Articles Program

What type of savings account is best for you?

When it comes to determining the best type of savings account or plan, you have a multitude of options.

“To help you sort through them, the first thing to do is to determine the intended purpose of your savings program, the amount you will have consistently available to save in a disciplined fashion, the term for which the funds will be invested and whether there are programs available to boost your returns, either through tax savings or government grant programs,” says Chartered Accountant Christine Clarke, President of First Affiliated Holdings Inc., a multi-family office located in Collingwood and Mississauga.

Below, Clarke discusses three types of savings accounts, each with different objectives.

Registered Retirement Savings Account/Plan (RRSP) – “RRSPs are the most popular of the tax deferral plans,” says Clarke. “For most individuals, the purpose of an RRSP is to accumulate retirement funds, with the intention that post-retirement withdrawals will occur at a time when your tax bracket is likely lower than it was during your income-earning years.”

Savings contributed to an RRSP are deducted from your taxable income in the current year and no tax is charged on the earnings in the plan until the money is withdrawn. There are set limits to how much you can contribute on an annual basis.

“The current 2011 RRSP contribution limit is $22,450, less any pension adjustments, which will exist when you are also contributing to a company registered pension plan,” says Clarke. “Your current contribution limit can be found on your 2010 income tax assessment provided by the Canada Revenue Agency (CRA). If you miss a contribution in any given year, that contribution room is carried forward and added to the next year’s contribution room.”

Tax-Free Savings Account (TFSA) – “As of January 2009, Canadians who are over the age of 18 can contribute up to $5,000 a year to a TFSA, regardless of their level of earned income,” says Clarke.

Much like an RRSP, the funds invested in your TFSA grow on a tax-free basis, as long as they remain in the account. “You pay no tax on investment income earned within the plan and you are not taxed when you withdraw the funds from the account,” explains Clarke.

New contribution room of $5,000 opens up every year after 2009 and is adjusted for inflation after 2011. “If withdrawals are made, the equivalent amount of contribution room is restored,” says Clarke. “Any unused contribution room can be carried forward to other years, but there are penalties for over-contributing. This makes holding emergency funds

in a TFSA account ideal. They are also terrific for holding stock portfolios where one hopes to achieve significant capital gains which, if earned within a TFSA, would be tax-free."

Registered Education Savings Plan (RESP) – "RESPs are a vehicle for saving to fund a child's education," says Clarke. "You can contribute up to a maximum lifetime amount of $50,000."

The federal government enhances RESPs through Canada Education Savings Grants, which top up your contributions to an RESP by 20 per cent of what you have put in. "These grants are subject to limits of $500 per current year, based on a $2,500 contribution, and $7,200 over the life of the program per beneficiary," explains Clarke. "Missed contributions can be made up in subsequent years, but catch-up Canada Education Savings Grants are limited to $1,000 per year."

Each RESP can exist for no longer than 25 years and contributions are not tax deductible. Earnings within the plan grow on a tax-deferred basis.

"If the funds are used to pay for post-secondary education, they are taxed at withdrawal in the hands of the beneficiary who attends school, which likely results in significant tax savings," adds Clarke. "If the beneficiary chooses not to participate in post-secondary education, there are penalties." In this case, income that has accumulated within the plan can be transferred to the contributor's RRSP, provided that the beneficiary has reached age 21, the plan has been in existence for at least 10 years, and the contributor has RRSP contribution room at the time the plan is terminated. Any excess income accumulated in the plan is paid out as income taxable to the contributor, after paying a 20 per cent penalty. The capital is returned tax-free.

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