TAX-FREE Savings Account

THE TAX-FREE SAVINGS ACCOUNT (TFSA)

Less tax can help save more.

ADVISOR USE ONLY

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Invest with advice.

WHAT IS A TAX-FREE SAVINGS ACCOUNT (TFSA)?

The TFSA was introduced by the Canadian government in 2009 as a way of helping investors save more. It is a flexible registered savings account, suitable for Canadians of all incomes.

HOW DOES THE TFSA WORK?

Contributions

- Canadian residents age 18 or older may contribute up to the following amounts per year:

  2009-2012: $5,000
  2013-2014: $5,500
  2015: $10,000
  2016 and 2017: $5,500

- Contribution room automatically accumulates each year, with any unused contribution room carried forward indefinitely for use in subsequent years.
- There is no tax deduction on contributions.

Withdrawals

- Withdrawals are tax free and allowed at any time and for any purpose
- The total amount of withdrawals can be re-contributed into your TFSA in future years. However, re-contributing in the same calendar year will result in a tax penalty, as it is considered an over-contribution.

Other features

- The account can hold any security that is RRSP-eligible
- TFSAs can be used as collateral for a loan. Interest on money borrowed to invest in this account is not tax-deductible.

WHO MAY BENEFIT FROM A TFSA?

Investors new to the workforce	Investors do not have to "earn" any room, as they would with RRSPs. This means that individuals just starting a career may use the TFSA and build RRSP contribution room to use in later years when they earn more.
People saving for education	Since 18-year-olds are no longer eligible for RESP grants, the TFSA can be a great way to save for post-secondary education. Money can be withdrawn from the account for any reason, even if post-secondary education is not pursued (unlike with RESPs).
Income splitters	Returns earned in the TFSA account are not taxable, so they do not have to attribute back to the depositing spouse. This means a higher income earner may contribute to the account of his or her spouse, as well as their own, and not have taxes on gains reverted back to them. Take a married couple with a primary income-earner. The primary earner is taxed on the majority of the family's employment and investment income. A TFSA lets them split this taxable income, which is helpful with one partner in a lower tax bracket, because the Income Tax Act's rules that forbid income splitting between spouses don't apply to TFSAs. And unlike RRSP contribution room, TFSA contribution room is not based on the income one earns. The result? Primary earners can give their lesser-earning partners $10,000 for their TFSAs, while putting $10,000 into their own TFSAs, allowing for tax-free growth on $20,000 each year.

Future home-buyers	Instead of putting the money into an RRSP and then borrowing it through the Home Buyers Plan, investors can save using their TFSA without paying taxes on the growth when the funds are redeemed, tax-free. Money does not have to stay in the account for 90 days before it is eligible for withdrawal, and the funds do not have to be paid back.
Investors already holding interest-bearing investments in a non-registered account	For these investors, there's simply no reason not to move these investments into a TFSA. The investor is being fully taxed on the interest in the year it is earned anyway, so why not move some to a TFSA and stop paying taxes on it? For example, if an investor moved $5,000 earning 5% interest from a non-registered account into a TFSA in January, he or she would save tax on $250 at their marginal tax rate in the first year. Assuming a marginal tax rate of 40%, that would be $100 in tax savings. Interest is earned (and taxed) on a compounded basis, so if they continued to contribute $5,000 per year at a 5% interest rate, the tax savings alone would be $6,025.99 in 10 years. They would also earn additional interest of $968.97 thanks to the compound interest earned on the tax savings over 10 years. As a result, when compared to investing in a non-registered account, the net benefit would be the sum of your tax savings and the additional interest earned on those savings. That's $6,994.96 in this example. In this example, total interest earned would total $16,033.94, and the account would be worth $66,033.94 at the end of 10 years.
Seniors and those concerned about clawbacks	Seniors are able to save and still collect Old Age Security when they use a TFSA. Investment earnings and withdrawals are not reported on one's tax return, which eliminates the possibility of clawing back income-tested benefits such as OAS. In fact, anyone who collects federal income-tested benefits like OAS, GIS Allowance, Child Tax Benefits or GST Credits should consider a TFSA. That's because any interest income they would otherwise earn outside the shelter of the TFSA could disallow them from receiving GIS, OAS or federal income-tested benefit payments or credits.
Investors who have maxed–out their RRSP contributions	Although there is no tax deduction on the contribution, there is also no tax to pay on the withdrawal, and a TFSA provides another alternative for increasing retirement savings.
RRIF holders	Unlike with RRSPs, there is no age limit on this plan. It never has to be collapsed or rolled into another type of plan. There are no mandatory taxable minimum withdrawals. Furthermore, it can be rolled into a spouse's plan upon death or inherited by heirs completely tax-free. RRIF holders who are used to having their investments tax-sheltered but have to withdraw a minimum amount each year can have that amount (or up to $10,000 of it) deposited into the TFSA if it is not needed right away. The TFSA will keep income levels down (by keeping interest earned tax-free), which can help to keep levels below the thresholds where GIS, OAS or Allowance amounts are reduced.

THE BOTTOM LINE ON TFSAS:

Regardless of age or investment time horizon, a TFSA should be considered as part of an overall investment strategy.

Ask your Dynamic Funds sales representative for more information on TFSAs.

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