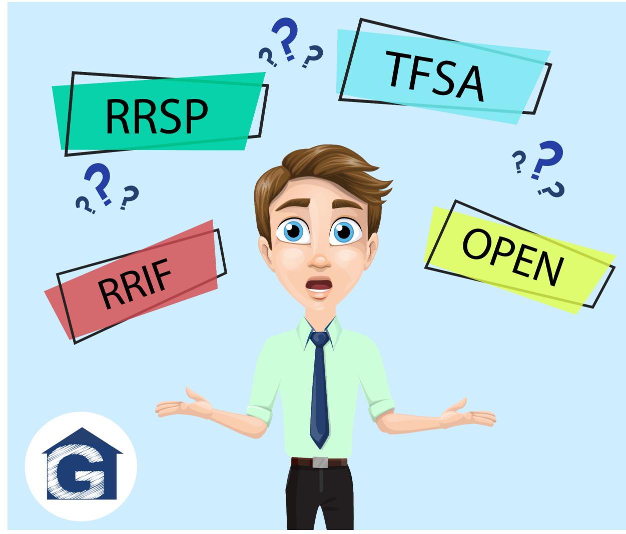
What is a TFSA, RRSP, or a RRIF??



Learning the basics of investing can be difficult and honestly quite time consuming. There are many different things to consider before you invest your first dollar.

One of the biggest mistakes in investing is failing to do your homework and just investing in something that you do not really understand.

When you finally become motivated enough to start investing you face one of the most confusing questions.

What type of account should I use?

There are so many different types of accounts and it is hard to decide which one is most suitable to fit your current situation or desired goals for the investment.

1. The Non-Registered Account

The most flexible account is a **Non-Registered Account**, sometimes referred to as an “Open” account.

You are able to open a non-registered account at almost any financial institution or online trading platform. There are no contribution limits on this type of account so during your lifetime you can put in as much money as you want. Since this account is not tax sheltered, you will have to pay taxes on any income that you receive from the investments either through interest or dividends. However, if you have a financial advisor, the fees that you pay for the purpose of earning investment income can be **claimed on your tax return**!

Also, since it is taxable, you will have to pay taxes on any capital gains that you incur. But if you sell your investment at a loss you can claim capital losses on your tax return to pay less tax.

Side Note:

Purposely selling at a loss is not always a good strategy to save paying taxes. Please talk to your financial advisor before trying to execute that strategy

What is Capital Gains Tax?

Simply put it is a tax that needs to be paid when your investments are **sold** at a profit. However, if you currently own an investment and it increases in value, you do not have to pay any capital gains tax since you have not sold it. Only 50% of the capital gain is taxable.

What is a Capital Loss?

When an investment is sold for less that it was purchased for. Capital losses can be used to offset tax from a capital gain.

2. The Tax-Free Savings Account (TFSA)

Whoever decided to call it a "*savings account*" has confused a lot of people. It is not like one of those chequing accounts where you earn miniscule amounts of interest just by letting it sit there. You need to actually decide what you would like to put in the account to earn the interest.

Think of a TFSA as a basket. You can choose from many financial products that you would like to put in the basket such as stocks, bonds, cash, mutual funds, exchange traded funds (ETFs), guaranteed investment certificates (GICs). Each investment option yields a different return and has different levels of risk. You should talk to a financial advisor to see what types of investments work best for you.

The TFSA was introduced in 2009 by Canada in order to encourage Canadians to save money. Due to the nature of the account being "tax free", you do not have to pay any taxes on any interest, dividends or capital gains.

Each year the Canadian government decides the maximum amount that a person can contribute that calendar year. This is called the “contribution room”. If you turned 18 in 2009 or earlier you have $75,500 of contribution room, provided that you have not put in any money to any TFSA. If you turned 18 after 2009 you will have to **add up the contribution limit** for each year since you turned 18. Be careful not to overcontribute to the TFSA, there will be **tax ramifications if you do**.

Fun Fact: You can hold multiple TFSAs as long as the cumulative total of all of your accounts is less than or equal to your contribution room.

If you withdraw any money from the TFSA you will be able to recontribute that amount. You will never lose your contribution room. However if you have maximized your TFSA room, and you withdraw money, you will not be able to recontribute until January of the next year.

TFSA Eligibility: Any Canadian resident who has a valid Social Insurance Number (SIN) and is over the age of 18.

3. The Registered Retirement Savings Plan (RRSP)

An RRSP is an account that allows you to defer paying taxes. Any money that you contribute to an RRSP will exempt you from paying the CRA in the years that you make the deposits but will make you pay the taxes in the future when you withdraw it.

The main idea is that in the years that you invest in an RRSP you are in high tax brackets and thus would be paying taxes at a high marginal rate. Once you retire, you should be in a much lower tax bracket and you will thus pay less taxes on the money you invested.

If you contribute to an RRSP you can deduct the contributions against your income. For example, an investor has a tax rate of 35%, for every $1000 that they invest in a RRSP they will save $350 in taxes.

There is a limit on how much you can contribute in one year. You can either contribute 18% of your past year's income or the yearly maximum amount, whichever is the lessor. In 2020 the limit was $27,230.

TFSA Vs. RRSP

It is similar to the TFSA in that any interest, dividends and capital gains are not taxed. However it differs when you withdraw the money. When you withdraw money from an RRSP it will be attributed to you as income earned in the year that you withdraw it. Then you will be taxed at your marginal tax rate.

4. The Registered Retirement Income Fund (RRIF)

The nature of an RRSP is to have your investments increase enough for you to retire comfortably. Once it is converted into a RRIF you are required to make minimum annual withdrawals which provides you with retirement income. You will not be able to make any more contributions once it has been converted to a RRIF. You can convert it at any age, but it is required that it be converted by December 31 of the year in which you turn 71.

Benefits of a RRIF

- Flexible Withdrawals: You can structure your retirement income plans as long as you withdraw the annual minimum amount. You can choose to take out more money earlier in retirement or later in retirement to cover any expenses that you may incur.
- Continued tax sheltering: Your investments can continue to grow on a tax-deferred basis during your retirement. An extra 20 to 30 years of compounding interest can seriously increase your investments.
- Control over your investments: You can choose exactly what investments you want to hold in your account which provides you with the flexibility to suit your objectives.
- Option to convert to an annuity at a later date

Overall

There are many factors that come into play when you are deciding which type of account is right for you. For example, if you are a student working a minimum wage job a TFSA would be an excellent option to start investing. Or if you are at the prime of your career and making the highest salary possible, an RRSP may be more suitable. Since there are many different circumstances to consider please talk to your financial advisor before making any investment decisions. A combination of different account types are a part of creating a strong financial plan. Contact a financial professional to help you choose the correct path for your situation.

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