How to use registered plans to save on taxes and get 'free' money

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There's an alphabet soup of registered plans available in Canada, so a question that regularly comes up in nearly all financial planning conversations is how to prioritize contributions to the various plans to eliminate, or at least reduce, taxes on investment income. This is even more relevant in 2024, since interest rates on guaranteed investment certificates may exceed 5% but interest income is fully taxable. With top personal marginal rates as high as 55% (Newfoundland and Labrador) in 2024, optimizing contributions to registered plans to eliminate tax on investment income has never been more important.

Before laying out my prioritization preferences, let's take a brief look at each plan and the 2024 limits and amounts.

Registered retirement savings plans (RRSPs)

Of all the registered plans, the RRSP has been around the longest and is certainly the most well-known. You can claim a tax deduction for contributions up to your RRSP deduction limit. For 2024, your RRSP deduction limit is 18% of your 2023 earned income, up to the dollar limit of $31,560, plus any unused RRSP deduction room from prior years.[1] Taxes are deferred on any income and growth while funds are held within the plan. Tax is only paid when the funds are withdrawn from the RRSP or from a registered retirement income fund (RRIF) or registered annuity that was funded from an RRSP.

Tax-free savings accounts (TFSAs)

Introduced in 2009, the TFSA can provide completely tax-free income. Although contributions made to a TFSA are not tax deductible, no tax is payable on income and growth, or on withdrawals. The 2024 dollar limit is $7,000.Unused TFSA contribution room carries forward indefinitely, so that if you are at least 33 years old in 2024, and have been a resident of Canada since 2009 but never contributed to a TFSA, you could contribute $95,000 in 2024.

Registered education savings plans (RESPs)

An RESP allows you to save for your child's post-secondary education by contributing up to $50,000 per child. The plans became extremely popular in 1998, when the government introduced the Canada Education Savings Grant (CESG), which is equal to 20% of total annual contributions, generally up to a maximum grant of $500 for each year, per child under age 18, with a lifetime limit of $7,200 per child.

Tax is deferred on investment income earned within an RESP. You can withdraw your contributions tax-free. Withdrawals of RESP earnings, growth and CESGs are included in income of the student beneficiary when they are paid out for post-secondary education purposes. By claiming the basic personal amount ($15,705 in 2024) along with federal tuition credits, the student may ultimately pay little or no tax on these withdrawals.

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1 Your RRSP contribution room is also reduced by any pension adjustments, and increased by your unused RRSP contribution room from prior years and any pension adjustment reversal

Registered disability savings plans (RDSPs)

If you or someone in your family has a severe disability that allows them to qualify for the disability tax credit (DTC), it's worth considering the RDSP. These plans are designed to help build long-term savings for individuals with disabilities. You may contribute up to $200,000 on behalf of a beneficiary who qualifies for the DTC. There is no tax on earnings or growth while in the plan.

In addition to the power of tax-deferred compounding, Canada Disability Savings Grants (CDSGs), with a lifetime maximum of $70,000 per beneficiary, and Canada Disability Savings Bonds (CDSBs), with a lifetime maximum of $20,000 per beneficiary, may be received up until the end of the year in which the beneficiary turns 49, depending on family income.

Original contributions are not taxed when disability assistance payments are ultimately made to the beneficiary, but earnings, growth and government assistance are included in the beneficiary's income. As with RESP withdrawals, if the beneficiary has zero or minimal other income, the basic personal amount combined with the DTC may allow most or all of the funds to come out of the RDSP tax-free.

First home savings accounts (FHSAs)

Finally, the FHSA for first-time homebuyers was introduced in 2023 and is the newest registered plan. The FHSA combines the benefits of both the RRSP and the TFSA because qualifying contributions are tax deductible, and income earned is not taxable while in the plan, nor taxable when withdrawn as long as the funds are used to buy a first home within 15 years. The annual contribution limit is $8,000 for year, with a total maximum contribution limit of $40,000.

Which plan to prioritize?

Assuming you don't have enough extra cash annually to maximize all your registered plans, here are some things to consider as you prioritize your contributions. My general advice is to go for the so-called "free money" first.

If you or a family member has a disability, contribute first to an RDSP, which can provide up to $90,000 in grants and bonds, depending on the age of the beneficiary and family income.

If you've got kids, I would then prioritize the RESP by contributing at least $2,500, per kid, for each year, to get the CESG match of 20 per cent, which can add up to $7,200 per child of free money deposited into the RESP.

Then, if you're a first-time homebuyer, put $8,000 into an FHSA, since there's a tax deduction on the way in and no tax on the way out. There's no downside if you don't end up buying a home. You can simply move the funds over to an RRSP without using up RRSP contribution room.

With any excess funds, an RRSP or TFSA may help you reduce tax while saving. Consider your short-, medium- and long-term savings goals.

For example, if your goal is to save for a wedding reception or a home renovation in a few years' time, perhaps the TFSA, which allows you to recontribute any amounts withdrawn in the following year, is your best vehicle. If you're saving long-term for retirement, an RRSP could be a better bet.

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