

by Rob Gerlsbeck



GETTING STARTED

The perfect piggy bank

They're easy, they're flexible, they're profitable. The new Tax-Free Savings Accounts just may make savings cool again

I

'm going to make a prediction for the new year. Try not to laugh out loud when you read it. Here goes: in 2009, Canadians are going to fall in love with saving money again.

I know, I know. Most of us are putting away next to nothing these days. But mark my words, that'll change once we clue in to the fabulous extra money to be earned with the new Tax-Free Savings Account (known as a TFSA), available starting in January.

How much? Let's assume you have \$50,000 invested in a regular savings account at 3%. After one year, you'll earn \$1,500 in interest. Sounds

great, until the taxman comes for his cut. Depending on your income, he'll take upwards of \$450. With a TFSA, the taxman goes home empty-handed.

If you're still in the dark about TFSAs, don't fret. Just think of them as a more flexible RRSP. Just like an RRSP, you can open a TFSA as a regular savings account or as a mutual fund, or fill it with stocks, bonds or guaranteed investment certificates.

The big difference is in how taxes are paid. With RRSPs, you get a tax break when you contribute. When money's withdrawn, you're taxed. For TFSAs the process reverses. There's no tax break at first, but what you earn in interest isn't taxed.

In that regard the longer you leave your money invested, the better off you are. If your \$50,000 investment grows to \$150,000, you'll keep every penny when it's withdrawn. "It's really hard to find the negatives in TFSAs. I mean, we looked for them," Greg Hurst, principal at Morneau Sobeco in Vancouver, tells me.

TFSAs also have fewer restrictions than RRSPs. Actually there are only two. First, you must be 18 to own one, and second,

the contribution limit is \$5,000 per year, no matter what your income.

Five thousand bucks doesn't seem like a lot until you realize unused contribution room carries forward every year for the rest of your life. If you only put in \$1,000 this year, next year you can deposit \$9,000. Plus, if you take money out (which, by the way, you can do whenever you like without paying a penalty) your contribution room rises by an equal amount. Withdraw \$20,000, and next year you can put \$20,000 back.

The easiest way to use a TFSA is as a regular bank account to save for a house, car or other big purchases. Say you're 25 now and don't expect to buy a house for another 10 years. If you contribute the full \$5,000 a year at 4% interest, you'll have \$61,200 for a down payment when you're 35. That's over \$2,500 more than a non-registered savings account.

Personally, I'm excited about the income splitting opportunities of TFSAs. My wife doesn't work, but any interest she earns in a TFSA account isn't attributed back to me.

If there's any debate about TFSAs it's whether they're a better way to save for retirement than RRSPs. For low-income Canadians, earning less than \$35,000 a year, the answer is yes. "It never made sense for anyone to contribute to an RRSP if they're always going to be in the low-income bracket," Jamie Golombek, managing director of tax estate and planning at CIBC in Toronto, says.

The reason is that government subsidies like Old Age Security and Guaranteed Income Supplement are based on income. Since TFSAs don't count as income, seniors won't see those payments clawed back when they withdraw money.

For the rest of us, the decision is a lot trickier. A simple rule of thumb is that if you're in the same tax bracket when you contribute money as when you withdraw it, there's no difference between TFSAs and RRSPs. Of course, few of us work 40 years without substantial pay raises. So TFSAs are best for young people just starting their careers. When they're 65, and in a higher tax bracket, they'll come out substantially ahead.

But older Canadians can benefit from TFSAs as well. Boomers who've contributed the maximum amount to their RRSPs now have another place to shelter their investments from taxes. And a senior who doesn't spend everything he's forced to withdraw from his Registered Retirement Income Fund can shovel the extra amount right back into a TFSA.

Golombek has one more way to hit the jackpot with TFSAs: as a holding tank for risky stock picks. Say a new mining company goes public and you think the stock's going to strike gold. If you buy \$5,000 worth and roll it into a TFSA, and then your stock value triples to \$15,000, all that money is yours. Normally you'd pay around 24% capital gains tax.

For Canadians and TFSAs, this could be the beginning of a beautiful friendship. **M**

ROB GERLSBECK is features editor of *MoneySense*. For more columns on getting started in investing go to www.moneysense.ca.