

Tax Talk

TFSA: A shelter for extra savings

Last month I wrote that RRSPs – Registered Retirement Savings Plans – are a great way to build a nest egg. That's because the amount you contribute every year can be deducted from your earned income, and any income from investments in your RRSP will compound tax-free.

Starting this year there's a new option for setting money aside: the Tax-Free Savings Account (TFSA).

Like an RRSP, a TFSA is a government-registered account where you can hold cash, GICs, stocks, bonds, and so on. Unlike an RRSP,

Tax Talk

Scott Taylor



TFSA contributions are not tax-deductible. What makes this plan "tax-free" is that capital gains and other income from investments held within a TFSA are not taxed, even when the money is withdrawn.

Any Canadian resident aged 18 or over with a valid social insur-

ance number can open one. Considering the onslaught of ads to promote TFSA's, banks and other financial institutions are eager to help.

Tax-free growth

Think of a TFSA as a special savings account where you can deposit money and shelter the investment income.

There are no restrictions on when you have to withdraw the funds or how you should spend them. Nor is there a tax penalty when you take money out.

A TFSA withdrawal won't af-

fect your eligibility for income-tested benefits like the Working Income Tax Benefit, Old Age Security, Guaranteed Income Supplement (GIS), or Employment Insurance (EI) benefits.

You can also contribute to a TFSA for your spouse or adult kids. Income attribution rules don't apply as they would with an RRSP.

If these tax rules seem liberal compared to an RRSP, remember that your TFSA deposits come from money that's already been taxed. Only income from investments held within the account is tax-free.

The \$5,000 question

The most obvious limitation on TFSA's is the amount you're allowed to contribute each year: a flat \$5,000 starting in 2009 (over time, this will be adjusted for inflation in \$500 increments).

Given the state of personal savings in Canada, not a lot of people have an extra \$5,000 to sock away. Fortunately, you can carry forward any unused contribution room to future years, and any withdrawals can be put back in the TFSA at a later date without reducing your contribution room. (The table shows how this might work).

The Canada Revenue Agency (CRA) will calculate your annual contribution limit on your notice of assessment, just like it displays your maximum RRSP contribution for the year.

As with RRSPs, contributions that exceed your TFSA limit will be taxed at 1% per month.

Worthwhile investments?

Because TFSA's are new, and there's so much hype about them, talk to your accountant or financial advisor about how this type of account can fit with your specific financial plan. Some points to consider:

- Can I use my TFSA for business expenses? Yes. But because TFSA's are personal savings accounts, the strategy may be different for sole proprietors vs. incorporated owner/operators.

- Is this really the best use of \$5,000? In today's world, a 3% return on a GIC will get you \$150, on which you'd owe \$35 in tax. You may be better off paying a lump sum on your mortgage or putting it into your RRSP where the tax relief is immediate.

On the other hand, if you have a personal savings account that you treat as a rainy day fund, a TFSA is a great alternative. Same thing if you've maxed out on your RRSP and need another place to stash some money.

And while \$5,000 may not net you much today, five years down the road the interest would be more substantial – and the benefits of a TFSA would have more impact. □

– Scott Taylor is vice-president of TFS Group, a Waterloo, Ont., company that provides accounting, fuel tax reporting, and other business services for truck fleets and owner/operators. For information, visit www.tfsgroup.com or call 800-461-5970.

ADD IT UP: Not everyone has the cash to top off a TFSA. Fortunately, your contribution room accumulates each year, and withdrawals made from your TFSA in the year will be added back to your TFSA contribution room at the beginning of the following year. For example:

2009 TFSA contribution limit:	\$5,000
Scott's actual 2009 contribution:	– \$2,000
Unused contribution room available for future years:	\$3,000

In 2010, Scott withdraws \$1,000 from his TFSA

Unused contribution room from 2009:	\$3,000
2010 annual TFSA contribution limit:	+ \$5,000
2010 unused TFSA contribution room available for future years:	\$8,000

In 2011, Scott's TFSA contribution picture looks like this:

2010 unused TFSA contribution room:	\$8,000
2010 withdrawal:	+ \$1,000
2011 annual TFSA contribution limit:	+ \$5,000
2011 available contribution room:	\$14,000

