FP Answers: Should I allocate a $75,000 inheritance to my RRSP or my TFSA?

Goals are key to indicating which investment to choose and often the type of account to choose

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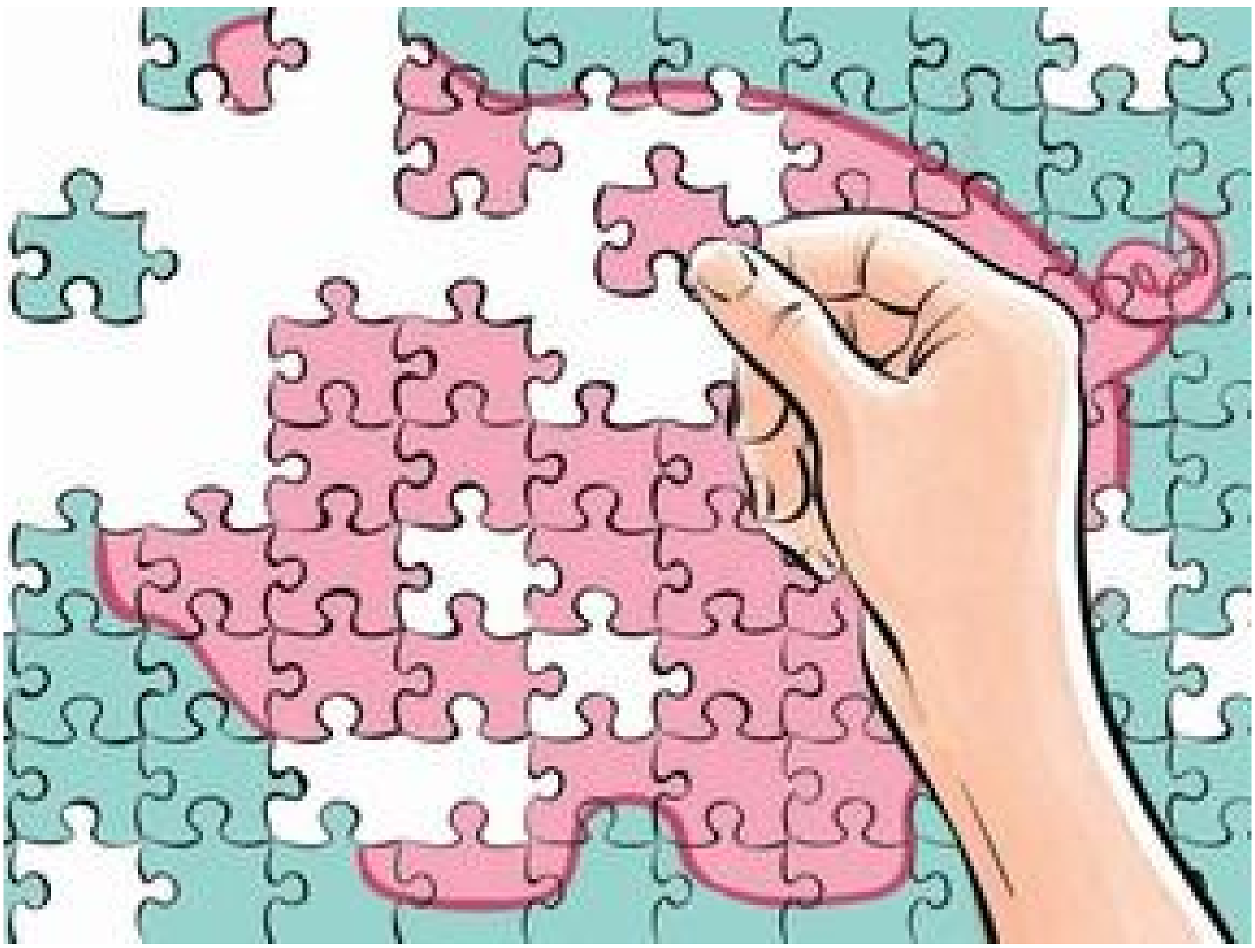

The choice of what type of account to use for your goals and investments — TFSA versus RRSP —depends on several factors. Photo by Chloe Cushman/Financial Post illustration files

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By Julie Cazzin with Janet Gray

Q: I am 45 years old, earn $75,000 annually and do not have a registered retirement savings plan (RRSP) or tax-free savings account (TFSA). I'm not married, and my condo is now fully paid. I recently inherited $75,000. Can you please advise me if this money should be placed as a split (50/50) between the RRSP and TFSA? Or should it all be put into just one of these accounts? Is there something else I should be doing with this money? — *Melinda*

FP Answers: Melinda, when someone receives sudden money, it's a good opportunity to consider the most efficient and prudent way to use the funds. Planning should always start with putting your final goal in sight. Ask yourself a few questions: What outcomes would you prefer? Do you want to retire early? Do you want to buy a new car or do some travelling?

The truth is that goals are key to indicating which investment to choose and often the type of account to choose. For example, if you have a shorter-term goal — meaning a goal you want to accomplish within six to 12 months — then cash is the best choice. If the funds are needed within the next one to five years, consider a guaranteed investment certificate (GIC) with a timeline matched to the intended use. The job of these investments is to protect the value of the money until you are ready to use it.

If the money is to be used for a longer-term goal (more than five years away), then your aim is to invest the money so it grows over several years. Equity investments are better for longer-term investment simply because returns often go up over a longer time period despite the volatility and general ups and downs of the equity markets.

The choice of what type of account to use for your goals and investments — TFSA versus RRSP — depends on several factors.

In general, an RRSP is for longer-term savings and best used mainly for retirement. You contribute to an RRSP in your working years when your income is high and you receive a tax deduction for it. Your income will likely be lower when you withdraw from your RRSP in retirement, so the tax paid on the withdrawal will be less. However, an RRSP is not the best account if you plan to take out funds in the shorter term or while your income is still high. The tax advantage would not be very beneficial.

A TFSA is best used for equity investments because any growth earned in a TFSA will be tax free. If that same investment was not in a TFSA, the tax owing could be significant.

Some people also hold medium-term investments in their TFSA, or even have two TFSAs — one for long-term goals such as retirement savings and one for medium-term goals like saving up for a new car. This is fine as long as the total is within their TFSA lifetime contribution room limit. As of 2023, in your case, Melinda, that lifetime limit would be $88,000.

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It would also be beneficial to use high-interest savings accounts (HISAs) for cash needed within six to 12 months. The job of money in a HISA is to be liquid and readily accessible.

Melinda, I have given you a general view of which accounts to use and for what goals. But you don’t mention if you have high-interest debt, are self-employed, have a pension, are expecting another inheritance or other factors that may lead to a different reply. If any of these apply to your personal situation, it could have some effect on whether TFSAs or RRSPs are best in your case.

Still, while you are considering the above, I suggest putting your money into a TFSA — or maybe a HISA — until you have decided on your desired outcomes.

— Janet Gray is an advice-only certified financial planner with Money Coaches Canada in Ottawa.