

## **Behind the Counter**

### **Looking towards the Tax Free Savings Account available in 2009**

As a result of the 2008 Federal Budget, effective in 2009 any person that is 18 years and older will be able to establish a Tax Free Savings Account (TFSA). These accounts will be administered thru the various financial institutions. The object of this account is to allow Canadian residents to earn investment income, interest, dividends and capital gains on a tax free basis. Any contributions to the account will not be tax deductible and any income earned in the account and withdrawn will also be tax free.

The annual contribution limit of \$5,000, regardless of how many accounts you hold, will be increased annually to coincide with inflation and rounded to the nearest \$500. If you don't contribute in a certain year, that \$5,000 or portion can be carried forward to the next year. Also if you withdraw an amount, you will regain your contribution room which is not an RRSP option. However, if you over-contribute in a year, you will be subject to a 1% penalty per month on the amount over your contribution threshold.

Here is an example of how the TFSA would work. In 2009 your contribution limit is \$5,000, but you only have \$2,000 to contribute, so the \$3,000 will be carried forward to 2010. So in 2010 an additional amount of \$500 is added to the contribution room for inflation so you would have \$3,000 carried forward from 2009, and \$5,500 for 2010 giving you contribution room of 8,500 for 2010. If you didn't make a deposit and instead withdrew \$1000 from your TFSA in 2010, you will carry forward contribution room of \$9,500 into 2011.

If you borrow money to invest in the TFSA, the interest paid will not be deductible just as any interest earned in the account is tax free. A TFSA can be used as collateral or security for a loan. This account is not creditor proof, so it can be taken to pay an outstanding debt.

There are many benefits over an RRSP or RRIF with this type of account. TFSA contributions or withdrawals will not affect your OAS or your age tax credit, so you won't have to worry about your OAS being clawed back. There is no time limit on the TFSA such as the age 71 on the RRSP. The attribution rules also do not apply to the TFSA so you can contribute to your family members TFSA without penalty keeping in mind that the family member must be 18 and older. Some financial institutions have

indicated that they will not allow a contribution to a spouse or a family member's TFSA, so you will need to gift the funds first and have the family member make the actual deposit. You will also not be required to dissolve the TFSA on death, but the income that accrues in the account after death will be subject to tax. To avoid this, you can roll the account over to the surviving spouse.

A good tax planning strategy may be to purchase speculative or more risky investments for your TFSA as the accumulation of the returns from investments in this account would not be taxable while in the account, or when they are withdrawn. There are rules as to the types of investments that will be allowed to be held in this account, similar to the RRSP. Investments in non-arms length ventures are not permitted, but you could hold mutual funds, publicly traded securities, GIC's, bonds and certain shares of small business corporations. I would not recommend moving any RRSP funds over to the TFSA because those funds will be taxed as they come out of the RRSP but perhaps you would like to trigger a gain, or a loss for tax purposes, so please check with your accountant for this kind of tax planning.

If there was a marriage breakdown, moving funds from one spouse's account to the other would not create any tax implications or affect contribution room of either spouse.

Should you decide to become a non-resident you will not be required to dissolve your TFSA upon leaving Canada, however any income made within the account while you are a non-resident will become taxable. Also, there will not be any increases to your contribution room while you are a non resident.

The Canada Revenue Agency will track the amount of contribution room available for each taxpayer that files a T1 return based on the information provided by the financial institutions to Revenue Canada. The information would be available to the taxpayer, much the same way that the RRSP contribution room information is now available.

For more information, please refer to the Canada Revenue Agency's website at <http://www.cra-arc.gc.ca/gncy/bdgt/2008/txfr-eng.html>

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