

5 Reasons to Contribute to a TFSA



The Tax-Free Savings Account (TFSA) was introduced in 2009 to give Canadians access to a registered account that can help them save for the future.

Let's consider five good reasons why a TFSA may strengthen your financial circumstances.

- 1. Complement your RRSP.** Although the TFSA has different features than the Registered Retirement Savings Plan (RRSP), both are tax-favourable investment vehicles. RRSPs generate a tax deduction for contributions and grow over time in a tax-deferred manner. However, once you start withdrawing from your RRSP, you'll be taxed on those withdrawals. A TFSA is the opposite: since you use after-tax dollars to contribute, any growth in your account and all withdrawals are completely tax free. Both vehicles help you save efficiently, so if your RRSP contributions have been maxed out, the TFSA is a great way to extend tax-smart investing.
- 2. Match your current income with the right vehicle.** It makes sense to contribute to a TFSA when your income is lower, and withdraw when your income rises and your income tax rate is also higher; because all TFSA withdrawals are tax free, the net result will be less tax paid. Conversely, you should withdraw RRSP funds when your income tax rate is lower, which is the case for most people when they retire and convert their RRSP to a Registered Retirement Income Fund or annuity. Contributing to both a TFSA and RRSP is ideal, but if you can't, you'll likely want to prioritize TFSAs when your income level is lower.
- 3. Reduce tax obligations on your investments.** Before the TFSA, most people who contributed the maximum to their RRSP would turn to non-registered accounts (like a regular investment account) to invest. However, any growth achieved – such as capital gains, dividends and interest income – in this type of account is taxable. Depending on your income tax bracket, it could mean a significant tax hit, especially for interest income, which is taxed at your highest marginal tax rate. The TFSA offers tax-sheltering benefits since, as mentioned above, growth in your account is never taxable.
- 4. Fund your short-term goals.** TFSAs are great for building your savings and creating a tax-free income stream in retirement. They're also valuable when you have shorter-term financial needs (e.g., home repairs, buying a vehicle, taking a vacation), and want to use your TFSA to cover those expenses. TFSAs provide flexibility because you can withdraw any amount you want with no penalty or tax, and then re-contribute that amount later on – just not in the same calendar year as the withdrawal – with no impact on your total allowable contribution limits.
- 5. Keep your government benefits intact.** Some government programs are income tested, which means you receive lower (or no) benefits as your income reaches a certain threshold. TFSAs offer the advantage of allowing you to withdraw funds without impacting the money allocated to you through government programs like the Canada Child Tax Benefit, Guaranteed Income Supplement or Old Age Security. This feature of TFSAs is especially valuable to members of lower-income households, and will help them preserve their government benefits.

A few other points about TFSAs:

- Any Canadian resident who is 18 years or older with a valid social insurance number may open an account at a qualifying Canadian financial institution.
- The annual contribution limit is currently \$6,000, but this amount is regularly reviewed and indexed to inflation, so periodically the contribution limit may increase.
- Unlike RRSPs, there is no deadline each year for TFSA contributions. You may contribute at any time, and many people prefer the convenience of pre-authorized contribution plans to automatically invest a certain amount in their TFSA using a regular timeframe (e.g., monthly) of their choosing.
- If you can't contribute the maximum in a given year, you may carry forward unused contribution room in your TFSA to future years. That way, you can always "catch up" and make the maximum overall contribution to your account.

To learn more about how we can incorporate the benefits of a TFSA into your investment plan, contact us today.

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