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**Tax Free Savings Accounts**

As of the first of January, Canadians have access to a new savings vehicle – the Tax Free Savings Account (TFSA). This article will review some of the key features of the TFSA and how they compare to RRSPs. We will then explore some uses for the TFSA.

The TFSA is an investment vehicle available to Canadians age 18 or older. Contributions can be made up to \$5,000 each year. Contributions are not tax deductible but funds grow tax-free and are not taxed when withdrawn. Withdrawals can be made at any time and funds can be used for any purpose ex. retirement income, vacation, home renovations, medical expenses, etc.

**TFSA & RRSP Similarities**

- Investments grow tax free
- Unused contribution room carries forward
- Investment options are similar
- If provided as part of a benefit program, both types of accounts are considered capital accumulation plans and are subject to the CAP Guidelines
- Penalties for over contribution (the TSFA charges 1% per month on each dollar over the contribution limit. Penalties to RRSP over-contributions are applied only on contributions over \$2,000)

**TFSA & RRSP Differences**

	<b>TFSA</b>	<b>RRSP</b>
Contribution Age	Age 18 or older	Under age 71
Contribution Limit	\$5,000 per year indexed annually to inflation and rounded to nearest \$500. Contribution room is restored if money is withdrawn.	18% of income to a maximum of \$21,000 (for 2009). Contribution room is not restored if money is withdrawn.
Tax Status of Contributions	Taxable (contributions are made with after tax dollars)	Tax Deductible (contributions are made with pre tax dollars)
Tax Status of Withdrawals	Tax Free	Taxable

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## TSFA & RRSP Differences continued

	TFSA	RRSP
Withdrawal Limits	None	Must be done by age 71 & minimum withdrawals required
Impact on eligibility for government programs (ex. OAS, GIS, etc.)	No Impact	Withdrawals are considered income therefore eligibility could be impacted
Collateral Assignment	Can be used to secure a loan	Cannot be used to secure a loan

### Uses of the TFSA

The TFSA has been criticized for only being relevant to the wealthy who have funds available for additional investment. However, the TFSA can benefit other investor groups. For the young, it offers a tax-effective means for short-term savings for large ticket items such as a car or home renovations. For older workers, it allows them to put some of their income into a tax-effective savings vehicle when they can no longer contribute to an RRSP due to age.

For those who do have more discretionary income to invest, the TFSA can be used to supplement RRSP contributions if the RRSP maximum has been reached. Retirees who do not need to draw from their retirement savings can invest their mandatory RRSP withdrawals into a TFSA and take advantage of further tax-free growth.

The TFSA can be incorporated into an employer sponsored benefit program. You will have to weigh the pros and cons of doing so before making that decision. The TFSA does offer employers an easy way to provide additional benefits to executives who may have reached their RRSP contribution maximum. Employers are also able to continue to make contributions for older workers who are no longer able to contribute to an RRSP due to age. That being said, remember that contributions are not tax deductible so this would be the equivalent of providing a cash bonus. Further, once the contribution has been made, the employer has no claim to the funds and they can be used by the employee in any way they see fit. This differs from RRSP and pension plans

which are specifically designed for retirement savings. CAP Guidelines will apply to TFSA set up on a group basis adding another level of responsibility to the employer.

### RRSP or TFSA?

When deciding to use the TFSA or an RRSP or both, you need to consider your current tax situation and your projected taxes at retirement. If your tax bracket is lower now than what you believe it to be at retirement, you will want to invest in a TFSA. This situation would apply to those with higher income levels. If you believe your taxes will be lower at retirement, you will want to use an RRSP. If you don't think there will be a difference in taxes between now and retirement, it doesn't matter which vehicle you choose.

## Quiz Corner

*Put your mental mettle to the test and a \$50 prize in your pocket!*

**Start with the number of lives a cat reputedly has, multiply by the number of stitches saved by a stitch in time and add ten. What is the number?**

**Answers can be sent to: [info@gmsinsurance.com](mailto:info@gmsinsurance.com) or by fax to 905-670-4146. We will draw a winner from the correct answers.**