RON GRAHAM AND ASSOCIATES LTD.

10585 – 111 Street NW, Edmonton, Alberta, T5M 0L7
Telephone (780) 429-6775 Facsimile (780) 424-0004
Email rgraham@rgafinancial.com

How Will You Use The TFSA?

What is a Tax Free Savings Account (TFSA)? Well, it is not necessarily a savings account! It is a trust account that you can use to save for anything you want. The great thing is that the earnings you make are “Tax Free”! The investment choices will be the same as your RRSP.

Starting in 2009, TFSAs were offered by Banks, Trust Companies, Life Insurance companies, Credit Unions, Caisse Populaires, Mutual Funds and Investment Dealers. You have until December 31st of the year to make your deposit (however, if you miss the deadline, you can make the contribution in a following year).

You were able to contribute up to $5,000 per year to a TFSA. This applies to each adult in Canada with a Social Insurance Number. Income is not a requirement to create TFSA contribution room, and there is no age limit (although you must be at least 18 to set up a TFSA). If you do not make your full contribution for the year, the unused room can be carried forward and contributed in a future year.

The contribution that you make is not tax deductible but any withdrawal of principal or investment return is not taxable. Your money is tax sheltered while inside the TFSA and you do not have to withdraw anything until death. If you do make a withdrawal, the amount withdrawn is added to the following year’s new contribution room. This means that you can put back what you took out.

Withdrawals will not have any impact on income tested government benefits such as: GST credit, Child Tax Benefit, Guaranteed Income Supplement, Old Age Security clawback or Employment Insurance repayment.

The contribution limit is increased by inflation (in $500 increments). Since 2013, the limit has been $5,500 per year and will increase to $6,000 in the future.

Each person can contribute to their own TFSA. If one person in a family does not have the money to make a contribution, someone else (spouse, partner, parent, child or others) can give them money to make the contribution. Upon death, the TFSA assets of the deceased can be transferred to a surviving spouse’s TFSA. If there is no surviving spouse, the funds must be withdrawn from the TFSA.

Once the money is in your TFSA, you can buy an investment. Qualified investments include all arm’s-length Registered Retirement Savings Plan (RRSP) qualified investments. The investments you buy should match your goals.

If you want to save for your annual vacation, you can set up a TFSA and contribute a monthly amount. The cash can be deposited in a high interest savings account, a money market (mutual) fund, cashable GIC, or other guaranteed and liquid investment.

If you want to save for a new(er) vehicle, you can contribute an annual amount to your TFSA and use the money to buy a GIC maturing when you want to purchase your vehicle. If you did not have an annual amount, you could contribute monthly until you had enough to buy a GIC. You are allowed to borrow to make a contribution to a TFSA, but the interest you pay on the loan is not tax deductible.

If you want to save for your retirement or other longer term goal, you can contribute a monthly or annual amount and invest it in the same type of investments that you use in your RRSP. This could be stocks, bonds, mutual funds, GICs, (arms length) mortgages and other qualifying investments. You are allowed to contribute assets “in kind” to your TFSA.

If you have enough money, you can contribute to your TFSA and your RRSP. You may even have money left over. If so, you may want to put your interest bearing investments inside your TFSA and RRSP while holding your equity investments outside your tax sheltered plans. This is because interest is taxed at a higher rate than capital gains and dividends from Canadian companies.

If you are drawing money out of your RRIF and you do not need it to fund your current lifestyle, some of this money can be contributed to your TFSA. In some cases, you will be able to withdraw the investment from your RRIF and contribute it to your TFSA (as long as your RRIF and TFSA are at the same financial institution).

If you do not have enough money to contribute to both your RRSP and TFSA, you should contribute to your TFSA to save for your short term goals and keep an emergency fund.

To save for retirement, you could contribute to your TFSA, your RRSP or save money outside your tax sheltered plans. To determine which is better, you need to know your tax bracket now and your tax bracket during retirement.

- With the same investment choices, if you are in a higher tax bracket now than you will be during retirement, the RRSP is better than the TFSA which is better than non-tax-sheltered savings.
- If you will be in the same tax bracket during retirement as now, then the TFSA and RRSP will be the same, and both will be better than non-tax-sheltered savings.
- If you are in the lowest tax bracket now and may be in a higher tax bracket during retirement, then the TFSA will be better than the RRSP and non-tax-sheltered savings.

If the TFSA is money that you do not need, you could invest the money in speculative investments. Any significant capital gains you realize will not be taxed at all. However, any capital losses you experience would not reduce your taxes.

The Tax Free Savings Account is the Government's attempt to encourage us to save. We encourage all to take advantage of the opportunity. Whether you use it for short term saving or longer term investing, you will benefit through lower taxes.

Types of TFSAs

How will you choose a Tax Free Savings Account (TFSA)? First you must realize that a TFSA is not an investment. It is simply a type of trust account that has been set up to receive your tax-sheltered contributions. The trustee reports your contributions and withdrawals to the Government. Once the money has been contributed then you must buy a qualifying investment.

