

Tax & Estate matters



The first 60 days - Coordinating TFSAs and RRSPs

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Whether or not you subscribe to the notion of “RRSP season,” the first 60 days of the year is a good time for a fresh review of your clients’ savings practices.

And with the TFSA now becoming more familiar to both advisors and investors, it may also be a good time to consider how the two plan types may be coordinated to make them mutually more effective.

Federal Budget 2011 - Live webcast

Join us for a live webcast as we provide a timely overview of the Federal Budget and how it affects your clients. This webcast will be available on our advisor site for your convenience.

Details to follow once the Budget details are announced.

Relative accumulation

Generally, we expect to move from a higher marginal tax bracket in our income-earning years to a lower bracket in our retirement years. With that dynamic, an investment dollar will yield a better after-tax return through the familiar RRSP over the newcomer TFSA (refer to my piece in the May 2009 issue of *Fundamentals*).

That certainly is the key point of distinction for investors between the two plan types when investment dollars are scarce. It does not necessarily mean, however, that an immediate direct deposit to an RRSP is the only route that will take us to our goal of a more secure retirement.

If we can resist the allure of the early tax refund connected to an RRSP deposit, there may be other benefits to reap by taking a more strategic path.

TFSA fundamentals

TFSA room may be carried forward indefinitely, but it remains at its nominal amount denominated in the year it was granted. To illustrate, if a person did not use the \$5,000 of room from 2009, that particular entitlement remains as \$5,000, whether used the next year (2010) or in any year in future. [NOTE: This should not be confused with the indexing of the annual TFSA dollar limit, which grows by \$500 increments about every three to four years.]

Consider also the novel feature of the TFSA that allows each dollar withdrawn in a particular year to give rise to a re-contribution credit the following January 1.

Is there a way that the TFSA re-contribution rule can assist the TFSA carryforward rule?

TFSA first, RRSP second?

Though counter to common practice, what if a person decided to forgo the RRSP deposit in the first 60 days and instead place those funds into a TFSA?

Assuming for illustration a fixed interest investment option, the TFSA would be at a higher value by year-end, at which time a withdrawal would be made to contribute to the RRSP. The credit to the TFSA room the following year would be larger than if the TFSA had been untouched, and the RRSP contribution would lead to a larger refund, albeit one year delayed.

Alternatively, if you want to keep closer to the traditional route, go ahead and make the RRSP contribution as usual and direct the tax refund into the TFSA, but remember to withdraw before year-end to make that RRSP contribution.

There may be a cost of not receiving the refund in the first year, but in my calculations that initial cost is not dire. After that first year, you are back on track with rolling annual RRSP contributions, though routed through the TFSA, and it's for you to decide whether any initial cost is worth the additional TFSA room gained.

Personally, I continue to contribute the bulk of my RRSP money directly, but in 2010 I isolated a small part of my TFSA and RRSP assets to test this strategy. While it worked fine, I'm cognizant that a drop in TFSA value (I'm principally in equities) will leave me with an interesting decision at a future year-end - which will be good fodder for a future article.

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