginal tax rate is 53%, his estate would receive $33,676 on an after-tax basis, $20,347 greater than the TFSA option.

Conclusion:

Keep in mind that Canadians face different circumstances and financial needs and concerns. Both the TFSA and RRSP are useful retirement savings vehicles and, in most cases, a TFSA can complement an RRSP.

When making the decision of contributing to an RRSP versus a TFSA, Canadian investors should be aware of the impact that income tax has on annual TFSA and RRSP contributions and account accumulation, and the tax treatment of redemptions during retirement. RRIF payments are considered taxable income whereas TFSA withdrawals are not. It is also important to be mindful of the OAS clawback – any taxable income in excess of the annual OAS threshold triggers the OAS clawback. It all comes down to what is most important to the individual Canadian investor.

For more information on Tax-Free Savings Accounts, please contact your Assante Advisor.

1604-0747_E (04/16)