TFSA BASICS

What is a TFSA? And why should it be part of your savings plan?

While many Canadians have Tax-Free Savings Accounts (TFSAs), there is still a lot of confusion around what they are actually for. Let's clear up a common misconception: the TFSA is not designed to be just a simple cash savings account.

TFSAs are actually tax-registered investment accounts that can hold a wide variety of assets. They were started in 2009 as a way to encourage Canadians over 18 to save by providing an account that allows your investments to grow **tax-free.**

How does a TFSA work?

Every year you can contribute a certain amount to a TFSA (for 2020 it's $6,000), which you open through a financial institution, such as your credit union. All of the investments that you hold within the account grow completely tax-free – this includes interest, capital gains and dividends.

Unused contributions can be carried over to the following year. If you were over 18 in 2009, have since lived continuously in Canada and have never contributed, your maximum contribution for 2020 could be as much as $69,500. It's important not to over-contribute, however, because penalties are high. You can check your contribution limit by calling the CRA's TIPS line at 1-800-267-6999.

What investments can you hold in a TFSA?

The TFSA is particularly effective at building investments, especially those with high-growth potential, because your gains are completely tax-free. Some of the investments you can include in a TFSA include:

- Stocks in publicly-listed companies
- Mutual funds
- Exchange traded funds (ETFs)
- Guaranteed investment certificates (GICs)
- Government and corporate bonds
- Real estate investment trusts (REITs)

There are some restrictions, however, such as that stocks must be listed on a designated stock exchange. Check with your financial institution to ensure that your investments are eligible because penalties can be high for unqualified investments.

Benefits of having a TFSA

It's not surprising that over 14 million Canadians have a TFSA, given its advantages:

- Your investments grow tax-free, including interest, capital gains and dividends
- It's flexible: you can take out as much as you like at any time with no tax or penalty
- A wide variety of investments can be held within it
- Withdrawals have no negative impact on government benefits
- You don't need earned income
- It can be switched over to your spouse or another beneficiary on death

Disadvantages of a TFSA

While having a TFSA may seem a no-brainer for many people, it does have some drawbacks:

- Unlike with RRSPs, your TFSA contributions do not lower your taxable income, so they bring no immediate tax benefit
- You may have to pay withholding tax on foreign dividend payments
- There can be heavy penalties if you over-contribute or hold non-qualified or prohibited investments
- It has a low contribution limit compared to RRSPs
- You can't claim capital losses within a TFSA

When does it make sense to invest in a TFSA?

TFSAs are an excellent choice for anyone looking to grow their savings tax-free, while being able to withdraw funds at any time with no penalty.

For this reason, TFSAs are perfect for short- and mid-term savings goals, such as a down payment on a home, paying for a wedding or an emergency fund.

In certain situations, TFSAs also make sense for long-term savings, such as retirement. If you're in a low tax bracket, the immediate tax benefits of an RRSP may not be worthwhile, so a TFSA can be a good way to grow savings that won't be taxed when you retire. Also, if you've maxed out your RRSP contributions, a TFSA is ideal for boosting your retirement savings.

If you have any questions about whether a TFSA is right for you, or if you'd like to start growing your savings tax-free, contact Cornerstone Credit Union at **1.855.875.2255.**

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