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Take Advantage of the Tax Free Savings Account

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Although Canadians have always taken advantage of Registered Retirement Savings Plans, they have yet to fully embrace the recently introduced Tax Free Savings Account, in large part because this option does not provide the tax deferral of an RRSP. For many people, however, the TFSA can be a much better alternative.

The benefits of the TFSA allow any Canadian resident aged 18 or older to contribute up to \$5,000.00 per year in the form of savings accounts, GIC's, stocks, bonds or mutual funds. Unused contributions can be carried forward and accumulated in future years, and any amounts withdrawn can be put back in at a later date. Income earned in the account is tax free, and assets can be withdrawn without being taken into income.

At certain stages in life, contributing to an RRSP is simply too restrictive. When preparing people's taxes, it is not uncommon to see a deduction slip for an RRSP contribution and an income slip for an RRSP withdrawal in the same return, which kind of defeats the purpose. An even worse scenario, however, is young people in a low tax bracket, who do not need the deduction, encouraged to plan for the future by contributing to RRSPs. While they may have been correctly advised that they can borrow from it to buy a house, or for future education, the reality is that they will require many things along the way, like cars, trips, furniture etc. Generally, they will withdraw money for these items when they are more established, and therefore at a higher tax rate than when they contributed to the plan, so any gain on the investment is reduced by the higher tax rate paid upon withdrawal. A tax free savings plan, however, would allow them to save for the future, withdraw at anytime for any type of purchase without paying tax on the amount, and the withdrawal would increase their contribution limit by that amount.

Another good use of the TFSA is for older people who have accumulated a significant amount in RRSPs, which are fully taxable upon death to anyone but a spouse. As they grow closer to retirement, and their income decreases, the investors can begin withdrawing \$5000.00 per year from their RRSPs, at a lower tax rate, and invest it in their TFSA, which can then be passed on to their heirs tax free. A handy way to decrease the tax liability, while still allowing the asset to increase with a tax-free status.

Clients who regularly invest in RRSPs often ask me whether they should switch to a TFSA. I don't think it's a case of either/or, they're both very important investment tools. It really depends on each person's situation at any given time. For a large percentage of people, it's beneficial to do both. For other people, an RRSP may not be a good option, depending on their circumstances. For anyone wanting to save or invest, however, a TFSA is an excellent idea. It provides the opportunity for anyone over 18 to invest money on a tax-free basis, with virtually no restrictions. Pretty hard to beat that.

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