TFSA Case Study

TFSA vs. RRSP

The situation:

Dave, age 50, is currently planning his retirement income. At age 65, when he intends to retire, he expects his income from his company pension, Canada Pension Plan (CPP) and RRSPs to be $65,000 annually before tax. Given his projected expenditures, Dave figures he will need another $12,000 after taxes when he retires. Dave is concerned about government clawbacks of benefits, especially Old Age Security (OAS), and he is wondering whether to continue contributing to his RRSP, or to save for retirement in a tax-free savings account (TFSA), which will not be taxed when he makes a withdrawal and will have no impact on his OAS.

The challenge:

To provide the most effective way for Dave to continue saving for his retirement and find a source of tax-efficient retirement income that will have the least impact on his future government retirement benefits.

Dave needs to:

- decide whether to save with after-tax or pre-tax dollars
- keep in mind the threshold level for government clawbacks when he retires.

The strategy:

Despite the fact that Dave will be in a lower tax bracket when he retires and it makes sense for him to continue saving in his RRSP, he must keep in mind that his estimated retirement income is very close to the government's threshold for OAS clawbacks. For every dollar of taxable income he earns over $64,718*, his OAS will be reduced by 15¢. For example, an additional $10,000 in income will reduce his OAS benefit by $1,500. Dave decides to save in his TFSA and to invest approximately $4,800 a year after taxes (equivalent to $8,500 before taxes). Here is the comparison:

Government retirement benefits*

Canada Pension Plan (CPP) – maximum $884.58 per month, or $10,615 annually.

Old Age Security (OAS) – maximum $516.96 per month, or $6,203.52 annually; individuals with net income above $64,718 must repay part or all of the OAS.

** All figures are for 2008. For complete details on clawbacks and income levels see: http://www.hrsdc.gc.ca/eng/isp/pub/factsheets/rates.shtml.*

	TFSA			RRSP		
	Contribution			Contribution		
Age	Before tax	After tax	Market Value	Before tax	After tax	Market Value
50	$8,500	**$4,810**	$5,075	$8,500	**$8,500**	$8,968
51	$8,500	**$4,810**	$10,429	$8,500	**$8,500**	$18,428
↓	↓	↓	↓	↓	↓	↓
63	$8,500	**$4,810**	$102,979	$8,500	**$8,500**	$181,974
64	$8,500	**$4,810**	**$113,717**	$8,500	**$8,500**	**$200,950**

Based on a balanced portfolio of 50% equities/50% income, assumes an annual compound rate of return of 5.5% and a marginal tax rate of 43.41%. Figures have been rounded.

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The result:

After 15 years, Dave's TFSA has grown to $113,717. At age 65, when he is eligible for OAS, Dave converts his RRSP into a RRIF and begins taking his company pension and CPP. Dave also withdraws $6,769 from his TFSA. Because these withdrawals do not affect his taxable income, Dave receives almost the maximum in OAS benefits of $5,231. These amounts allow him to meet his goal of generating an additional $12,000 in after-tax retirement income.

If Dave had chosen an RRSP instead, it would have grown to $200,950 – significantly more than his TFSA. However, in retirement, he would need to withdraw $15,702 annually from his RRIF in order to have the same after-tax income. In addition, because of his higher taxable income, a portion of his OAS benefits would be clawed back and his payments reduced to $2,876.

By choosing a TFSA instead of an RRSP, Dave saves $6,578 annually in taxes and his OAS benefits were increased by $2,355 a year. In addition, his capital lasts significantly longer by using a TFSA, instead of a RRIF, for his additional retirement savings.

In choosing between the two accounts, it should also be kept in mind that each individual faces different circumstances and financial needs.

	TFSA				RRIF			
Age	TFSA withdrawal	OAS received	Net amount	Market value	RRIF withdrawal	OAS received	Net amount	Market value
65	$6,769	$5,231	**$12,000**	$113,203	$15,702	$2,876	**$12,000**	$196,300
66	$6,769	$5,231	**$12,000**	$112,660	$15,702	$2,876	**$12,000**	$191,395
▼	▼	▼	▼	▼	▼	▼	▼	▼
85	$6,769	$5,231	**$12,000**	$94,275	$15,702	$2,876	**$12,000**	$25,256
86	$6,769	$5,231	**$12,000**	$92,691	$15,702	$2,876	**$12,000**	$10,943
87	$6,769	$5,231	**$12,000**	$91,020	$11,545	$3,499	**$10,271**	$0
88	$6,769	$5,231	**$12,000**	$89,257	$0	$0	**$0**	$0

Based on a balanced portfolio of 50% equities/50% income, assumes an annual compound rate of return of 5.5%; a MTR of 43.41% for RRIF and 32.98% for TFSA. Figures have been rounded.

The table shown here is used only to illustrate the effects of the compound growth rates and is not intended to reflect future values of invested contributions. The rate of return used is for illustrative purposes only.

For more information on Tax-Free Savings Accounts, please contact your Assante advisor or visit www.assante.com

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