TFSAs will generally be grouped in three ways according to the limitations of the trustee. The three groupings are: Single Investment / Single Supplier TFSAs, Multiple Investment / Single Supplier TFSAs, and Multiple Investment / Multiple Supplier TFSAs.

Single Investment / Single Supplier TFSAs

These plans will only allow a single type of investment within each TFSA. The investment may be one of: a savings account, a term deposit or GIC. The advantage of these types of TFSAs is that they are simple to use. The drawback is that if you want to transfer from one type of investment to another, it may be troublesome to do so.

Banks, Trust Companies, and Credit Unions will offer these plans. Usually no fee is charged. This should be determined before you invest, as some institutions may charge an administration fee or a termination fee.

Be wary of Savings Account TFSAs as the interest rate paid may change without notice. Ask for a history of the rates paid and how often interest is compounded. Ask what amount the interest will be paid on. Some plans may pay interest on a minimum monthly balance. If so, the best time to contribute is on the first day of the month.

TFSAs that are invested in term deposits or GICs are issued for a specific period of time and at a guaranteed rate of interest, usually not longer than five years. GIC and Term Deposit TFSAs guarantee the principal amount of your deposit at the maturity of the investment term, while providing a constant rate of interest. Some GICs provide an interest payment based on the rate of return of a basket of stocks or other investments. You are guaranteed to get your principal back but no guarantee of any "interest".

These investments are usually offered by Trust Companies, Banks, Credit Unions, Life Insurance Companies and Mutual Fund Companies. Often there are no fees involved, but check for these carefully before investing. Also check the interest features. For example, if the deposit is compounding, how often does this take place? Most plans offer semi-annual or annual compounding. The GICs linked to other investments only pay interest at maturity.

Multiple Investment / Single Supplier TFSAs

These plans offer many different types of investments within the TFSA. However the investments will be from the financial institution's own group. The investments may be any of: savings accounts, term deposits or GICs, or mutual funds. The advantage of these types of TFSAs is that you can keep better track of all your investments within the TFSA and you can transfer from one type of investment to another without hassle.

These types of TFSAs are offered by Trust Companies, Investment Dealers, Credit Unions, Mutual Fund Companies, banks and many Life Insurance Companies.

There are a variety of mutual funds that qualify as investments for a TFSA. They can be classified by the type of investments they hold.

Money Market Funds
This type of mutual fund pools the deposits of individual investors and buys money market instruments like Treasury Bills, Commercial Paper, and short term Bonds. The unit value on these funds does not fluctuate, however, the interest rate changes from time to time.

Fixed Income Funds
These mutual funds invest in residential Mortgages, and government or corporate Bonds and Debentures. Fixed Income Funds will invest in all of these investments. Mortgage Funds invest mainly in Mortgages, and Bond Funds invest primarily in corporate, municipal, and government Bonds. The unit value of these Funds fluctuate according to the underlying value of their assets which are measured against prevailing interest rates on the day the unit value is calculated.

Equity Funds
This group pools the deposits of individual investors and invests in Common Stocks. Investors receive units of a diversified or specialized common stock portfolio and, depending on the movement of the stock market, the units of these Funds fluctuate, and in some cases can be quite volatile.

Balanced Funds
A Balanced Fund invests in both Fixed Income investments and Equity investments and from time to time in Money Market investments. It is up to the Fund's investment manager to choose the appropriate asset mix. These Funds will fluctuate in value; however, these Funds will not be as volatile as Equity Funds.

Specialty Funds
These funds invest their assets in specific markets such as Precious Metals, Natural Resources or other Countries. The unit value of these Funds will fluctuate the most of all the mutual funds.

Multiple Investment / Multiple Supplier TFSAs

This type of Plan has been set apart from the groups already mentioned because it relies on the Planholder to set investment policy, rather than an institutional fund manager. A Self-Directed TFSA is usually offered by a Trust Company that acts as the Trustee of the Plan. Investment Dealers and Banks also offer these Plans directly.

The most important thing to remember about Self-Directed TFSAs is that the Planholders are solely responsible for investing the assets of the Plan. Therefore, this type of Plan usually appeals only to the more sophisticated investor, with larger TFSA deposits.

Eligible investments for self-directed TFSAs include:

- money in Canadian currency,
- Canada Savings Bonds,
- bonds, notes, debentures or similar debt obligations issued or guaranteed by the Canadian government,
- bonds or debentures of Canadian corporations listed on a stock exchange,
- shares of a listed Canadian corporation,
- shares listed on certain foreign stock exchanges,
- warrants or rights listed on stock exchanges,
- units or shares of investment funds or insurance company pooled funds,
- annuities issued by a Canadian financial institution,
- shares or interests in a credit union,
- Mortgages in Canadian real estate and shares in mortgage investment companies,
- shares and other investments in certain Canadian private small businesses.

Most of these types of Plans will charge a $100 to $200 per year trustee fee, but some will charge activity and termination fees, so check carefully before deciding. Some Self-Directed TFSAs also offer the advantage of discount brokerage service on stock trades, which can produce an attractive saving over regular commissions.