Johnstone's Journal

JOHNSTONE'S JOURNAL is published monthly, and designed to provide topical information of interest not only to plan administrators, but to all employees who enjoy coverage under the benefit plan. Feel free to make copies, and use as a payroll stuffer.

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TAX FREE SAVINGS ACCOUNT (TFSA)

As announced by the federal government in the 2008 budget, effective January 1st, 2009 the **Tax Free Savings Account (TFSA)** will be available to all Canadian residents 18 years and older. The TFSA is a flexible investment savings plan that allows individuals to invest after-tax dollars into an account that can grow tax-free.

Some have called this the greatest innovation to encourage Canadians to save since the introduction of the RRSP. Although similar to an RRSP, there are differences each of us should consider.

TFSA	RRSP
Contributions **are NOT** tax deductible.	Contributions **are** tax deductible.
Income from investment grows tax-free.	Income from investment grows tax-free.
Withdrawals are allowed and **not considered income,** there is no tax withheld and it does not impact income-based government benefits.	Withdrawals are allowed but **are considered income** (other than the Home Buyers' Plan or Lifelong Learning Plan) and do impact income-based government benefits.
Maximum annual contribution is $5,000 (indexed to inflation) regardless of earned income.	Maximum annual contribution is 18% of the previous year's earned income, up to $20,000 in 2008 ($21,000 in 2009).
Unused contribution room, plus withdrawals will be carried forward to the next year.	Unused contribution room is carried forward to the next year. Withdrawals do not increase contribution room.
No maximum age limit.	Maximum age is 71.
Upon death, total value can be rolled over to a beneficiary, tax-free.	Upon death, total value is deemed to have been sold and therefore taxable unless a spouse or common law is the sole beneficiary.

The Main Differences to Consider

Although there are similarities, here are the two main differences:

1. RRSP contributions are tax deductible, while contributions to a TFSA are made in after-tax dollars.
2. Withdrawals made from an RRSP are considered taxable income at the time of withdrawal, but TFSA are not.

The question on everyone's mind is why contribute to a TFSA rather than an RRSP, given that RRSP's are tax deductible during your working years when presumably income, and therefore, your marginal tax rate, is at its highest.

The answer to this question will depend on personal circumstances and each investor should seek professional advice from a financial planner. However, we know that TFSAs will offer unique benefits for:

- Those who have contributed the maximum to their RRSP.
- Those starting their careers and whose income is currently low but will increase.
- Those looking for a short term savings plan for purchases like a car or vacation as withdrawals are added to future contributions room.

Group TFSA Added to a Group RRSP

If you have a Group RRSP, you should consider adding the TFSA as another investment option for employees to invest. Group programs offer the same list of investment alternatives as the RRSP with the same benefits; lower investment fees, more investment options (not available to individuals), and easy payroll deductions.

One consideration is that Group TFSAs will have a fee for each withdrawal (from $25-50), which needs to be clearly communicated. This will encourage employees to use the Group TFSA as part of their long-term savings strategy similar to their RRSPs.