A great new opportunity

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The Tax-Free Savings Account **[1]** (TFSA) was introduced in the February 2008 Federal Budget and will be **available January 1, 2009**. It is touted by the Government of Canada as 'the single most important personal savings vehicle since the introduction of the Registered Retirement Savings Plan (RRSP)' in 1957. As always, there are some rules:

Must be a Canadian resident aged 18 or over. Deposit up to $5,000 per year (inflation adjusted in nearest $500 increments going forward). TFSA deposits are not deductible for income tax purposes, but investment income will not be taxed while accumulating or upon withdrawal.

Unused TFSA contribution room can be carried forward and used in future years. Funds can be withdrawn from the TFSA at any time for any purpose. Withdrawal amounts are added back to the contribution room. Withdrawn amounts can be deposited back to the TFSA at any time. However, the account holder may not re-contribute the amount withdrawn by making a deposit in the same year (unless he or she has unused contribution room available). The withdrawn amount will be added to the available contribution room allocated for the next year.

Eligibility for federal income-tested benefits (like the Guaranteed Income Supplement and Child Tax Benefit) will not be affected by investment growth or withdrawals from the TFSA.

The TFSA will give Canadians an opportunity to accumulate more future dollars with the same today dollars. For example, Larry saves $5,000 per year of after-tax income. Assuming a 4% annual compound return and a 40% income tax bracket, he will accumulate $55,760.54 in ten years outside a TFSA.In a TFSA, he will have $60,030.54 with the same annual savings commitment. **Both an RRSP and a TFSA have tax advantages, but there are also two key differences:**

RRSP contributions are deductible from your income to reduce taxes. Deposits to a TFSA will not be deductible.

RRSP withdrawals will be added to your income and fully taxed at then current tax rates. Withdrawals from a TFSA are tax-free.

RRSPs are intended for retirement income and TFSAs are like an RRSP for everything else in your life. However, for those of modest income, a TFSA may be an effective way of providing a better income in retirement. Consider that $2,000 of RRSP income for someone who would qualify for the Guaranteed Income Supplement (GIS) would see a $1,000 reduction of this government benefit. The same income from a TFSA would not reduce the GIS at all.

The ability to earn investment income tax-free can be very valuable. For example, Jill saves $4,000 annually for ten years in a TFSA. She withdraws $50,000 (her deposits plus some growth) to start a small business. The full withdrawal amount is tax-free and she can return the full amount to her TFSA to continue earning tax-free investment income.

Withdrawals can be for any purpose at all. You can finance home renovations, a new vehicle, financial emergencies, a recreation property down payment and anything else you can think of with a Tax-Free Savings Account.

Want help with your tax-free savings plans ?

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