my money At a Glance

Helping You Understand Financial Planning and Investments

TFSA refresher: rules for smart management

The Tax-Free Savings Account (TFSA) is a great way for Canadians to save or invest without paying taxes on gains or withdrawals. While the rules governing this relatively new savings option are straightforward, there are a couple of areas related to contributions, withdrawals and transfers that need special attention.

This TFSA refresher will help make sure that you're clear on the rules to avoid an over-contribution, and the tax penalties that may occur.

TFSA basics

The TFSA is a multi-purpose savings vehicle that allows people 18 years old and over to save up to $5,000 per year* and includes many powerful features:

- Tax-free investment growth
- Tax-free withdrawals
- The ability to carry forward unused contribution room indefinitely
- No age-related withdrawal requirements

* *Starting with the 2010 tax year, the contribution limit will be indexed to inflation and rounded to the nearest $500.*

How many TFSAs can I have?

You can open as many TFSAs as you like, as long as your total contributions are no more than your annual limit.

TFSA smart tip: It's far easier to keep track of your TFSA contribution limit if you have just one account. If your company offers a group TFSA, it's a good option that's easy to manage because you can contribute through the workplace.

How do the contribution rules work?

- ☒ Your dollar limit each year for deposits is $5,000. Down the road, this will increase from time-to-time (see TFSA basics)
- ☒ **Plus** – any unused contribution room from **previous** years
- ☒ **Plus** – any withdrawal amounts from **previous** years

How do the withdrawal rules work?

There are no withdrawal restrictions on the TFSA. Any money withdrawn is added to your contribution room for the **following and/or future years**.

TFSA smart tip: While you may withdraw money at any time, the TFSA is not meant to be a substitute for a chequing or bank-style savings account. Processing fees may apply to withdrawals. Use the TFSA for money you don't anticipate needing in the short-term.

How do I know how much contribution room I have?

Shortly after December 31 of each year, the financial institution that issues your TFSA reports your total deposits and withdrawals to the Canada Revenue Agency (CRA). The CRA calculates your available contribution room and reports it on your personal income tax notice of assessment or reassessment, which is issued after you file your income tax return.

TFSA smart tip: Remember – you are responsible for keeping track of your account! Sign up for the CRA service called ***My Account for Individuals*** and you can check your available contribution room for the year online. **www.cra.gc.ca**

Does the interest or investment growth earned on my TFSA investments affect my contribution room?

No. All investment growth (or interest) from your TFSA investments is tax sheltered permanently. It won't affect your TFSA contribution room now or in the future.

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What are the penalties for over-contributions?

The CRA will impose a one per cent penalty fee for each month that the extra contribution remains in the account.

Can I transfer from a personal TFSA to my company-sponsored group TFSA I have through work?

Yes. A direct transfer from one financial institution to another is not considered a withdrawal or contribution and can be completed without a tax penalty. However, closing an account, withdrawing the money and contributing to a new account somewhere else in the same calendar year may result in an over-contribution.

Test yourself…how well do you understand the TFSA rules?

1. John opened a TFSA in January 2009 and contributed $5,000. In May 2009, he withdrew $3,000 to pay for an overseas vacation. In September 2009, he received a bonus at work, and decided to pay back the $3,000. Will John incur a tax penalty?

2. Mary opened a TFSA in 2009 and contributed $2,000. She bought a new car in 2010, and didn't have any extra money to set aside in her TFSA until 2011. What will Mary's contribution limit be for the 2011 tax year?

3. Steve opened a TFSA in January 2009 and contributed $4,000. In June 2009, he opened a second TFSA at another financial institution offering a higher interest rate. He withdrew all his funds, closed his first account and deposited the $4,000 in his new TFSA. Steve received a tax penalty of $210. What did he do wrong?

Answers:

1. Yes, John could receive a tax penalty. Any money withdrawn is added to his contribution room **for the next year**, and can be carried forward to future years if he doesn't reach his maximum. John should have waited until at least January 1, 2010 to re-contribute the amount withdrawn, when his limit would have been $8,000 ($5,000 + $3,000 withdrawal room).
2. Mary will have $13,000 in contribution room (plus indexation, if applicable) for the 2011 tax year because unused contribution room is carried forward indefinitely. ($3,000 for 2009; $5,000 for each of 2010 and 2011).
3. If Steve had made a direct transfer between accounts, he would not have received a tax penalty. By withdrawing and re-contributing $4,000 in the same calendar year, Steve made an over-contribution of $3,000. The over-contribution penalty is 1% per month ($3,000 x 1% x 7 months = $210).

Learn more about the TFSA

The information in this article is meant to clarify basic TFSA rules. More details about the TFSA can be found at **www.sunlife.ca/groupTFSA**. If your company offers the TFSA administered by Sun Life, call the Sun Life Customer Care Centre at **1-866-733-8612** for more information.

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