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# Which one's better?


This is a question that comes up regularly in financial planning and tax planning circles. But before we attempt to answer the question, we need to understand the difference in the tax treatment between these two plans.

ALTHOUGH some commentators call the first 60 days of the year the "RRSP season", that's not quite true. As noted below, to receive a tax deduction for an RRSP contribution in a year, you can make the deduction in the year or within 60 days after the year. Since an RRSP and a TFSA earn tax-free income, contributing to your RRSP *and* your TFSA should be year-round tax plans.

## RRSP BASICS

A registered retirement savings plan (RRSP) is essentially a personal "money-purchase" pension plan, usually set up with a trust company or an insurance company.

Your contributions to the RRSP are **deductible** in computing your income, subject to the limits described below. The RRSP can invest in various investments, including publicly-traded stocks, bonds, mutual funds, Guaranteed Investment Certificates, and so on.

The income earned in your RRSP is completely tax free while in the plan. However, when you withdraw the funds, they are fully **included in your income** for tax purposes.

"Earned income" is basically your employment or net business income, with some additional types of income allowed as well.

The "unused contribution room" component means that if you don't fully contribute in a year up to your RRSP limit, you can carry that deduction room forward indefinitely.

The contribution is normally made in the relevant year, but the deduction for a given year is available for any contributions made within 60 days after the year.

## TFSA BASICS

A tax-free savings plan (TFSA) is normally set up with your bank or trust company. Similar to the RRSP, it can invest in stocks, bonds, mutual funds, etc. Also similar to the RRSP, there is no tax payable on the income earned in the plan.

The difference is that there is **no tax deduction** when you contribute to the plan, and **no income inclusion** when you withdraw from the plan.

The monetary limits do not depend on earned income. (As noted, the RRSP limits do depend on this). There are flat monetary limits each year, which accumulate if you don't use them up.

In 2009, when TFSAs were introduced, the annual limit was $5,000, and this amount has been indexed annually to inflation, but rounded to the nearest $500. (There was one exception in 2015, when it was bumped up to $10,000). For 2022, the limit is $6,000.

In addition, if you withdraw from the TFSA in one year, the amount of the withdrawal is added back to your contribution room starting with the next year.

Unlike the RRSP, you have to be 18 years or older to set up a TFSA. Like the RRSP, any unused contribution room can be carried forward indefinitely.

SEE **RRSP vs. TFSA** P. 4

# Simplified instalments...

## *If* you have the cash

If you are required to pay the CRA personal or corporate instalments for income tax or GST/HST purposes, here is a useful tip that can simplify your payments. But it is only worth considering if you have ample cash available and no concerns about running short of cash.

Personal income tax instalments are payable quarterly. Corporate tax instalments are payable monthly, or quarterly for certain small Canadian-controlled private corporations. GST/HST instalments, if you are a registrant that files GST/HST returns annually, are payable quarterly. Instalments are normally based on your previous year's tax, although if your current year's tax is lower, you can use that figure instead.

Personal income tax instalments for March and June are based on the two previous years, so the Canada Revenue Agency (CRA) can send you a statement in February – before you have filed last year's return – telling you how much you need to pay to ensure that you won't be charged interest. Your notice for September and December will then tell you how much to pay so that your total instalments for the year equal your last year's tax.

### Late payment interest

If you pay an instalment late, interest is charged for each day that your payment is late. As of the first quarter of 2023, the interest rate is currently 8% annually, compounded daily. This rate is the base commercial treasury bill rate, rounded up to the next 1%, plus four percentage points. It is adjusted quarterly.

### Refund interest

Normally, refunds owing to you from the CRA bear relatively low interest after 30 days, currently at 6% for individuals and 4% for corporations (compounded daily in each case).

### Early payments and offset interest

However, if you pay an instalment early, the CRA will credit you with "offset interest" or "contra interest", at the same high rate of interest that applies to your late payments. This "offset interest" is offset only against late instalments; it is never paid out to you.

This offset interest is not simply CRA administrative policy. It is legally required by subsection 161(2.2) of the Income Tax Act and, for GST/HST, subsection 280(3) of the Excise Tax Act.

