FROM YOUR ADVISOR

TAX-FREE SAVINGS ACCOUNTS

Simple, powerful TFSAs are great, all-purpose savings vehicles. But pay close attention to the rules

Anyone can appreciate the benefits of getting a break from taxes.

A case in point is the tax-free savings account (TFSA), which allows Canadians to increase their savings without having to share gains with the taxman.

TFSAs are highly flexible savings vehicles that can be used to achieve any savings goal, such as a holiday, an emergency fund or for retirement. All interest, dividends and capital gains earned in a TFSA are free of taxes.

"TFSAs are so simple and so powerful," says Evelyn Jacks, tax expert and president of the Winnipeg-based Knowledge Bureau, an educational institute for financial advisors and their clients.

Unlike RRSPs, TFSAs offer no tax break on contributions. However, unlike RRSPs, for which withdrawals are taxed, TFSAs allow accountholders to withdraw amounts free of taxes. Just like RRSPs, you can open a TFSA with a bank, insurance company, investment firm or other financial services institution.

All residents of Canada over the age of 18 receive TFSA contribution room annually whether they have opened a TFSA or not. In 2009, when the TFSA was introduced, every eligible Canadian received $5,000 a year in TFSA contribution room. This figure increased to $5,500 annually in 2013; in 2015, the figure was increased to $10,000 annually. For 2016, the maximum was reduced to $5,500. Also, the annual contribution limit will be indexed to inflation and rounded up to the next $500.

All unused TFSA contribution room is rolled over into the following year. For example, if you've never contributed to a TFSA, you would have accumulated a total of $46,500 in unused contribution room as of 2016.

You can provide funds for your spouse or common-law partner, or children aged 18 and over, to invest in their TFSA without triggering the "attribution" rules that normally would see the gains those family members realize taxed in your hands.

Jacks stresses the TFSA's amazing potential to boost a family's total wealth: "Find a way to fund a TFSA for everyone 18 and older in the family."

As with RRSPs, amounts inside a TFSA can be invested in a wide variety of investment vehicles, including guaranteed investment certificates, bonds, mutual funds, exchange-traded funds or shares of publicly traded companies.

Any TFSA withdrawal is not only free from taxes, but an amount equivalent to the withdrawal amount is added to contribution room for the following calendar year. So, if you withdraw $1,000 from your TFSA in 2016, you would have $1,000 added to your total contribution room for 2017; this room also would consist of any unused contributed room accumulated from previous years, as well as the annual contribution room of $5,500 for the year.

You should take heed, however: withdrawing funds and recontributing within the same calendar year could lead to you overcontributing to your TFSA if your total contribution room has been exceeded. The penalty tax on overcontribution amounts is 1% per month.

If you're uncertain about what your TFSA contribution limit is, you can contact the Canada Revenue Agency, which tracks each Canadian's contribution limit.

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By Rudy Mezzetta

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