Women's financial learning centre

Tax Free Savings Accounts (TFSA)

The federal government recently introduced a new incentive for Canadians to save and invest. The new Tax Free Savings Account (TFSA) will be available as of January 1, 2009. To give you a better understanding of this new plan we have compiled a list of 10 common questions about the Tax-Free Savings Account (TSFA).

1. **Who can contribute to a TFSA?**
   Any Canadian over the age of 18 who files a tax return will be eligible to contribute to a TFSA.

2. **Where can I set up a TFSA?**
   All banks, credit unions and financial institutions will likely offer TFSAs.

3. **What types of investments can I hold in my TFSA?**
   You can hold any type of RSP eligible investment including publicly traded stocks, bonds, mutual funds and cash deposits.

4. **How much can I contribute to a TFSA?**
   Starting in 2009 your annual contribution is $5,000 per year. The $5,000 annual contribution limit will be indexed to inflation in $500 increments. Any unused contributions will be added to your next year's contribution room. For example, if you do not contribute to a TFSA in 2009, then you will have $10,000 (+ indexing) of available room in 2010.

5. **Are contributions to a TFSA tax deductible?**
   Unlike with RSPs, contributions are not tax-deductible.

6. **Who keeps track of my contribution room?**
   The Canada Revenue Agency (CRA) will track your TFSA room just like they do for your RSP contribution room. Keep an eye out for your TFSA balance on your 2008 or 2009 Notice of Assessment from CRA.

7. **What are the Advantages of a TFSA?**
   - Investment income (such as interest, dividends and capital gains) earned in your TFSA will not be taxed. Your savings and investments grow tax-free.
   - Withdrawals from a TFSA do not affect government benefits that are income tested such as Old Age Security (OAS), Guaranteed Income Supplements (GIS) or GST credits.
   - You can withdraw money from your account at any time.

8. **What should I use a TFSA for?**
   A TFSA can provide additional savings for retirement and can also be used for shorter term goals such as saving for a trip, wedding or to buy a home.

9. **Is it better to contribute to my RSP or to a new TFSA?**
   This is a tough question, as everybody's situation is different. Here are a few general guidelines that might help out.

   You should consider contributing to a TFSA if:
   - you have already maximized your RSP contributions
   - you are in a low income year for tax purposes (~ $37,000 or lower)
   - you want to save for something other than retirement, such as an emergency fund, house down payment, wedding or a new car
   - you expect you will be in a very low income tax bracket at retirement (withdrawing from your TFSA account will not affect government benefits that are income tested)
   - if you expect to be in a high tax bracket at retirement withdrawing from your TFSA for a large one time purchase such as a new car or big trip will be more tax efficient than withdrawing from your RSP.

10. **Can I withdraw funds from my TFSA?**
    Yes, you can withdraw funds from your TFSA at any time and will not pay tax on the income or withdrawal amount. In addition you will not lose the contribution room due to the withdrawal. The amount withdrawn from your account will be added to your contribution room for the coming year. This means you can reinvest the money that you withdrew at a later date.

Example: Don and Susan have built up $40,000 in their TFSA accounts and now they would like to withdraw $25,000 to pay for a new roof and minor renovations on their home. They can withdraw the money tax-free from their TFSA accounts.

Had they used their RSP savings, they would have had to withdraw just over $35,000* to pay taxes on the RSP withdrawal and to cover the $25,000 renovation costs. And the RSP contribution room would have been lost.

By withdrawing money from their TFSA Don and Susan will save on taxes and be able to re-contribute the $25,000 to their TFSA accounts in the future.

*at 30% marginal tax rate