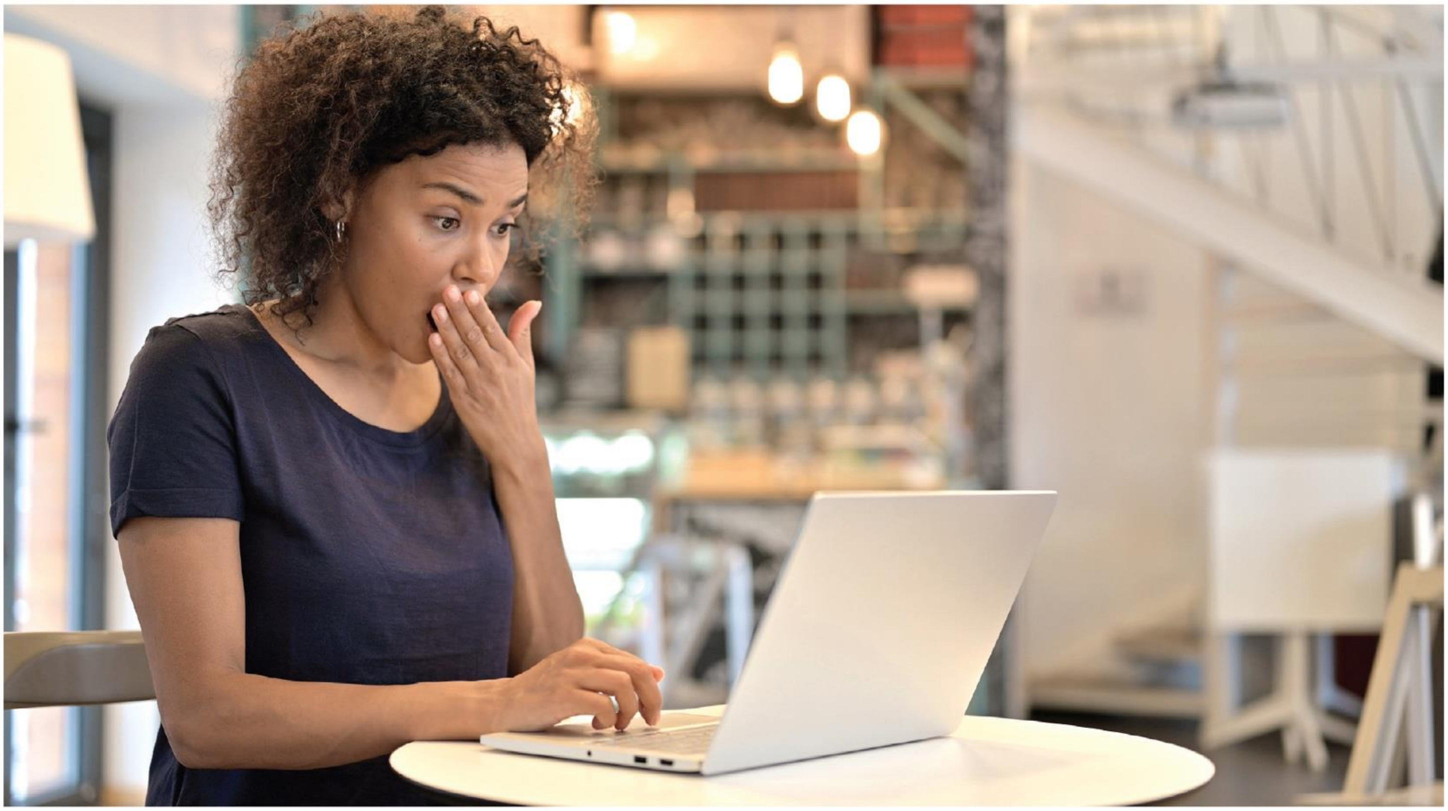
What this means is that, if your total "late payment" interest owing on late instalments matches your total "early payment" offset interest, the two will cancel each other out.

### Avoiding interest

As a result, if you make a single payment at the midpoint of all your instalment obligations for the year, then—provided the interest rate does not go down after mid-year (and at the current 5% it cannot go any lower)—you will not be assessed any interest.

# **Guilty** until proven innocent

**If the CRA assesses or reassesses you for income tax (or GST/HST) and you disagree, it is *your* responsibility to prove the assessment wrong.**



If you file a Notice of Objection and the Canada Revenue Agency (CRA) turns you down, you can appeal to the Tax Court of Canada (the Court). But in the Court, you cannot simply challenge the government to prove that it is right. The onus is on *you* to disprove the assessment, on a "balance of probabilities".

