Hate paying taxes on your savings?

Consider setting up a Tax-Free Savings Account (TFSA).

Starting January 1st, 2009, the TFSA gives Canadians a new way to save money tax free. That's right… tax free! Considered to be the next best thing to the introduction of the Registered Retirement Savings Plan (RRSP), the TFSA is a great way to set aside funds for just about anything. Not having to pay tax on your investment income will allow you to save much sooner for a new car, education, home renovations, a family vacation or even for a rainy day.

So what exactly is a TFSA?
It's simple, a TFSA is a registered Tax-Free Savings Account that was introduced by the federal government as an incentive for Canadians to save money without being penalized by the tax system. All Canadians, 18 years of age and older, can now set up an account by visiting their local bank, credit union or financial advisor.

Here's how it works:

- Each year, every adult Canadian will be allotted $5,000 of contribution room to invest within a TFSA.
- The contribution room will be indexed to inflation and rounded to the nearest $500. Excess contributions are subject to a 1% per month penalty, as with RRSPs.
- TFSA contribution room is not lost. It can be carried forward to future years and there is no maximum age in which contributions can be made.
- Contributions to a TFSA are not deductible for tax purposes. However, investment income earned in the account is not taxable, even when it is withdrawn.
- There are no withdrawal restrictions as there are with other registered plans. TFSA funds can be taken out of the account at any time and for any purpose. Unlike RRSPs and Registered Education Savings Plans (RESP), withdrawals from a TFSA can be replaced at any time, starting in the
- calendar year after the withdrawal (or in the same year, if there is sufficient contribution room). In effect, your accumulating room (which includes the generated income) is a lifetime balance that will fluctuate over time, as will your financial needs.
- Eligible investments are the same as those held within an RRSP. This list includes savings accounts, GICs, bonds, mutual funds and stocks. Borrowing to contribute does not create deductible interest, and investment management and brokerage fees do not yield deductible expenses in a TFSA.

- Withdrawals from a TFSA (and any income earned in the account) will not affect one's eligibility for federal income-tested benefits and credits such as the Guaranteed Income Supplement and the Canada Child Tax Benefit.
- Attribution rules between spouses do not apply to TFSA's because of their tax-free nature. Therefore, one spouse can provide the money to fund the other's TFSA contributions. However, since there are no "spousal" plans, as with RRSP's, each individual must contribute to their own TFSA, subject to their own contribution room.

Who benefits from a TFSA?

Canadians from all income levels and all walks of life can benefit from a TFSA. Here are some situations where a TFSA may prove to be advantageous:

Saving for an Emergency:

As a general financial planning rule, every family unit should have an emergency reserve set aside for 3-6 months of living expenses. A TFSA, compared to a non-registered savings account, is a better alternative for this purpose, as the income generated would not be subject to annual taxation.

Additional Tax-Deferment:

For those individuals who have maximized their RRSP contribution room, a TFSA provides another avenue of tax-sheltered growth. Five thousand dollars may not seem like a lot of money right now but when you consider twenty years worth of built-up contribution room, this equates to over $100,000 in tax-exempt investments.

Supplementing Education Savings:

Consider setting aside some of your TFSA contribution room to save for your children's (or grandchildren's) education. You could supplement other investment vehicles, such as the RESP, or in-trust account (ITA). However, in order to avoid the attribution rules, you'd have to wait until the child turns 18 to gift the money to them. This strategy would be ideal for the parent (or grandparent) wishing to retain control of the funds until the child is actually enrolled in an education program.

Access to Capital:

If you just happen to be starting your career, chances are your need for cash will grow over time. A TFSA may prove to be a better investment vehicle than the RRSP in the early stages, as it allows unrestricted access to your money without tax consequences. Furthermore, the value of the RRSP deduction (assuming you even have contribution room) is directly related to your marginal tax rate – the higher the tax rate, the greater the tax deduction. Therefore, it makes sense to hold off on contributing to an RRSP until you move into a higher tax bracket and are disciplined enough to not access the funds.

The above scenarios demonstrate a few of the many possible applications for a TFSA. To see if a TFSA is right for you, be sure to speak with a financial advisor for an assessment of your individual needs.

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