How to take advantage of the Tax-Free Savings Account (TFSA)

The Tax-Free Savings Account (TFSA) provides Canadian investors with an exciting opportunity to earn tax-free income. Opening a TFSA through RBC Direct Investing™ allows you to take control of those tax-free savings. You can create a diversified portfolio with access to a broad selection of investments and the tools and research you need to make confident investment decisions.

How the TFSA works

The TFSA presents a valuable opportunity to save for your future. Investment earnings within your TFSA, whether in the form of dividends, capital gains or interest, do not incur any income tax. Withdrawals, too, are tax-free.

Contributions can be invested in the same wide range of investments that can be held in your Registered Retirement Savings Plan (RRSP). These include GICs, mutual funds, stocks, options, exchange-traded funds (ETFs) and bonds.

There are a variety of ways the TFSA can be used. You might use yours to supplement your retirement savings, for example, or to start a small business, renovate your home — even take a family vacation. In all cases, your savings will benefit from tax-free growth.

Who can contribute

All Canadian residents who are 18 years or older[1] and have a Social Insurance Number (SIN) can open a TFSA. Unlike RRSPs, you are not required to close out the plan by the end of the year in which you turn 71. As long as you're 18 years or older and a Canadian resident, you can contribute to a TFSA for as long as you like.

Contribution details

You are allowed to contribute up to $5,000 per year to your TFSA. This limit will be adjusted for inflation in future years by $500 increments (subject to government guidelines). Excess contributions are subject to a penalty tax of 1% per month for each month that the excess remains in the plan.

Unlike an RRSP, you do not have to have earned income in order to contribute and there is no tax deduction for making your contribution.

Unused contribution room can be carried forward indefinitely, on a cumulative basis. For example, if you contributed $3,500 to a TFSA during the previous year, you will be able to carry forward $1,500 in unused contribution room. This amount will be added to your contribution room for the current year, meaning that you will be able to contribute $6,500 ($5,000 annual limit for this year plus $1,500 in unused contribution from last year). This example assumes there are no adjustments to the annual contribution limit to reflect inflation.

There is no limit on the number of years or the amount that can be carried forward. The Canada Revenue Agency (CRA) tracks your contribution room and you can find your contribution limit for the year through the "My Account" function on the CRA website.

TFSA withdrawals

Withdrawals can be made at any time for any purpose (such as purchasing a car, vacation, home renovations) and the money withdrawn is not taxed.

In addition, you can recontribute your withdrawals in a future year. Amounts withdrawn are added to your contribution room for the following year and can be carried forward indefinitely, just like your regular unused contribution room.

For example, suppose you contribute $3,000 per year to a TFSA for 10 years, for a total contribution of $30,000 and total unused contribution room of $20,000. You earn investment income, including capital gains of $10,000 over the 10 years, bringing your TFSA balance to $40,000. If you decide to withdraw the $40,000 in year 10, you can do so with no tax consequences. Your contribution room for year 11 will be $65,000: the $40,000 withdrawal (includes capital gains for the 10-year period), plus $20,000 unused contribution room, plus your $5,000 annual contribution for year 11. (This example assumes there are no adjustments to the annual contribution limit to reflect inflation.)

Effect on government benefits

One of the biggest advantages of the TFSA, especially for retirees, is that income and withdrawals are not considered "income" for tax purposes. As a result, your income and withdrawals will not affect your eligibility for income-tested government benefits and credits such as the Guaranteed Income Supplement, Child Tax Benefit, Old Age Security, Employment Insurance and so on.

Using your TFSA

Because of its flexibility and special characteristics, the TFSA can be used for a wide range of purposes and can be an attractive choice at every stage of life. Here are some examples, to get you thinking about how you might want to use your TFSA.

Younger Canadians who are just starting out. If you are still in school, a recent graduate or just beginning to build your career, a TFSA provides a valuable opportunity to save for short-term goals, such as a new car, a vacation or education costs. Its tax-free compound growth will help you achieve your savings target faster than a regular savings plan. And once you've withdrawn the money, tax-free, to make your purchase, you can recontribute it to the plan in a future year, when you may be earning more.

If your goals are longer-term, such as retirement, you can benefit from the TFSA's tax-free compound growth potential over the longer term. You may find it reassuring to know that the money is there, if you need it, in case of emergency. In addition, this approach allows you to preserve your RRSP contribution room for a later year, when you may be earning more and taxed at a higher rate, making the RRSP deduction more valuable.