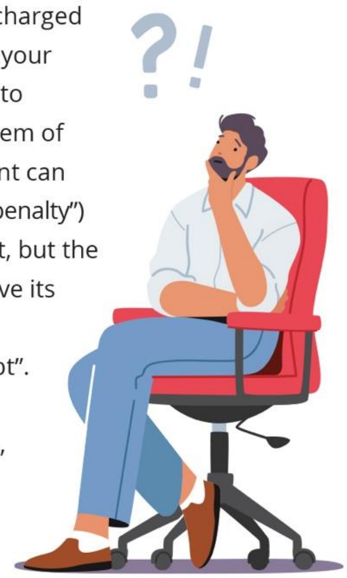
Many people find this surprising and disturbing. They feel that it goes against one's right to be considered "innocent until proven guilty". However, it does not.

To understand this, you need to realise that when the CRA issues you an assessment, you are not being charged with an offence. You are simply being assessed tax. Even if you are assessed interest and "penalty", that is still a civil assessment. It may seem punitive, but the cost is purely monetary. You are not being "fined", merely assessed tax, interest and penalty. There is no concept of "wrongdoing" or "innocence"; there is only an assessment.

You must demonstrate that an assessment is wrong to dislodge it. Otherwise, it is deemed valid. There is a reason for this. We have a "self-assessment" system of tax administration, and the facts relating to your income are normally solely within your possession. As a fair trade-off for this information being in your hands, the onus is on you to disprove the assessment.

### On the other hand

There are also offences under the Income Tax Act (under the Excise Tax Act for GST/HST). If you are charged with an offence, your case is moved into the criminal system of rules. Punishment can be a fine (not a "penalty") or imprisonment, but the Crown must prove its case "beyond a reasonable doubt". As with other criminal charges, you remain innocent… until proven guilty.



RRSP vs. TFSA CONT'D FROM P. 1

## Which is better on after-tax basis?

**If you are in the same tax bracket** in the year of contribution and the year you withdraw the funds, the RRSP and TFSA are economically equivalent.

Although an arithmetical formula can prove this, you can think of it conceptually this way. Both plans earn tax-free-income while in the plan. The TFSA provides no deduction for the contribution but no inclusion upon withdrawal, while the RRSP provides a deduction for the contribution but an inclusion upon withdrawal that effectively "offset" each other, providing the same result as the TFSA.

The practical problem is that we often don't know whether our tax rates will be higher or lower in the year of withdrawal.

Of course, if you are fortunate enough to be able to contribute the full limit amounts to both your RRSP and TFSA, you should do that.

**Another related issue** comes up if you withdraw the amounts when you are 65 years old or more. The RRSP option means you include the withdrawal in your income. In turn, that means – depending on your income – you might be subject to the Old Age Security "clawback tax". It could also affect your age tax credit, which is phased out after a certain amount of income. (On the positive side, income from the RRSP, or from a registered retirement income fund (RRIF) to which it is converted, may generate the "pension credit" on your return.) With the TFSA option, these issues do not arise, since the withdrawal is not included in your income. So that is another issue to consider, in addition to your tax rates in the year of contribution and the year of withdrawal. But again, this is often hard to predict.

## Potential for income-splitting with spouse or partner

One tax plan that can be considered for either an RRSP or a TFSA is the potential to split income with your spouse (or common-law partner).

### Under the RRSP rules

You can make a contribution to either your RRSP or your spouse's RRSP (provided it is set up with the institution as a "spousal RRSP"), and you can claim the tax deduction to reduce your taxes. Your spouse will benefit from the tax-free income while it is in the RRSP. Furthermore, if your spouse is in a lower tax bracket than you when they withdraw the funds, you will obviously save tax as a couple.

There is one **caveat**: Your spouse must wait until the third year after the year in which you make your contribution to withdraw. If the withdrawal is made earlier, there is an attribution rule that provides that it will be included in your income.

### Under the TFSA rules

You can similarly give money to your spouse to contribute to their TFSA. Although there is no attribution of income while the funds are in the TFSA, future attribution is not prevented if funds transferred to the TFSA are withdrawn by the spouse.



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