



THE TAX-FREE SAVINGS ACCOUNT (“TFSA”)

WHAT IS A TFSA?

A TFSA is a flexible account designed to allow taxpayers the opportunity to invest income tax free. Canada Revenue Agency (CRA) describes TFSA as being “like an RRSP for everything else in your life.” In other words, while an RRSP is primarily a retirement savings vehicle, a TFSA is designed to help you earn investment income tax free during your entire life, including your working years.

TFSA are available from your financial institution, credit union, or insurance company. Contributions to a TFSA are **not** deductible for tax purposes and similarly the withdrawal of contributions and earnings are **not** included in taxable income. In other words, the primary benefit of establishing a TFSA is the ability to shelter income earned within the account from tax; unlike an RRSP, contributions to the account are not deductible. Rules concerning what investments are permitted within a RRSP also generally apply to a TFSA.

WHO IS ELIGIBLE FOR A TFSA

Contributions can only be made by an individual who is at least 18 years old, who is a resident of Canada and who has a valid social insurance number (SIN). There is no upper-age limit for contributions or withdrawals, nor any prerequisites for earned income.

TFSA DOLLAR LIMIT AND CONTRIBUTION ROOM

In 2009 an eligible taxpayer can contribute up to \$5,000 to a TFSA (the “dollar limit”). After 2009, the annual TFSA dollar limit will be indexed to the inflation rate and rounded to the nearest \$500. In other words, barring significant inflation we can expect the annual dollar limit to remain at \$5,000 in 2010, 2011 and possibly beyond.

The TFSA contribution room is made up of:

- your annual TFSA dollar limit (\$5,000 per year plus indexation as noted above);
- any unused TFSA contribution room in the previous year; and
- any withdrawals made from the TFSA in the previous year (excluding transfers between TFSA of the same holder or an amount that is transferred directly to a spouse or common-law partner on marital breakdown).

Your annual contribution room will be indicated on your notice of assessment. Withdrawals made from your TFSA in the year will be added back to your TFSA contribution room at the beginning of the following year. If you contribute more than your TFSA contribution room in a given year you will be subject to tax equal to 1% of the highest excess amount in the month, for each month that you are in an over-contribution position.

TFSA Tax Tips

THE TAX-FREE SAVINGS ACCOUNT (cont'd)

- TFSA's for rapidly appreciating investments - since any amount withdrawn in a given year is added to your TFSA's contribution room the following year, any investments expected to increase significantly in a short period of time will not only be protected from capital gains, but will also create additional contribution room when withdrawn, which will generate the potential for further savings.
- TFSA's for seniors - since TFSA's do not need to be wound up at any particular age, they may be an attractive alternative for seniors with excess RRIF or RRSP income.
- TFSA vs personal debt - consideration of whether to use excess funds to pay down personal (i.e. non tax-deductible) debt such as a mortgage, or to contribute to a TFSA will depend on the circumstances of each situation (and in particular the comparative rate of return within the TFSA versus the interest rate payable on the personal debt). If liquidity is desired, a TFSA may be preferable. If liquidity is not a concern, it may be preferable to repay mortgage and other personal debt before contributing to a TFSA as in many cases your borrowing rate will exceed your expected rate of return within the TFSA.
- TFSA vs RRSP - on the assumption that you will never need to withdraw the funds until retirement, it is also preferable, generally speaking, to contribute to your RRSP before contributing to your TFSA. Where funds are going to be contributed, withdrawn and recontributed with some regularity, or for individuals in low tax brackets who will not generate a significant tax saving from a current RRSP deduction, a TFSA may be preferable to an RRSP.

NON-RESIDENTS OF CANADA

If you become a non-resident of Canada you will be allowed to keep your TFSA and you will not be taxed on any earnings in the account or on withdrawals from it. No TFSA contribution room will accrue for any year throughout which you are a non-resident. Any withdrawals made during the period that you are a non-resident will be added back to your TFSA contribution room in the following year, but will only be available if you resume your residency status in Canada.

IMPACT ON INCOME-TESTED BENEFITS

Neither income earned in, nor funds withdrawn from a TFSA will affect your eligibility for federal income-tested benefits and credits, such as the Working Income Tax Benefit (WITB), the Goods and Services Tax Credit (GSTC), the age amount and the Canada Child Tax Benefit (CCTB).

These amounts will also not reduce other benefits that are based on your income level, such as Old Age Security benefits (OAS), the Guaranteed Income Supplement (GIS), or Employment Insurance benefits (EI).

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