Career-builders. As you get older, your career advances and your annual earnings rise, you might use your TFSA to help build education savings for your children (alone, or in addition to a Registered Education Savings Plan) or to save for important personal goals like home renovations.

If you have maximized your RRSP contributions, the TFSA provides an opportunity to generate additional tax-favoured earnings. Should you face an unexpected financial emergency, you can use your TFSA.

It's also effective if you want to take advantage of income-splitting with your spouse or common-law partner. Ordinarily, if you give your spouse money to invest, any investment earnings are attributed back to you for tax purposes, but these "attribution rules" may not apply if your spouse uses the money to contribute to his or her own TFSA.

Retirees and pre-retirees. There is no requirement to close your TFSA account at a certain age. So retirees — who are required to begin drawing down their registered retirement savings at age 71 — can use their TFSA as a tax-free savings vehicle to meet ongoing needs.

If you're unable to contribute to an RRSP because of your age or because you have no qualifying income, a TFSA enables you to benefit from tax-free compound investment growth.

If you are receiving income from a pension plan or Registered Retirement Income Fund (RRIF), some of the excess can be contributed to a TFSA, where it can generate tax-free income.

TFSA, RRSP and RESP: How do they compare?

The TFSA is unlike anything Canadian investors have seen before. This table shows how it differs from the more familiar RRSP and Registered Education Savings Plan (RESP).

Account Type	TFSA	RRSP	RESP
Contribution Limit	Contributions up to $5,000 a year. This limit will be adjusted for inflation in future years by $500 increments.	Contributions up to 18% of previous year's earned income, less any pension adjustments, up to the maximum for the tax year.	Lifetime contribution limit of $50,000 — no annual limit; however, only $2,500 annually is eligible for Canada Education Savings Grant consideration, plus up to another $2,500 to catch up on previous years' eligible contributions.[2]
Tax Treatment for Contributions	Contributions not tax-deductible. Savings grow tax-free inside account.	Tax-deductible contributions resulting in a possible income tax refund. Contributions grow tax-deferred inside account.	Contributions are not tax-deductible, but may lead to government grants. Contributions grow tax-deferred inside account. Tax on the income earned on investments within the plan is deferred until the beneficiary withdraws the funds.
Tax Treatment for Withdrawals	Tax-free withdrawals at any time with no tax payable on interest, capital gains or dividends accumulated on the original savings.	Earnings on contributions (interest, capital gains or dividends) taxed when withdrawn.	Money (other than a return of contributions) paid out of the RESP is taxed in the hands of the beneficiary when used for higher education. Since most students have little or no income, they can usually withdraw the money tax-free.
Special Features	Withdrawals do not reduce contribution room — they are added to future contribution room.	Converting to RRIF continues tax shelter and generates retirement income. Contributions/earnings can be withdrawn without tax and used for first home or life-long learning, provided they are returned to the plan.	Eligible for Canada Education Savings Grant up to $7,200 per child.

Why choose RBC Direct Investing for your TFSA?

- **No withdrawal fees**
- **Pricing that has the self-directed investor in mind, with equity trades from as low as \$6.95 – \$9.95 flat[3]**
- **Broad selection of investments, including stocks, exchange-traded funds (ETFs), options, bonds, GICs and thousands of mutual funds**
- **Wide range of tools and research to help you make confident investment decisions**

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- In person at your local RBC Royal Bank® branch

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[1] The age of majority is 19 for residents of Newfoundland and Labrador, New Brunswick, Nova Scotia, British Columbia, Northwest Territories, Yukon and Nunavut, which may delay the opening of a TFSA. However, the accumulation of contribution room will start at age 18.

[2] The maximum annual CESG amount is \$500. This annual amount can increase to as much as \$1,000 if there is unused eligibility left over from previous years.

[3] Terms and conditions apply. \$6.95 flat Canadian or US equity trade when you trade 150 or more times per quarter. \$9.95 flat Canadian or U.S. equity trade with \$50,000 or more in household assets held in RBC Direct Investing account(s) or between 30 and 149 trades per quarter. This pricing only applies to trades placed through an available Automated Service, including the online investing site. Visit www.rbcdirectinvesting.com/lowtrades for complete details.

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